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Frazer, Helen

From: Brennan, Mike
Sent: 15 January 2017 13:44
To: Morelli, Emer; Scott, Michelle
Cc: Sterling, David
Subject: RE: RHI Business case Janaury 2017 queries to DfE mb

Michelle / Emer – other than removing the DN in para 5 and inserting the DoF legal view reference I think we are there.

The key concern remaining that the Minister needs to take a view on is Emer's concern about introducing to Assembly in the absence of Executive endorsement.

Hopefully we will get SCC input (or at least Hugh might have some initial feedback) before 3.00 call. I wonder if we should let Minister see this draft before then as it might give him some comfort on the approval safeguards that you have incorporated? I suspect he is probably more worried about the wide political of presenting RHI to Assembly

M

From: Morelli, Emer
Sent: 15 January 2017 13:14
To: Scott, Michelle; Brennan, Mike
Subject: RHI Business case Janaury 2017 queries to DfE mb

Michelle

I have add in some further detail on the engagement with DfE on the VFM points pre November 2015 amendments and both VFM and affordability from December 2015. Grateful for your review against the engagement timeline. It is important to stress that in considering the November 15 amendment DoF was unsighted on any potential, significant overspend against the AME modelling, indeed the business case submitted at that time advised that the proposal would support a sustainable VFM solution.

Many thanks once again for your work on this over the weekend period.

Mike

Subject to any final amendments, I am content that this version is sent to DSO for transmission to Snr Counsel.

Emer

Frazer, Helen

From: Brennan, Mike [Mike.Brennan@finance-ni.gsi.gov.uk]
Sent: 15 January 2017 11:37
To: Morelli, Emer; Brennan, Mike; Sterling, David
Cc: Morelli, Emer; Scott, Michelle
Subject: Re: WORKING DRAFT RHI Business case Janaury 2017 queries to DfE (2) (2) (2)

E / M - thanks

I'll let you know what Minister's view is after 3.00 chat.

M

Sent from my BlackBerry 10 smartphone.

From: Morelli, Emer
Sent: Sunday, 15 January 2017 11:14
To: Brennan, Mike; Sterling, David
Cc: Morelli, Emer; Scott, Michelle
Subject: Re: WORKING DRAFT RHI Business case Janaury 2017 queries to DfE (2) (2) (2)

Mike

Apologies for my delay in responding. Yes Snr Counsel advice key now.

Also it may be useful to understand the status of the draft Regulations as tabled to the Business Cttee on Friday. I understand from the media that DfE Cttee is due to meet on Monday morning to discuss. Also as highlighted in AG'S advice to DfE, contextual point 2, these draft Regs are also proceeding without Exec approval.

DfE is content to rely on AG advice on this point.

Emer

Sent from my BlackBerry 10 smartphone.

From: Brennan, Mike
Sent: Sunday, 15 January 2017 10:31
To: Sterling, David
Cc: Morelli, Emer; Scott, Michelle
Subject: FW: WORKING DRAFT RHI Business case Janaury 2017 queries to DfE (2) (2) (2)

David – Minister now seems worried about being 'bounced' into approving. I think Council view will be critical as I suspect Minister will reject if the legal view differs from AG

M

From: Brennan, Mike
Sent: 15 January 2017 10:30
To: Morelli, Emer; Scott, Michelle
Subject: RE: WORKING DRAFT RHI Business case Janaury 2017 queries to DfE (2) (2) (2)

Emer / Michelle – thanks. This reads very well. I've tracked a few suggested amends / queries. I have also added a suggested para on fuel cost variability but maybe irrelevant at this stage?

The Minister wants to talk to me at 3.00 so all really depends on Tony McGleenan view. It might be worth letting him see where we have got to once you are content with this letter.

Also Minister wants to know if you could meet him in Parl BIs tomorrow at 9.00

M

From: Morelli, Emer
Sent: 14 January 2017 22:47
To: Scott, Michelle
Cc: Brennan, Mike
Subject: WORKING DRAFT RHI Business case Janaury 2017 queries to DfE (2) (2) (2)

Michelle

Many thanks for an excellent draft and for working last night and today on this issue. I have added in some text and reflected your critical friend point which is valid. I have used the language of the business case on a number of occasions as I am aware that DoF asked DfE to agree the terminology used to define the critical first stage process with their legal advisors. I have also noted a number of areas where DoF legal advice can be usefully reflected.

