

NORTHERN IRELAND ASSEMBLY

Committee for the Economy

Renewable Heat Incentive Scheme (Amendment) Regulations (Northern Ireland)
2017: Department for the Economy

19 January 2017

Members present for all or part of the proceedings:

Mr Steve Aiken (Deputy Chairperson)
Ms Sinéad Bradley
Mr Thomas Buchanan
Mr Alan Chambers
Mr Gordon Dunne
Dr Stephen Farry
Mr Gordon Lyons

Witnesses:

Dr Andrew McCormick	Department for the Economy
Mr Stephen McMurray	Department for the Economy
Mr Shane Murphy	Department for the Economy

The Deputy Chairperson (Mr Aiken): Before we start, I will just say that I will not be asking the questions that I posed on 'The Nolan Show' this morning — you will be happy with that, Andrew. Stephen, you must have the most thankless task of anybody in Northern Ireland, but you are welcome. Shane, you are welcome as well. For those who do not know, Stephen McMurray is the renewable heat incentive (RHI) task force leader.

Mr Stephen McMurray (Department for the Economy): Yes, indeed.

The Deputy Chairperson (Mr Aiken): You must have been standing in the wrong place at the wrong time, and somebody volunteered you.

Mr McMurray: I must have committed a sin in a previous life.

The Deputy Chairperson (Mr Aiken): Andrew, one of the reasons we want you here is to talk about the business plan. In particular, we want to talk about the business plan going forward and, specifically, any alternatives that you looked at. That, a windfall tax and rateable issues are among the issues that we will be considering going forward. As you are aware, we had a legal briefing just before this session, and I would like to hear your view on the potential legal risks. Another issue that has been raised is the question of whether, going forward and bearing in mind that we have already had one year in which £30 million was spent, there is any process of recovering that excess money from the scheme. Those are the points that I would like to open up with. It is over to you and the team, Andrew.

Dr Andrew McCormick (Department for the Economy): Thanks, Deputy Chair, and thanks for the opportunity to do this. In a moment, I will ask Shane to talk through the analysis in the business case, including, as you asked, the options that were considered, the bones of the analysis and the appraisal of those options that takes us towards the recommendation that emerged in the business case. That is what Shane can do with the economic expertise that he brings to that.

I got one chance to talk about the big picture perspective at the Public Accounts Committee (PAC) yesterday. I was following on from the question that you asked me on Monday — we touched on it on Saturday as well — on the issue of ministerial direction. I said to the PAC that, on the contrary, not to do this would probably require ministerial direction. That is a slightly contrived point because there is no such provision as a ministerial direction for inaction. However, I want to make that point rhetorically to emphasise that the imperative that I am under as accounting officer is to secure value for money, regularity and propriety of expenditure. As we stand, in 2016-17, the expenditure on RHI will be irregular. That is not because it was not approved; some of it was approved by the Department of Finance. That, however, is not the only condition. If you look at 'Managing Public Money', you will see that regularity also requires that there is adequate control. As we stand, as is well known, there is not adequate control, so my obligation as accounting officer is to take action to secure that. One key to the whole analysis is that we have not found a quicker or better option to move towards regularity in relation to this expenditure. That is one reason why we regard this as urgent and imperative.

The Deputy Chairperson (Mr Aiken): Andrew, on another point, we talk about how you are the accounting officer for the Northern Ireland side of the funding, but, for the annually managed expenditure (AME) —

Dr McCormick: I am also the accounting officer for the AME.

The Deputy Chairperson (Mr Aiken): You are accounting officer for both.

Dr McCormick: Yes. Part of the fallacy that crept into this was, "This is free money. Treasury will pay". For my responsibilities as accounting officer, that is totally irrelevant: I am accountable for the whole lot. My accounts cover the lot.

The Deputy Chairperson (Mr Aiken): To clarify, you account to the Northern Ireland Executive and to HM Treasury.

Dr McCormick: All of it goes through the Assembly request for resources process, so it is all approved by the Assembly through the Budget Bill.

The Deputy Chairperson (Mr Aiken): It is all on the vote.

Dr McCormick: It is all on the vote, so, in that sense, the accounting officer role is purely within Northern Ireland, although I have to say that HM Treasury has noticed — they read the Northern Ireland newspapers.

The Deputy Chairperson (Mr Aiken): I am sure that they have.

Dr McCormick: They have noticed this and are very concerned. There is something of a postbag going to Treasury Ministers and to Ministers at the Department for Business, Energy and Industrial Strategy (BEIS) asking, "What is going on here?", given the contribution from UK taxpayers through the subvention to Northern Ireland. There is concern in London, and, therefore, we have, de facto, a responsibility to act and secure control of public expenditure.

The Deputy Chairperson (Mr Aiken): For clarification, Andrew, have you received a letter from the Chief Secretary to the Treasury or any direction from Her Majesty's Government (HMG)?

Dr McCormick: No, we have not, but we are aware informally of concerns.

I have given my perspective as accounting officer and my strong reasons to back the approach. I draw your attention to the appraisal of the business case. One of the suggestions that came to me from the Department of Finance, as it was considering this last week, was whether it would be a good idea, given that we are moving at pace, to secure an independent opinion on the business case. The Minister mentioned this briefly on Monday, and I will elaborate slightly. We approached a colleague

called Bob Hanna, who does some independent work. He is the chief technical adviser to the Department of Communications, Climate Action and Environment (DCCA) in Dublin, and he is doing this work in an independent capacity.

The Deputy Chairperson (Mr Aiken): I know Bob.

Dr McCormick: He told us:

"The documents constitute a very good and complete analysis of the current situation and possible early-term courses of action, albeit that it is recognised that this had to take place over a very short period of time and with quite limited data. The documents are extremely well prepared. There are a small number of typos and grammatical issues but nothing substantial, and the conclusions are logically drawn and the recommendations well stated."

We had that independent scrutiny over the past weekend. He has done an urgent piece of work for us, and that is totally independent expert advice on the quality of the work.

The Deputy Chairperson (Mr Aiken): Can we have a copy of that?

Dr McCormick: Subject to the Minister's approval, yes, we will get it to you.

The Deputy Chairperson (Mr Aiken): I am sure that the Minister will be content.

