

From the Office of the Minister



Department of  
**Enterprise, Trade  
and Investment**

[www.detini.gov.uk](http://www.detini.gov.uk)

NETHERLEIGH  
MASSEY AVENUE  
BELFAST  
BT4 2JP  
Tel: 028 90 529452  
Fax: 028 90 529545

E Mail: [private.office@detini.gov.uk](mailto:private.office@detini.gov.uk)  
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Alban Maginness MLA  
Chairman  
Enterprise, Trade and Investment Committee  
Room 375  
Parliament Buildings  
BELFAST  
BT4 3SW

28 June 2012

Dear Alban

### **RENEWABLE HEAT INCENTIVE – REGULATIONS**

I am writing to formally notify the ETI Committee that DETI has received notification that the EU Commission is content to authorise the Northern Ireland Renewable Heat Incentive (RHI) scheme. This approval means that my Department can officially begin the implementation phase of the scheme including setting the legislative framework and putting in place the necessary administration arrangements.

I therefore append the SL1 letter notifying the Committee of my Department's intention to legislate in this area. The legislation that is required will prescribe the eligibility standards for the scheme, outline the administrative arrangements and set the initial tariffs of support. I would be grateful if you would consider this letter at your first convenience; this will allow the scheme to be launched once legislation is passed following the summer recess.

In order to inform your considerations my officials have provided a briefing paper on the proposed RHI. My officials will also be available to provide further briefing, if required, following the recess.

The launch of the RHI, in conjunction with the Renewable Heat Premium Payment already in place for domestic customers, represents £25m of funding to 2015. This demonstrates my commitment to this sector and my desire to increase levels of renewable heating to 4% by 2015 and 10% by 2020, in line with set targets. The tariffs set have been calculated to bridge the gap between the costs of renewable heating technologies and conventional fossil fuels.

I would be grateful if you would consider the SL1 letter and appended briefing document.

Yours sincerely

**ARLENE FOSTER MLA**  
Minister of Enterprise, Trade and Investment

**To:** Committee Members  
**From:** Jim McManus, Committee Clerk  
**Date:** 2<sup>nd</sup> July 2012  
**Subject:** **SL1 – Renewable Heat Regulations**

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### **Background**

1. The Committee considered the renewable Heat Regulations SL1 at the meeting on 19th April. The Committee agreed to receive more detail from the Department on incentives for domestic installations (Regulation 15 (1) (a) and 15 (2)) and on payments to participants, levels of tariffs and how these will be calculated (Regulation 37).
2. The Department responded that, as EU State Aid approval has not yet been received, exact details of bandings and tariff levels cannot be provided. The Committee agreed to wait until bandings and tariff levels were available before considering further.

### **Summary of Content/Clerk's Analysis**

3. Banding and tariff levels are included in the table at paragraph 6 along with the tariff levels proposed in the consultation and a comparison with GB levels. In almost all cases tariff levels are higher than those proposed in the July 2011 consultation. The exception is solar thermal where there has been no change. All tariff levels are lower than those in GB however, the Department states that incentivisation is calculated against a counterfactual position of heating oil as the dominant fuel, whereas in GB gas is used as the counterfactual position.
4. Details of tariff levels for the Renewable Heat Premium Payment (RHPP) element of the scheme are provided at the table at paragraph 13 of the Department's paper. This is an interim measure before Phase 2 of the RHI is introduced for the incentivisation of domestic installations. It is likely that it will be at least summer 2013 before this is introduced.

### **Suggested Way Forward**

5. If members require further information or clarification, the Committee may wish to receive an oral briefing following summer recess.

## UPDATE ON NORTHERN IRELAND RENEWABLE HEAT INCENTIVE (NI RHI) AND RENEWABLE HEAT PREMIUM PAYMENTS (RHPP)

### Background

1. The EU Renewable Energy Directive (RED) (2009/28/EC) set a binding target that 20% of the EU's energy consumption should come from renewable sources by 2020. The UK share of this target commits the UK to increasing the share of renewable energy to 15% by 2020 and Northern Ireland is expected to contribute to this share. The Department of Energy and Climate Change (DECC) has indicated that renewable heat levels of around 12%, coupled with 30% renewable electricity consumption are required for the UK to meet its requirements and a target of 10% renewable heat for NI by 2020 was therefore included within the Strategic Energy Framework; this is a challenging target given that the current level is 1.7%.
2. £860million has been made available from central Government funding to support the introduction of a Renewable Heat Incentive (RHI) in GB over the period 2011-2015; HMT has notified the Northern Ireland Executive that £25million of funding is available for a NI RHI over the same period. A renewable heat incentive was introduced in GB on 28 November 2011.
3. Given the very different heat market in Northern Ireland, it was appropriate to separately assess how the NI renewable heat market could be best be developed. Cambridge Economic Policy Associates in conjunction with AEA Technologies (CEPA/AEA) conducted an economic appraisal to consider the most appropriate form of a Renewable Heat Incentive (RHI) for Northern Ireland. This work formed the basis for the proposals contained in the public consultation which ended in October 2011. The ETI Committee was briefed on the response to the public consultation at its meeting on 24 November 2011. In view of the response to the consultation, DETI engaged the original consultants (CEPA/AEA) to review the proposals and the economic model underpinning them. This work informed the final policy position the key points of which are presented below.