I will add some more of our economic analysis into the body of the submission and the legal advice once received.

I am copying to Mike only at this stage by way of progress update. I will review again in the morning, once I have re-read the DfE legal advice. It remains my intention to circulate to the wider cc list tomorrow afternoon subject to the caveat that the draft may be subject to change pending DoF legal advice.

Many thanks again and happy to amend/ discuss further.

Emer

Frazer, Helen

From: Morelli, Emer
Sent: 15 January 2017 15:22
To: Brennan, Mike
Cc: Scott, Michelle; Sterling, David
Subject: RHI Business case Janaury 2017 queries to DfE mb (4)
Attachments: RHI Business case Janaury 2017 queries to DfE mb (4).docx

Mike

All drafting notes have now been addressed in the attached draft letter. This follows the receipt of DoF legal advice which supports DfE's assessment of the preferred option:

"The issues are complex and involve consideration of EU, ECHR and domestic legal principles. There is a significant risk that the favoured option proposed in the DE business case will be subject to legal challenge. However, there is a reasonable prospect that a challenge based on legitimate expectation and Article 1 Protocol 1 ECHR can be successfully resisted."

Many thanks
Emer

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Stephen McMurray
Head of RHI Taskforce
Netherleigh
Massey Avenue
Belfast BT4 2JP

January 2017

Dear Stephen

ADDRESSING THE DEFICIENCIES IN THE NON DOMESTIC RHI SCHEME - BUSINESS CASE

Thank you for your letter of 11 January 2017 in which you recommended the DfE business case 'addressing the deficiencies in the non domestic RHI scheme' to DoF for approval.

The business case states that "the purpose is to assess the available options to reduce the net cost to the Executive of the Renewable Heat Incentive scheme in the 2017-18 financial year as the first stage of a comprehensive programme to ensure the value for money and financial sustainability of the scheme going forward." It is noted that a comprehensive programme for an enduring solution has yet to be designed and will be informed by further review and consultation. This longer term, wider programme will be supported by a more substantive business case in due course.

The business case estimates that the successful implementation of the preferred option could reduce the 2017-18 cost of the RHI scheme to £25.3m, from the £49.7m projected if no action is taken.

The shortcomings in the design and implementation of the RHI scheme are well documented in both the NIAO report (July 2016) and the PwC report (November 2016). DoF is therefore well sighted on the significant value for money and affordability concerns associated with the scheme. While DoF's primary concern was VFM in the period prior to the November 2015 amendments, both considerations have been the subject of discussions from December 2015.

Following the closure of the scheme to new applicants in February 2016, DoF has, as part of the monthly stocktake process and in dedicated meetings in May 2016 and October 2016 sought advice from DfE on the potential options available to DfE to reduce the significant RHI overspend and ensure VFM. DoF therefore welcomes the submission of a proposal to begin to address this issue.

As was the case in October 2015, DoF has been afforded limited time to consider this complex issue. In assessing the business case, we have noted the following assurances provided by DfE both within the document submitted and through our recent engagement:

- An immediate move to an enduring solution runs the very real risk that a best value for money solution is not achievable (para 4.11)
- DfE remains content that the tariff structure introduced in November 2015 represents value for money (S McMurray email 11 Jan 2017).
- DfE has received formal, written legal advice and this provides support to the preferred option in the business case and the contingency plan as set out at para 8.10 (S McMurray letter 13 Jan 2017).
- DfE has considered the risks arising from the need for European Commission notification and this will be taken into account when setting the date for the new regulations to come into force. (S McMurray letter 13 Jan 2017).

While it is agreed the status quo position is not sustainable, the limited range of 'do something' options considered within the business case reduces the certainty that the preferred option represents the optimal way forward. That said, if implemented as outlined within the business case, the preferred option will significantly improve the value for money of the scheme while minimising the overspend.