Dr McCormick: I will touch briefly on the legal issues. I am not sure that there is much I can do to expand on what the Minister said in the Chamber on Monday. We have analysed this on the basis of two main potential lines of challenge. The first is a general one in relation to legitimate expectations, where we go back to the fact that the expectations created at the time of the launch of the scheme were very clear and stated the nature of the incentive that was being drawn together. There are references in Hansard and in documents produced in 2012 that indicate that the expectation was that the rate of return that would apply to beneficiaries of the scheme would be of the order of 12%. Shane can explain this in more detail, but that is the kind of expectation that needs to be in place to incentivise an investment in something that is unusual or novel. That is good economics, in that sense.

The Deputy Chairperson (Mr Aiken): One of the questions that have come out is about the incentivisation — maybe Shane could talk about this — for other renewables and the likely return. One of the things that seem to be out of step is the incentivisation for the renewable heat scheme compared with the incentivisation process for other renewables. Perhaps you could address that when you are talking it through.

Mr Shane Murphy (Department for the Economy): My understanding of the logic is that this was about incentivising renewables compared with what a business would otherwise do. A business could choose to continue with its oil boiler for its heat — let us say that it is heating an office — and choose to invest its capital in another activity. The benchmark is not necessarily an investment in different energy systems and what were the returns for energy investments. This was to incentivise businesses to use their capital in order to change their boiler system compared with what other investments they might have made by keeping their oil boiler. The difference between oil boilers and biomass boilers is substantial, so that was the logic — that a commercial-orientated rate of return was likely to be required. You could argue the toss about whether 12% was the right number.

The Deputy Chairperson (Mr Aiken): For clarity, then, was the incentive for the replacement of existing systems?

Mr S Murphy: Yes, or to choose a renewable boiler over an oil boiler if building, for example, a hotel. The idea of the tariff was that it would cover the additional investment and the additional operating costs by way of a tariff-based system. It was not for the entire cost of the biomass boiler or geothermal system or for the entire operating cost; it was for the additional costs. The logic was that they should be existing businesses with a heat demand that was par for the course for a business. A leisure centre with a swimming pool, for example, needs to heat that pool anyway, so this makes sense for it. It needs a boiler of some sort in order to generate revenue for its business. If someone who has an office block wants to have tenants, they need to have a heating system. That is just part of their normal business and their normal income and outgoings. Given that it will potentially be more

expensive to go green, the idea of the tariff was to cover the extra. That is important, because it is sometimes lost.

The Deputy Chairperson (Mr Aiken): It was only for the heating; it was not for anything additional to that.

Mr S Murphy: It was for heating, and the tariff is based on heat output from boilers.

Dr McCormick: I will go back to a point that was made in the Chamber on Monday. There was a very clear statement of intention; the problem with this is a mismatch between intention and delivery. The mistake was made in designing the system and in the overgenerous tariff. That was not intended; indeed, it was not understood and spotted. I explained at length yesterday the nature of the mistakes that were made in the Department and the responsibility that we, as civil servants, have to take for the departmental flaws in that design, but no one can say that there was any intention to provide anything more generous. That is an important point that goes to the legal advice.

The second main potential ground of challenge, as the Minister explained, is in relation to article 1 of protocol 1 (A1P1) of the European Convention on Human Rights: the right to property. The clear advice from our senior lawyers is that the right to property in this context — the context of future income — is very different from the right to property in relation to existing property and that the A1P1 contains a specific reference to the public interest, so there is a power. It says that there is a need not to interfere with people's property except in the public interest. The exception for that to be done is explicitly there in A1P1. The clear argument behind this proposal is that the public interest is not being served by the excessive compensation that is going to beneficiaries of the scheme through the existing tariff. The legal advice that we have is very clear and robust, and we are very confident that the case is there.

I think that I have touched briefly on your main points, Deputy Chair. Is it best to let Shane expand on the analysis of options and the basis for the recommendation?

The Deputy Chairperson (Mr Aiken): Yes, please.

Mr S Murphy: I will start by talking about the driver of actions. At times, there appears to be a mixing up of abuse and overcompensation as one and the same thing and a view that the only issue with the scheme is abusers and, if they went away, the scheme would be fine: that is absolutely not the case.

On drivers for action, I will start with overcompensation. I might dwell on this a bit longer than I will on other things because we could well return to it. The tariff that was set initially within the Cambridge Economic Policy Associates (CEPA) work was based on a 50-kilowatt boiler running 17% of the time. It envisaged moderate-sized office blocks, with office hours driving the heat loads.

The Deputy Chairperson (Mr Aiken): That was based on the Department of Energy and Climate Change (DECC) decision in the original GB scheme.

Mr S Murphy: What came along, however, were not 50-kilowatt boilers but 99-kilowatt boilers, already doubling the heat load assumption. What came along was not a 17% load factor but something like a 40% or 45% load factor, so the heat load assumption was out by a factor of about five. There were fewer offices and far more industrial processes, so the load and size of boiler were much greater. Tiering has been talked about a lot in terms of cost control: its biggest function is actually to regulate the rate of return. The rate of return goes up until the tier is reached and then starts to flatten out. It would flatten out around the 12% mark. However, without tiering, as loads go up, the rate of return keeps rising. In practice, for far too many people, the rates of return are 30%, 40% or 50%-plus. That is very significant. We can come back to this, and I can give you more evidence, but overcompensation is a key driver. That leads to —

The Deputy Chairperson (Mr Aiken): I am sorry, but I just want to check something. The standard boiler at the time was about 50 kilowatts, is that right?

Mr S Murphy: That was assumed.

The Deputy Chairperson (Mr Aiken): Those were the industry standard. However, the 99-kilowatt —

Mr S Murphy: That was the most popular boiler, by a long stretch, put in in that tariff band.

The Deputy Chairperson (Mr Aiken): In GB, they were mostly 50-kilowatt boilers, weren't they?

Mr S Murphy: I do not know what was installed in GB. Certainly, the analysis anticipated that something like a 50-kilowatt boiler would be typical.

