From: Morelli, Emer
To: Sterling, David; Brennan, Mike
Cc: Scott, Michelle; Caldwell, Alison
Subject: Re: RHI - Regularity
Date: 18 December 2016 14:48:56

David

Yes, agreed. Minister has asked for an update tonight at 6.00. I will reflect the advice below. Supply will need a commensurate business case which considers all options. We will need SPD input to this complicated issue.

Emer

Sent from my BlackBerry 10 smartphone.

From: Sterling, David
Sent: Sunday, 18 December 2016 14:30
To: Morelli, Emer; Brennan, Mike
Cc: Scott, Michelle; Caldwell, Alison
Subject: RE: RHI - Regularity

Emer/Mike

Can we think carefully about this and have a quick word early tomorrow morning before we respond. I can see the political attractions of Option C particularly if Treasury could be persuaded to switch some anticipated Res AME to Cap AME to fund a "buy out". The AG's advice also favours Option C.

However you've already highlighted several drawbacks to Option C which we'll need to work through before we give a considered DoF response.

David

From: McCormick, Andrew (DFE)
Sent: 18 December 2016 09:55
To: Sterling, David
Cc: McCoy, Laura; TEO HOCS; Cousins, Heather; McCann, Brendan; McMurray, Stephen; Stewart, Chris (DFE); Morelli, Emer; Scott, Michelle; Caldwell, Alison; Coyne, Terence; Marten, Lucy
Subject: Fw: RHI - Regularity

David,

The NIAO Report of June 2016 says the following:

"My report below reviews the results of my audit of the Department's 2015-16 financial statements and sets out why I have decided to qualify my regularity audit opinion in relation to two issues:

• expenditure amounting to £11.9 million which was incurred without the necessary approvals in place for the non-domestic Renewal Heat Incentive (RHI) scheme (paragraphs 4 to 16) and is therefore irregular; and

• because I was unable to obtain enough evidence to be assured that expenditure on the non-domestic RHI scheme amounting to £30.5 million had been incurred for the purposes intended (paragraphs 17 to 27). This was due to the fact that I did not consider that the systems in place to prevent or detect abuse of the scheme were adequate."

The PwC Report (Project Heat) will almost certainly lead C&AG to treat the expenditure IN 2016-17 on the RHI as irregular irrespective of DFP/DoF's position, on the basis of the second bullet point above – the qualification re 2015-16 was based on absence of evidence of control systems – PwC provides clear evidence of the absence of adequate control systems.

Hence I think that any course of action other than option C – even if the full cost was to fall on the NIE DEL – would require a Ministerial Direction on the grounds of irregularity. In fact, of course, there is good reason to hope that the Treasury would agree to help in the circumstances.

Many thanks.

Andrew

Parameters of Renewable Heat Incentive Scheme

1. **The scheme must meet the requirements of regularity, propriety and value for money as set out in Managing Public Money NI.**

does it really need to? legislative target?

2. **The scheme must contribute to the renewable heat target – the primary objective of the original NI RHI scheme (2012) was to increase the update of the renewable heat to 10% by 2010 (baseline 1.7% 2010)**

   Clarity is required from DfE on what contribution to this target NI is currently making. Is there is defined contribution required from NI to the overall UK target?

   Is there a risk of infraction proceedings from EU if NI does not contribute its share?

   As part of the RIA submitted by DfE in February 2016, DfE estimated at the Executive's 2015 target of 4% renewable heat had been met and exceeded. Given more recent information regarding the design of the scheme, can all the renewable heat generated under this scheme count towards this target?

3. **The proposed level of support must be the minimum necessary to deliver the scheme objectives**

   There should be an agreed, enforced ceiling on the rate of return achievable on the scheme. There must be no opportunity for 'excess profits' to be made from the scheme.

   The original 2012 business case was based on a 12% rate of return. The October 2015 addendum reported that the reality was a rate of return of 33%. That addendum reported that the tiered tariff, cap and revised banding introduced in November 2015 would reduce the rate of return to between 11.6% and 12.8%.

   The rate of return achievable can be affected by a number of variables – the most volatile being fuel prices. There will need to be consideration given to measures which could ensure the rate of return does not increase above the agreed limit.

   Advice would be required from DfE on rate of return dependencies and volatiles across the scheme life. Legal advice would also be required on whether additional 'degression' style controls could be added to ensure tariffs could be reduced in line with changing market conditions and budget availability.

If it has exceeded the EU limit is it in breach of State Aid

4. **The scheme must be State Aid compliant, and have all necessary approvals including DoF and HMT**

   The original scheme was notified to the EU Commission, and noted that the UK authorities concluded that the necessary rate of return to incentivise the scheme was between 8% and 22%.

   Information subsequently provided by DfE demonstrates the rate of return has significantly exceeded this range.

   Any future operation of this scheme will require the revised approval of the EU, HMT and DoF which would be based on a value for money assessment undertaken by DfE.

5. **The scheme must be underpinned by robust, clearly defined and enforceable regulations which ensure the scheme continues to operate within the original policy intent**

   A criticism of the scheme operation to date has been that much of the activity which is out with the policy intent, is actually permissible under the scheme regulations.

   Should a decision be taken to continue with any form of incentivised scheme, it would be essential that the regulations were reviewed and amended to ensure any practices which are inconsistent with the overall scheme intent can be quickly addressed, and the non-compliant installations can be immediately removed from the scheme.

6. **The scheme must have sufficiently robust administration arrangements**

   The original 2012 Business Case set out a range of measures which would be put in place to manage the risk of fraud. Any future operation of this scheme would require the robust oversight of both the Department and the administrator.

   There must be assurance that both department and administrator are appropriately resourced and skilled to robustly enforce anti-fraud measures and interrogate usage data to quickly identify and address any gaming of the scheme.

   There must be clarity that only heat produced with an economic use, which would otherwise be produced using fossil fuels is incentivised.

7. **Regular reviews must be built into the scheme**

should NIAUR not be given a formal role?

In addition to real time monitoring by the administrator and the department, there should be regular interim evaluations undertaken of both the scheme and its administrations.