In that context, and having considered the detail of the business case and the additional assurances provided by DfE, DoF is content to grant approval for DfE to proceed with the preferred option. This approval is conditional on the following -

Implementation of Preferred Option

1. DfE is satisfied that their legal advice supports the introduction of the preferred option, and that the decision to proceed on a time limited basis at this stage does not increase the risk of a legal challenge.
2. DfE is satisfied that the risks attached to State Aid notification for the RHI scheme in its entirety, to include the proposed amendment as set out in the

preferred option and the existing post November 2015 amendments, have been adequately considered and appropriately mitigated.

Audit and Inspection

3. The recommendations of the PwC report are implemented in full as outlined within the November 2016 report. Any decision not to implement a recommendation should be approved by the DfE Accounting Officer and notified to DoF.
4. DfE should implement a comprehensive programme of inspection and audit as a matter of urgency. For each instance of fraud detected DfE should provide evidence that all possible steps have been taken to recover payments in full and appropriate action taken to prevent future occurrences of the fraud detected.

Longer term solution

5. It is recognised that the preferred option is the first stage of a longer term process to ensure the value for money and sustainability of the scheme going forward. Given the significant budgetary risks associated with the scheme it may be useful if DfE seeks the views of an informed third party as it develops its proposals, for example the policy team at BIS. Given that the RHI scheme operates across the UK, albeit under differing models, an informed third party could help inform the reasonableness of any proposals and the associated costs. In addition a DoF economist must have membership of the steering group overseeing the production of business case for the post 2017-18 RHI position. [DN is this needed if "critical friend is in place as above? Yes – think so to impress scrutiny point]The Steering Group should operate under PRINCE project management principles.

5.6. The longer term resolution must also incorporate all appropriate safeguard mechanisms to reduce risks to the public expenditure position (eg fuel price adjustment mechanisms).

Review

6.7. It is noted that DfE will take a decision in November 2017 as to whether the longer term solution can be implemented by the start of 2018-19 or whether the approach for 2017-18 will need to be implemented for another year. Given the potential significant budgetary risks associated with any delay, DoF requires that the DfE Accounting Officer advise formally DoF of the outcome of any such decision in November 2017.

Conclusion

As outlined above, DoF has been afforded a very limited window to review the proposals and, while it is accepted that a tariff reduction is required, it is difficult for DoF to conclude that the proposed changes will deliver the optimal outcome. That said, it is acknowledged that the status quo is not acceptable from a value for money or budgetary perspective and action must be taken.

DfE's response to this issue to date has not been as timely as it could have been. The next twelve months will be critical in ensuring there is a satisfactory, long term solution to this issue. It will be vital that the business case for this long term solution is accurate, comprehensive and informed by specialist and, where necessary, external advice. DoF will expect the business case to contain comprehensive consideration of a wide range of options. In considering options which involve the continuation of an annual incentive payment there must be in-depth consideration of controls to ensure individuals are not over-compensated and the scheme remains affordable. The recent engagement on annual adjustment for fuel price differentials is one example of an issue which should be considered.

In addition to the project specific conditions set out above DoF approval is also subject to the strict adherence to the following conditions:

- that there are no substantial changes to the scope/scale of the project as described in the business case.
- that the costs or assumptions vary by no more than 10% from the value stated.

Requests for revised approval will take account of factors such as:

- Where Supply is approached on the earliest indication that compliance with one or more of the above conditions is under question.
- Adherence to correct appraisal procedure.

Should the request for DFP Supply approval be declined, these factors, along with any other mitigating circumstances will be taken into account when determining the extent of the irregular spends.

It should be noted that this approval relates solely to agreement to proceed with the project. It does not imply approval for expenditure to be incurred beyond existing agreed public expenditure controls. The AME funding available for the RHI scheme (domestic and non-domestic) in 2017-18 is £22.3m at present. Any expenditure on the RHI scheme above the available AME funding in 2017-18 will need to be funded from within the DfE departmental baseline.

cc

DRAFT