Dr McCormick: It is quite a natural behavioural response that businesses would say, "We will get this high tariff for a bigger boiler, so let us get as big boiler as possible to maximise the tariff". It is a logical commercial response; indeed, we also have the phenomenon of multiple boilers — eight 99s where one really big one would do. That is part of the way that this is worked.

Mr Chambers: You talked about the returns. The layman is hearing that people were getting back £1.60 for every £1 that they put in; that is the story going around. Was it only the abusers who were getting that return, or was everyone getting it?

Mr S Murphy: The abusers are a subset of the overcompensated. I will give you an illustration of the profile. For this tariff, the tier is set at 15%, which, by our calculation, will, broadly speaking, deliver a 12% return on the additional investment and operating environment for a biomass boiler. For the profile of applicants for whom we have sufficient data — some had not logged invoices, usage and so forth — about 15% of applicants currently run their boiler at load factors of 15% or less. Those 15% are, therefore, earning no more than 12% or so. The remaining 85% range from minor or marginal overcompensation right up to earning multiple rates of return. We reckon that about 70% are outside the range that we gave to the European Commission. Those are where there are the most serious rates of return that are out of kilter. We also gauge that probably about 10% have earned so much to date that, if you cut off their payments completely, you would still need some retrospective action to get them back into kilter.

The Deputy Chairperson (Mr Aiken): Gordon, did you want to make a point of clarification?

Mr Dunne: My point is that there was no pre-approval system in place for the boilers. Is it possible that applicants brought in 99-kilowatt units and were almost setting their own specification for suppliers rather than there being a pre-approved specification?

Mr S Murphy: I am not sufficiently technically orientated to answer some of the questions.

Mr Dunne: It is the case that there was no pre-approval. People went ahead and installed the boiler and then applied for it to be approved: is that not correct?

Dr McCormick: Yes, that is the case. However, there is a stage of testing between installation, application and accreditation. Ofgem looks at the application, the schematic and the diagrams that are provided to show what the installation does and what it is there for. The typical pattern is that they have several exchanges with the applicant to clarify points of information. Then, assuming that all is well, Ofgem accredits, and the payments are backdated to the date of application. The date of application is still the determining point for expenditure, but there is a process of approval. That is why there are still cases in the pipeline of people who applied before the scheme was suspended at the end of February. Those cases are still in the process of consideration by Ofgem. They will still get payments backdated to the date of application.

Mr McMurray: They have to go through accreditation.

Dr McCormick: Exactly.

Mr Dunne: There was no pre-approval system.

Dr McCormick: No.

Ms S Bradley: It might seem an obvious question, but how is that measured? If I have a boiler, how do I tell you how much heat I have generated? How do you determine how much was above what I would have generated in my business anyway? Do I give you a copy of an invoice for the material for burning that I have used? How does that system work?

Dr McCormick: I am not sure that any of us are aware of all the precise details of how Ofgem does that, but a requirement to submit meter readings is part of the process. Part of the test of our inspection, enforcement and audit process to ensure that there is a verification process. There are two stages to your question. First, what is required by way of information at the point of application? That is where they need to understand the design of the boiler. The second stage is to get information on the purpose for which the heat is being generated. That looks at boiler size and the proposed load factor. What proportion of the day will it be used for? Are we talking about 17% — the classic working day — or the kind of usage that the poultry industry needs? All of that information comes in, and there is not a single definition of "excess" in that context. That is why, in looking at enforcement and inspection, we will have to design and specify exactly what we mean by "excess". That is part of the process that we are in.

Mr S Murphy: We will touch on some of the attempts in the business case to gauge what that might mean for expenditure. Overcompensation is a driver, and that feeds through to overcommitment. The AME budget next year is a bit over £22 million, and we are nowhere near on track. Unless we change, we will be closer to £50 million.

The Deputy Chairperson (Mr Aiken): Sorry, excuse me?

Mr S Murphy: Without any change — without this course of action — we will have something like a £50 million cost for domestic and non-domestic RHI next year, of which just over £22 million will be available from AME.

The Deputy Chairperson (Mr Aiken): OK.

Mr McMurray: That means a £28 million potential overcommitment.

Mr S Murphy: There is a big budget driver there as well.

The third driver is undesirable behaviours. You have heard about those, so I do not want to list them again. That leads to pretty poor value for money, and there has been much public concern.

The objective of the business case was to undertake a legally defensible course of action that, starting next year, could remove the perverse incentive to produce excessive heat. Work has been done on longer-term options, but the conclusion was that they are not sufficiently developed. Bearing it in mind that we will be setting something for 18 to 20 years, we are not at a stage where there is full assurance in legal terms, incentive terms or budgetary terms and we could take the plunge on them without crossing our fingers. Therefore, in conclusion, we asked, "What's available to us as a first step to get the excesses of the scheme back to normal standards, as far as we can, in the incoming year?". That led to several standard options. We can continue as we are, which will cost something in the order of £50 million. We can take something off the shelf that is known to the industry and is grounded in the logic of the scheme, going back to the other legal points, namely the post-November 2015 tariff structure. There was also an option of suspending all non-domestic payments for the coming year. There were options in between that involved fairly arbitrary reductions in tariffs, whether they be budget-driven or driven by some other arbitrary process.

In the main, the concentration comes down to a choice between staying where we are, which overcompensates and is, basically, taking money out of the block and paying people supernormal profits — that is pretty much what it is — and continuing poor behaviours, or do we take some action? Then the question becomes the severity of that action and how well it gets us within budget for next year. Superimposing the November 2015 tariffs on to installations that were there beforehand can get you somewhere around £24 million to £25 million for the incoming year, depending on how much behavioural change is incentivised. I will talk about that in a minute.

The Deputy Chairperson (Mr Aiken): Will you clarify that? Do you mean that £24 million to £25 million, even if there is no behavioural change, would be —

Mr S Murphy: No, we have some variations in it. With some behavioural change, we have got it to £24.5 million or so; without it, a bit over £25 million. I will come back to behavioural change in a minute, because I do not want it to be taken as fact that that is the cost of behaviours. Just bear with me.

Another option on the table is one that was reverse-engineered from the budget, to deliver something that would keep you within the AME allocation of just over £22 million. That is where the key choice comes: do you go with an off-the-shelf set of tariffs that was publicly grounded in the logic of the scheme and could be used to aid your defence, or do you risk going for the extra £1 million or £2 million financial gain, with a potential reduction in the legal strength of your case?

The Deputy Chairperson (Mr Aiken): One of the big drivers is legality. To what extent will it be challenged? There will be legal challenge, but the question is this: what is the worst-case option?

Mr S Murphy: Is it worth going for the extra £1 million or £2 million, given the extra legal risk? That is the judgement inherent in this.

Mr McMurray: I suppose, Shane, that this is getting us back to the original policy intention and what the scheme was about in the first place.

Mr S Murphy: Yes. It might be reasonable to expect that, by bringing in the tier and the cap, there would be some change in behaviours. Certainly, the incentive to burn above the tier when you do not need the heat should pretty much plummet or disappear. The question will be how much of the current heat and loads are truly not needed or would not be needed with some adjustment and whether the heat loads will start to gravitate towards the levels of the tier and the cap.

There was some endeavour, based partly on logic and partly on guesswork, to model the outcome of heat loads starting to gravitate towards the tier of 1314 hours and to the cap of 400,000 kilowatt-hours. That is the lower figure — the £24-odd million — that we are talking about. Let us be very clear: it is a logic-driven scenario; it is not driven on any data that we have, because we do not have data. In a year's time, if this tariff operates for a year, we will be able to gauge what the behavioural effect seems to have been by looking at the usage of installations before and after.

The Deputy Chairperson (Mr Aiken): I am quite shocked to hear that you do not have any data.

Mr S Murphy: We do not have any data post-behavioural change. We have data on current behaviours, but we do not know, within that data, which is good behaviour and which is bad. We do not know which is which.

The Deputy Chairperson (Mr Aiken): I am getting quite nervous here. To confirm, you are talking about logic, guesswork and having no data about looking forward.

Mr S Murphy: No. We have an estimate of around £25 million next year based on there being no behavioural change and if the patterns of consumption in previous years are repeated in future years.

The Deputy Chairperson (Mr Aiken): It has been running for only a year.

Mr S Murphy: No, we have some applicants for which we have two or three years of data.

The Deputy Chairperson (Mr Aiken): You have the data for that, but what data sets do you have at the increased rate since 2015 from the spike and going forward?

Mr S Murphy: For the November tariffs.

The Deputy Chairperson (Mr Aiken): Yes.

Dr McCormick: The reduced tariffs.

Mr S Murphy: We do not have as much data because that came in later. We do not have the same amount of data for people on those tariffs as we had for those on the earlier tariffs. A lot of times, those installations are still getting accredited and, until they are, they cannot put in invoices. Until there are invoices, there is no usage data.

We have very limited data on those who have this tariff in place, and, as a result, there is not a means to nicely model what before-and-after usage looks like. The range is not that large though, because,

in the new tariff structure, if there is a gravitation towards the 400,000 kilowatt cap, while that might be useful for policy outcomes, it will not save any money because it will be at zero pence. Everything beyond the cap is at zero pence. A gravitation towards the tier saves 1.5 pence per kilowatt hour, so it is not truckloads of money. The big thing that delivers, first, rate of return regulation and, secondly, cost saving, is the existence of the tier itself. That is the big factor that takes this down from £50-odd million to half or a fraction less.

Dr McCormick: Any exercise like this involves using empirical evidence on past behaviour and projections forward involving a range of assumptions. Let me say something risky. It is a well-known fact that all financial models are wrong but some are useful. This is useful. This is a useful analysis.

The Deputy Chairperson (Mr Aiken): Andrew, I worked for the Ministry of Defence before; I am well aware of models.

Dr McCormick: The numbers will not turn out exactly as projected; that is certain. This gives as good an indication as it is possible to get on how future behaviour will run, and we are also clear that, without this, the present way of doing things is easier to model and easier to project. It is exactly as we have it now, which is excess heat. The case for doing this, which is to do something for one year, is as well founded as it could be. Going back to what Shane said about the objectives, this is not trying to design the perfect model that will last for 20 years. We need to take on this task because we need to have a more stable and permanent solution for April 2018 and we need to buy time to let that happen. The beauty of this is that it introduces clear control straight away. It goes back to my urgent need for regularity in expenditure, the need for value for money and the need for some degree of restoration of confidence through people no longer having an incentive to burn to earn. To me, that is the summary of the case. Shane, have I interrupted your flow?

Mr S Murphy: No, that was pretty much it.

Mr McMurray: Tied in with this is the idea of 100% inspections and the information that we will get from those. This will influence us as well and provide a whole new data set for us.

Mr S Murphy: It is important to note that those figures do not involve any presumption. There could be 50 or 75 installations, but I do not know what the number might be. Whatever number of installations the inspection regime might pick up and discard or remove from the scheme is not part of that figure work.

Dr McCormick: When I was talking to the team about the business case in the last couple of weeks — it is only during that period that we have been doing it — I was asking, "How much can we get? How much more of a reduction would we be likely to secure through a highly effective inspection, audit and fraud prevention regime?". The recommendation was to adopt not a conservative or safe figure but a prudent mid-range figure of £1 million or so of possible savings. When Moy Park or others claim that all you have to do is come down on fraud, that is simply not the case. There is no evidence whatever that that would be sufficient to make a difference. Yes, separately, we need to pursue 100% inspection and bear down on every case where there is abuse or fraud in the system.

The Deputy Chairperson (Mr Aiken): This is the difference between abuse and overcompensation.

Dr McCormick: Exactly. That is Shane's point.

The Deputy Chairperson (Mr Aiken): I am very conscious of time, and I know that some people want to come in. You said that you have been working on the business plan for only a couple of weeks. The Minister told us, categorically, in July that he was looking —

Dr McCormick: On this particular business case. We had examined a range of options; indeed, as I said to the PAC yesterday, we had consultation papers worked up in September/October on other options that were full and complete long-term solutions. Then, as I said to the Committee yesterday, we spent some time looking very hard at the closure option, especially in November and December. Those are all dealing with solutions that would have been long-term and permanent.

The particular task in the last few weeks has been to come up with a short-term solution that would bear down immediately. That was just an evolving set of considerations. For example, the closure option was exposed publicly before Christmas and there was a lot of criticism and concern about the

potential loss of future AME. We do not want to lose out. It is still beneficial to Northern Ireland to have the flow of that resource; it is our 3% share of what is going on for renewable heat across the water and it is right to try to continue to make use of that. All those considerations came in, hence the work that has been done. There has been extensive work and, again, some degree of consultation. We probably could have written more to the Department of Finance in the course of the autumn, but, as a matter of fact, we are where we are and we have got a very defensible and viable proposal.

The Deputy Chairperson (Mr Aiken): On what date did you start this revised business plan?

Dr McCormick: 30 December.

The Deputy Chairperson (Mr Aiken): OK.

Mr S Murphy: You should be aware, though, that, because the core of this business plan is superimposing the November 2015 tariffs, that was part of the options work that was done earlier in the autumn.

Dr McCormick: Yes, that is right.

Mr S Murphy: The modelling work that was done in September, October or November was refined further in that last two-week period.

The Deputy Chairperson (Mr Aiken): Shane, that is fine; we fully understand that.

Dr Farry: To pick up on that point and before I get into specific questions, I want to say that these exchanges are useful. What you are setting out, as it is explained, is that the process of reassurance is ongoing. The pity is that the timescale for all this is so tight. That leads me into the first point that I want to make, which is about the timescales and what is, in essence, a paradox in what we are hearing you say. It is causing us concern. It is probably feeding our frustration in the current context. On the one hand, you are telling us that what you are going for is, in effect, the easiest and most simplistic off-the-shelf approach, designed to be a one-year patch to allow for a wider public consultation and policy process around what will be a much more long-term, sustainable process. It begs the question as to why, if you were doing this from a standing start in the autumn or even at the end of December, this particular process could not have been initiated in June and reached the point where regulations were before the Executive and Assembly in early September. I cannot get my head around why we are where we are.

Dr McCormick: I commented on this yesterday as well. The truth is that, for a fair bit of last year, we were limited by the view that the grandfathering concept — the commitment — could not be overcome. It took us some time to realise that there were grounds to challenge the illegitimate expectations point. We have probably been too limited in our thinking. You cannot do something before you think of it, is the honest answer to your question. The thought of doing it this way only came to us over the Christmas period. That is just the human explanation. We thought of it. In fairness, it came from special advisers.

Dr Farry: There is a saying that sometimes the most obvious solution is just in front of your nose. It is a case of that. Nonetheless, it is frustrating for us and it does not really help us in our process.

Dr McCormick: I accept entirely that there is that sense of frustration.

Dr Farry: In that spirit, Andrew, could you give us an indication as to whether the Department has a preferred, or even a preliminary, view of the best longer-term solution? Can you give us an idea as to what the trajectory of this will be?

Dr McCormick: Obviously, I am wary of saying anything that might indicate pre-judgement of the consultation process. That is part of how we regularise this. It is not unreasonable to say that this looks quite good for the longer term. Continuing with exactly this tariff for the longer term might be quite a good idea. I think that we have to really stress-test that and look at the implications. We will have a lot more data to consider and we will understand the behaviours. Also, in the course of the next few months, we will have the emerging progress on inspection and so on. All that will feed into a consideration of those future options. Certainly, as I said yesterday, I was highly attracted to the

closure option, for accounting officer reasons, because it kills the abuse just like that. It wipes it out instantly, and it would have been very attractive. It would have left us with no question marks. This deals with a lot of problems, but it does not instantly deal with abuse.

The Deputy Chairperson (Mr Aiken): Could I just interject? Andrew, I know that you are under time pressure, but I also know that this is vital. If I ask for your indulgence for another 10 to 15 minutes from the time you said, I will guarantee that you will be out of here by 4.45 pm.

Dr McCormick: I am not sure yet whether the meeting that I have been trying to organise is working. It is quite an important meeting. If someone could check with Siobhan Tweedie and establish whether the 4.30 pm meeting is confirmed, it would be helpful. My device is turned off.

The Committee Clerk: We will get one of our team to do that. I assume that we can get that from the ministerial office upstairs.

Dr Farry: I will pick up the pace.

The Deputy Chairperson (Mr Aiken): If you could. I know that every member wants to ask questions, and we have three more want to speak.

Dr Farry: I will group this into three broad areas. Maybe Shane could outline the risks, in terms of this approach, cited in the business case, to give us a picture of the preferred outcome, and the cleanest, most effective way to address the overspend in the short run. Is it also the least risky? Is there greater risk with other approaches?

Mr S Murphy: The least risky approach is to do nothing, but then that will cost us 25-plus million quid next year, which I do not think that anyone around this table is keen to live with. There was a description earlier of the legal defence for this type of move.

There were risks in the business case around operational risk. Putting the tariffs into regulations is all fine and dandy, but can Ofgem operationalise them? Stephen can probably say more about that, but my understanding is that comfort has come from Ofgem that it actually can put this through their computer systems and deal with the operational aspects of it. It is very easy to think that this is just changing something on the computer and Bob's your uncle. It is a much more complicated process than that, but that assurance is there. Clearly, legal risks have been talked about.

Dr Farry: What about European Commission risks? Is that a legal risk or a compliance risk?

Dr McCormick: It is a separate process. I had a discussion with the Commission in December when we were exploring the closure option and the message they gave us then was that: closure would, of course, be accompanied by compensation, and if that compensation was equivalent to the entitlement of the individuals under UK law, then that would not be aid and, therefore, there is no process required whatsoever.

That, to me, was another reason for thinking of that as quite a good idea. However, the Commission also made it very clear that any other proposal would be notifiable. The process for the Commission on state aid is that it likes pre-notification. So, a member state sends a paper explaining the proposal and that allows for discussion and testing of the idea with Commission officials, and only when that has been through a process and a good understanding has been secured, you move to the formal process of notification. That is significant because, once a formal notification goes in, the Commission has two months in which to take a decision. You will now be picking up the significance of the timing. We still would like to keep on good terms with DG Comp and ensure that there is goodwill towards the process. That is probably one of those situations where the least said the better, given one or two of the other things that have happened in the last few months. Therefore, the proposal is to have an early discussion with them, but that is best done after. Subject to Assembly approval, we will then have a clarity of role here, and we would ideally move to notification immediately and therefore have a hopeful expectation of a decision before the end of March. We could not take a chance on that, hence the formulation in the regulations that says 1 April or notification —

Mr McMurray: That ties in neatly with Ofgem because giving it that window gives it enough time to make those changes. It has given us that assurance.

Dr Farry: My final question has two parts and relates to the core issue of excessive profits or superprofits of the overcompensation. It is normal. I will not ask you why that did not happen; that is for another place. It is normal in contracts to build in a clawback clause in terms of superprofits. De facto, is the tiering approach the cleanest, smoothest way of protecting against superprofits, if you were doing this from day one, or are there other conceivable approaches around clawback on superprofits that you could envisage and were they considered in the business case?

Mr S Murphy: This was probably not in the Cambridge Economic Policy Associates (CEPA) report. One of the jobs of tiers is to regulate the rates of return and significantly reduce the scope for variation.

The Deputy Chairperson (Mr Aiken): Sorry, just to halt it. Andrew has to go to a meeting at 4:30 pm, but Stephen and Shane will stay.

Dr Farry: Can I park my question on the tiering? I want to ask Andrew —

The Deputy Chairperson (Mr Aiken): We will have Andrew back again on Monday morning.

Dr Farry: It is a question ahead of Monday. It is actually more of a point than a question.

The Deputy Chairperson (Mr Aiken): Quickly, Stephen.

Dr Farry: I am very conscious that the Minister wrote to party leaders today about a public inquiry. I appreciate that the issue and content of that is for another time and another place in the PAC process, but the fact that a public inquiry is potentially being set up is a scrutiny issue for this Committee and I am conscious that there is a lot of concern and that reassurance is required around the terms of reference. I want to make the point and the request that, while we may not be in a position to discuss it today, if Andrew and the Minister are coming back on Monday, we should be in a position to discuss it then. We will not go into what happened or why it happened — that is for another discussion — but what will happen in any proposed inquiry should be brought to our attention on Monday.

Ms S Bradley: Andrew, we were thrown a bit of a lifeline by having extra time before the debate. Has anything changed from that? Have we got any further Department of Finance cover? Has the Minister been in touch with the Department of Finance?

Dr McCormick: There has been contact and my understanding is that the process is progressing well. We have certainly dealt with any questions that have come from the Department of Finance. There is no reason to believe that that should not come through. Obviously, a much better position would be for that to be secured before the resumption of the debate, whether that is Monday or Tuesday. We are very hopeful about that and we have also made progress with the Examiner of Statutory Rules. She is considering it and we have provided documentation and analysis to her to facilitate her process. We are confident about these processes.

Ms S Bradley: I appreciate that. Given the weight of consideration on this Committee, it is important that we get live updates on where that is. We are trying to balance leaving due process against the public interest, and we are not — I certainly am not — privy to the information that I need. That is a critical piece of information that we need to be fully aware of.

Dr McCormick: We will do our best on that. Certainly —

The Deputy Chairperson (Mr Aiken): Can we make a firm commitment that we are kept fully informed regularly —

Dr McCormick: Sure.

The Deputy Chairperson (Mr Aiken): — and updated on a 24-hourly basis on where we are? That would be very appropriate to the members here.

Ms S Bradley: Are you getting the reassurance directly from the Minister or departmental officials?

Dr McCormick: We will keep you up to date with what we have from whatever source.

Mr McMurray: We have had three to four days of quite intensive going back and forward to DOF, and as far as we are concerned we have completed that process. We have supplied all the information that was requested.

The Deputy Chairperson (Mr Aiken): Andrew, we look forward to seeing you at 9.30 am on Monday, bright and breezy. Thank you.

Dr McCormick: I will leave you with my expert colleagues.

Mr S Murphy: Would you like me to return to the tiering question —

Dr Farry: I will reframe the question in two parts. Essentially, is tiering the only, or most efficient, means of dealing with a super-profit situation? My second point is on what is maybe the slightly broader issue of the justification for the 400,000 kilowatt-hour cap and the potential there for unfairness. That is maybe a more blunt instrument. Tiering is much more clearly linked to use, irrespective of the level of investment. Does the cap potentially throw up more anomalies or grievances than the tiering process?

Mr S Murphy: Tiering is good at regulating rates of return. Superimposed on the pre-November 2015 applications, it will do a good job of regulating rates of return going forward. It will not do the job of addressing overcompensation already received. Some of the other options that we have been looking at long-term might be more helpful in that respect. There might be long-term scope to look at tariff structures that help that. However, we do not have time for that level of innovative thinking if we want to get a first step in the correction ready for 2017-18.

Mr McMurray: There are examples of that happening, especially in big capital-based projects, where super-profits are looked at. There are grounds to do that, but, as Shane said, we need more time to look at that sort of thing.

Mr S Murphy: My understanding is that the cap was brought in as a budgetary control to limit what any one installation could receive. It is a feature of the November 2015 tariff changes. This was something off the shelf. It was publicly stated to be in line with the original objectives of the scheme. Then you are into the question of whether, if you deviate from that, there is an impact on the legal assurance because what you have is no longer the same as something that you claimed in November 2015 was in line with the original objective of the scheme. I am not legally competent to say whether that would damage your case not at all, significantly or somewhere in between.

Dr Farry: But from an economic or financial point of view, is there a rationale for the 400,000 kilowatt-hours particular to that —

Mr S Murphy: My understanding is that the rationale for the 400,000 kilowatt-hours was driven by what was typical in the poultry industry. From recollection, there was an assessment by the College of Agriculture, Food and Rural Enterprise (CAFRE) that the poultry industry might be expected to use something like 388,000 kilowatt-hours per annum per shed. That could be a little bit higher in a colder year. I think that was the basis for choosing 400,000 kilowatt-hours. However, I am going on the basis of my memory bank, not having been involved.

Mr McMurray: That is correct.

Ms S Bradley: I am just a little concerned by the last answer that it seemed to be built up around a particular industry, but I will leave that aside for now.

I will run through some questions. I am conscious of time, and my colleagues will, equally, want to ask questions. I will not repeat the question that Dr Farry put so eloquently. My first concern is about why it could not happen sooner. We were firmly told that there were no grounds on which we could deny anybody their right to a valid claim, but that thinking seems to have changed. For me to put any weight to that, I really need to know where the business case is as regards approval from the Department of Finance. I did get an answer, but I am no wiser, to be quite honest, at this stage.

Mr S Murphy: For example, Department of Finance economists were round today. They would have been there on Monday, but, obviously, the regulations were initially moved on Monday. They had a second session on the modelling on the rates of return inherent in the tariff band. Certainly, there are no questions from DOF on the numbers and the financial side of things that are sitting with me.

Ms S Bradley: But there is no DOF approval as such? It is still within the gift of the Minister, I understand, to have a look and say, "Give this the nod", but there is no action there. I am reading between the lines.

I will move on to my question. Basically, I want to know whether the savings we are looking at that could be achieved out of any remedial measures could also extend to the Treasury. If there were past misspendings, would they necessarily also extend to AME in terms of what could be clawed back?

It is a matter of record that the regulations expired in March 2015, but spending continued. I just want to know how that period from April through to September was covered when they would not have been granted retrospective approval. Did that come out of the Department of Enterprise, Trade and Investment budget or the Department for the Economy budget, or was there AME money to close that gap?

We keep talking about going back to the objective and the original intent, which was about a renewable heat incentive. Have you had anything to suggest that the materials being used in some of the boilers are not renewable? I know that that is maybe looking at fraud as opposed to overcompensation, which is what we are trying to make a distinction about here. If that is the case, whilst we are changing things, fraud could still be happening even within the new limits. I just want to know whether there has been any suggestion, or whether any inspections have picked up anything to suggest, that the materials are not all renewable.

In the application process, did an applicant not have to give the nature or type of business, the reason for installing and the anticipated usage? Would that not be a good measure then to visit the anticipated usage that they would have subscribed to at the outset and their actual usage. Again, how is that measured? I know you said that is done through meter readings, but what if a non-renewable product is being used? There still seem to be lots of questions here, and I know that the answer to one will only reveal probably 10 or more questions that I want to put to you. I am trying to garner sufficient information to make a judgement here.

Mr S Murphy: I will take the anticipated usage question; all the previous ones are operational. Yes, applicants indicated their level of anticipated usage. We have a database on that, but there are probably a few blank cells in it. By and large, the applicants in the pre-November 2015 era, using 99 kW boilers, tended to indicate that they were going to run between 50% and 55% of the time. The data to date suggests that those expectations were probably a bit high, and the more typical usage was 40% to 45%. Post-November applicants indicated usage that was — if I can remember correctly — about 25% lower than that. Our behavioural-change modelling shows that it is not as high as 25%; it is around 14%, which is about 60% of that. So, yes, we have information about anticipated usage, but what turns out seems to be a bit less than that. There does seem to be a difference, albeit there are different boiler sizes as well, which could partly account for these differences. The bands are going to extend to 199 kW boilers, which are twice the size. Whether you would expect load factors to be exactly the same we cannot say, but there is certainly a difference in the anticipated running hours between those who applied before and those who applied after the changes. I am not sure if that has exactly answered your question.

Ms S Bradley: I want to know that it is one of the measures that you are recording, because that would indicate abuse if someone has that intent and then maximises the boiler.

Mr S Murphy: Going forward, I imagine that they will want to prioritise inspections. One way of prioritising that would be to use the data to gauge where you would want to focus your resources early. You would imagine that data such as usage compared with expected usage and usage compared with comparators would be indicators as to those you would prioritise for inspection and those that you might leave until later.

Mr McMurray: You are absolutely right about that. With the 100% inspections, for which we are writing the spec at the moment, that will be a big part of it. Even looking within industries at what the typical usage should be and comparing it with the actual usage has been will be built into the 100% inspection regime.

On the question of things being used for renewable heat that are not renewable, I am personally not aware of any of those cases. All cases are referred to Ofgem for follow-up, but I could take a look to see whether that has been the case. I am not aware of anything myself on that front to date.

I will now turn to the question of clawback and whether the Northern Ireland block or the Treasury gets the clawback funds. My understanding is that those stay in the Northern Ireland block, but there is a thing called a consolidated fund extra receipt (CFER), which is a non-budgetary estimated amount that returns to the Treasury. I will look into that specific point for you. Just off the top of my head, I think that the clawback funds stay in the Northern Ireland context. Does that answer all your questions?

Ms S Bradley: I asked about the period when money was paid outside Budget cover and outside any legal cover. Do you know whether that came out of AME or from the Departments?

Mr McMurray: I am not sure. I would need to check that.

Mr S Murphy: My understanding is that the approval would not impact on what budget line it comes from. This was in the period when there was no DFP approval in place and whether that would impact on its going against either AME or DEL.

Ms S Bradley: I do not know where that money came from; it did not have cover.

Mr McMurray: I will check up on that.

Mr Dunne: Thanks, gentlemen. In relation to the contracts that each applicant signed, is there any reference there to the Department having an option to review the tariff, that you are aware of?

Mr McMurray: I am not sure. That whole concept of review is very important, and we will be building that in as we go forward. In comparing us with the GB scenario, that was one of the major failings. In GB things are reviewed quarterly; they look at what the tariff is compared with how the market is changing. That is what we intend to do as well.

Mr S Murphy: I am not an expert on the legal advice by any stretch of the imagination. Andrew knows more about it than I do. This is part of the consideration of the legal advice. It is a question of a legal distinction between whether these were contracts or whether they were tariffs set in regulations by government. That is a feature of the legal advice, but I am not competent to go into the technicalities of it.

The Deputy Chairperson (Mr Aiken): To do that again, we do not know whether they are contracts or not.

Mr S Murphy: I am not saying that. I am not competent to say. My understanding is that part of the legal advice draws a distinction about what is a contract. In this situation, the tariffs were set in regulations, and that is a feature of the legal advice that has drawn particular comment in respect of our case. I am not competent enough legally to describe exactly why that distinction is important, but it was drawn out as important.

Mr Dunne: Earlier, you said that 388 kilowatt hours per annum per poultry unit is a figure produced by CAFRE.

Mr S Murphy: From recollection.

Mr Dunne: Yes, approximately or thereabouts.

Mr S Murphy: Yes, 388,000 per annum was the CAFRE analysis. Again, this is from recollection, not from the time but from recent documents that we have looked at, and that is what I understand helped to drive the choice of the 400,000 cap.

Mr Dunne: Do you think that that is a fair benchmark for a lot of the units that are working on farms across Northern Ireland? Do you think that that is a reasonable figure to be working on?

Mr S Murphy: If I were sitting here next year with the benefit of the data, with the tier in place and with abusive behaviour better exposed by comparing next year's data with this year's, I think that I would be in a much better position to answer the question on whether the cap is set at the right level. That might be something that is reasonably looked at in the next year, but, at the minute, I cannot answer that question because there is evidence that there is abuse in the system. I do not know how extensive it is, and I do not know whether it is distorting the pitching of the cap.

Mr McMurray: The poultry industry accounts for roughly 40% of the total amount of applicants.

Mr Dunne: That is with an operational time of about 40% to 45%. Is that right? That is what your assessment was.

Mr S Murphy: The load factor is around the mid-forties. I could do my calculation if you want.

Mr Dunne: You mentioned that, under the new tiering system, that reduced down to 25%. Is that right?

Mr S Murphy: Under the new tiering system, if you had a load of 400,000 kWh per annum, for the first roughly 130,000-odd kilowatt hours, you would get 6.5p. For the balance of that, the 270,000-ish, you would get 1.5p.

Mr Dunne: You are saying that the behavioural change brought around a 20% reduction —

Mr S Murphy: No, what I was saying earlier was that the new tariff was introduced in November 2015. We do not have that much data. Accreditations for a lot of those applications are still pending in the system. As a result, there is no invoice and there is no data on usage, so there is only limited data. I do not think that I have enough data at the minute to give you an indication of the extent of the behavioural change.

We do have data based on what people said they were going to run, and there is a material difference in what people said before. That is the 1,800 or so people who applied before November 2015 compared with the 300 or so who applied after. There is about a 25% reduction. That may not be an absolutely fair comparison because the applicants in the pre-November era predominantly had 99 kW boilers. Post-November 2015, there were a lot of 199 kW boilers. Those boilers are twice the size and might not be expected to run at the same load factor because it takes fewer hours to produce the same heat. Until we have a year's data, I cannot really give you a conclusive steer on that. I am trying to give you the best indication that I have from the data that I have, which is not ideal without having a year or two of data for a sufficient number of installations running on the new tariff to do that compare and contrast. I just do not have that yet.

Mr Chambers: I do not know whether you are empowered to answer these questions, and maybe Andrew would have been better placed, but I will ask them anyway. We understand that John Robinson, Minister Hamilton's special adviser, has stood aside from any further involvement in the renewable heat incentive scheme. Has Mr Robinson had any involvement in crafting this scheme to date?

Mr McMurray: I am not aware of any.

Mr Chambers: No politician is coming forward to call the botched scheme their plan, but I have heard the Minister referring to this mitigation plan as being his plan. Is it his plan? Did he knock on somebody's door on a Monday morning and say, "Look, I've been thinking about this over the weekend; I've come up with a great idea here to mitigate this", or has the plan been developed and crafted by the civil servants in the Department as opposed to it being a political plan?

Mr McMurray: It is fair to say that it is an element of both. We have had a number of round-table discussions internally about what options we have. Those have involved the Minister.

Mr Chambers: Is it fair to say that there were ministerial round-table talks about formulating the botched RHI scheme and putting it together? Presumably, if that is the way you do it, the original

scheme would have been put together in the same way, with ministerial input and round-table discussions —

The Deputy Chairperson (Mr Aiken): May I just interject at that point? Thank you, Mr Chambers, for your point. I have just been advised that we are straying into PAC territory. The question is on the record. I fully understand that Stephen and Shane are probably not in a position to answer.

Mr Chambers: I did not want to put you in an impossible position. Thank you.

Ms S Bradley: I notice that 31 March has been used as the closing date. For the public record, whose job do you anticipate it will be to note that date, revisit it and make sure that action is taken before it? We know that there has been slippage in the past. Will that date be in the diary of any future Committee as well being in the diary of the Department?

Mr McMurray: We have developed a timeline of what we need to do in the next 12 months. We need to do things far sooner than March. I think that decisions have to be taken by November in terms of what the new second-stage, permanent solution will be. That would allow us time to bring forward regulations that would even allow us to extend the current system. We have a timeline, and we will work very much to it. There are key milestones that we have to achieve. November is a key date by which we have to have things in place.

Ms S Bradley: Who is "we"? Is that the Minister?

Mr McMurray: That is at official level.

Ms S Bradley: Would the Committee have —

Mr McMurray: Absolutely.

Ms S Bradley: OK. It is in diaries.

The Committee Clerk: It might be useful for me to clarify that this is a one-year set of regulations. Once this set of regulations expires, something else has to come into place. If there is a Committee to scrutinise it, it will look to scrutinise any subsequent —

Ms S Bradley: It is just that we have already had the gap in legislation. A repeat of that would not be helpful. It might be helpful to put any longer-term vision that may be in the discussions of the Department into the public domain so that potential applicants that may look at the scheme now and be minded to take legal action or a judicial review may see a satisfactory balance in the longer term. There is a bit of an onus on the Department to be more open than it has been to date.

The Deputy Chairperson (Mr Aiken): One final thing before you go, Shane and Stephen. You will probably be very thankful to get out of here. Stephen, when were you appointed to this role?

Mr McMurray: On 19 December.

Mr Chambers: Your Christmas box.

The Deputy Chairperson (Mr Aiken): Shane, when were you appointed?

Mr S Murphy: I am not part of the RHI task force or team; I am part of analytical services in DFE. I have been in DFE since it was set up. Before that, I was in the DETI analytical services unit. I am not part of Stephen's team, but I was drafted in to help with the number-crunching and the modelling of the tariffs.

The Deputy Chairperson (Mr Aiken): I do not envy either of you your tasks. Thank you very much indeed. Please pass on our thanks to the permanent secretary as well; tell him that we look forward to seeing him on Monday morning.