## NI RHI – Key Points

4. The NI RHI represents a long term approach to developing the renewable heat market by providing consistent, secure, long term payments for renewable heat generation. The incentivisation involves payments to installers of renewable heat technologies, with tariffs dependent on the type and size of technology installed, and in the form of pence per kilo watt hour (p/kWh) for heat generated. Payments will be made quarterly over a 20 year period for all eligible installations (following accreditation) and are '*grandfathered*<sup>1</sup>', however they will be amended on a yearly basis, for existing installers and new schemes, to reflect the rate of inflation.
5. The NI RHI will be introduced in two phases. **The first phase will be for non domestic installations across a range of eligible technologies.**
6. The NI RHI tariffs have been calculated to cover the cost difference between traditional fossil fuel heating systems and a renewable heat alternative. The tariffs account for the variances in capital costs, in operating costs, as well as seeking to address non-financial 'hassle' costs. The tariff is generated against a counterfactual position of heating oil; this is due to the fact that Northern Ireland is primarily dependent on oil and most of those switching to renewable heat will be oil consumers. In GB the predominant fuel is gas and so gas is used as the counterfactual. As gas is a cheaper fuel than oil the incentive required to promote a switch to renewable heat is inevitably less; this is the basis for the difference in the NI and GB tariffs. The following table shows the NI RHI tariffs against the nearest corresponding GB RHI tariff.

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<sup>1</sup> Provides certainty for an investor by setting a guaranteed support level for projects for their lifetime in a scheme, regardless of future reviews

Technology	Size	Proposed tariff	Equivalent tariff in July 2011 consultation	GB equivalent tariff
Biomass	Less than 20kWth	6.2	4.5	<sup>2</sup> Tier 1: 7.9 Tier 2: 2.0
	Between 20kWth and 100kWth	5.9	<sup>3</sup> 4.5	Tier 1: 7.9 Tier 2: 2.0
	<sup>4</sup> Between 100kWth and 1000kWth	1.5	1.3	<sup>5</sup> Tier 1: 4.9 Tier 2: 2.0
Biomethane	Biomethane all scales, biogas combustion less than 200kWth	3.0	2.5	6.8
Ground source heat pumps	Less than 20kWth	<sup>6</sup> 8.4	4.0	4.5
	Between 20kWth and 100kWth	4.3	4.0	4.5
	Between 100kWth and above	1.3	0.9	3.2
Solar thermal	Below 200kWth	8.5	8.5	8.5

7. Applying the same methodology to large industrial users, i.e. treating them exactly the same as other users, shows that installations above 1 MW should not require an incentive; it should make economic sense for them to make the change to renewable heat by 2020 without any government intervention.

<sup>2</sup> Tiering is used to ensure the technology is not 'over-used' just to receive an incentive. It works by dropping the paid tariff after the technology reaches its optimum use for the year; this is deemed at 1314kWhrs (15% of annual hours). After this level is reached the tier 2 tariff is paid. Tiering is not included in the NI scheme because in each instance the subsidy rate is lower than the incremental fuel cost.

<sup>3</sup> Previous consultation set out a tariff of 4.5p/kWh up to 45kWth and then 1.3p/kWh above

<sup>4</sup> The GB RHI has an open band above 1000kWth of 1p/kWh. Given the oil counterfactual it is deemed that Northern Ireland installations over 1000kWth are already cost-effective to 2020 and therefore do not require an incentive. If evidence to the contrary is provided by stakeholders this upper limit will be reviewed under Phase 2 of the RHI.

<sup>5</sup> As the GB banding is different the tariff of 7.9p/kWh applies up to 200kWth and then it drops to 4.9p/kWh

<sup>6</sup> This tariff reflects a deeming approach for the domestic sector. If a metered approach was introduced a tiered tariff would be more appropriate. This would be 9.3p/kWh for the first 1314 hours and then 4.9p/kWh after that.

8. Using assumptions developed by independent consultants, the following example can be generated for a 3MW biomass system being installed instead of a similar oil system.

	<b>Biomass (3MW)</b>	<b>Oil (3MW)</b>	<b>Difference in costs</b>
<b>Overall capital cost</b>	£995,000	£95,000	<b>£900,000</b>
<b>Yearly operating cost</b>	£43,000	£600	<b>£42,400</b>
<b>Annual fuel costs</b>	£800,000	£1,210,000	£410,000

9. In this scenario, whilst the upfront capital cost is £900k more than the counterfactual on an annual basis around £370k is being saved, this results in the capital costs being recovered in less than 3 years. If a tariff of 1p/kwh was set for installations over 1MW the annual payment for this installation would be £215,000, this would reduce the payback to around 18 months – the tariff would, however, be for 20 years. Given these figures and these assumptions, DETI cannot justify setting a tariff for larger biomass heating systems and when making calculations a negative tariff is produced i.e. no tariff is necessary.
10. However, if evidence to the contrary is forthcoming, this issue can be reconsidered under Phase 2 of the scheme.
11. The NI RHI will have scheduled reviews built-in to the scheme to allow DETI to ensure that the scheme remains fit for purpose and value for money for the duration. The scope of these reviews will include analysis of tariffs (either to be reduced or increased), the appropriateness of technologies (remove existing technologies or add new innovative ones) and an assessment of the effectiveness and success of the scheme.

12. **Phase 2 of the NI RHI, which will look at how best to incentivise domestic installations and may include some additional eligible technologies for non domestic installations** (if it is viable and economic to do so), will commence as soon as possible but is likely to be at least Summer 2013. This two phase approach is in line with the scheme in GB.

### RHPP Scheme – Key Points

13. As you are already aware, in the interim period, a Renewable Heat Premium Payment is available for domestic installations. The RHPP is available to all consumers wanting to switch to eligible renewable technologies and is in the form of a one off payment. The eligible technologies and levels of support are as follows:-

Technology	Support per unit (£)
Air Source Heat Pump	1700
Biomass boiler	2500
Ground Source Heat Pump	3500
Solar Thermal	320

14. All installations under this scheme are required to be certified under the UK Microgeneration Certification Scheme (MCS) and installed by MCS accredited installers. Applicants are required to provide routine information on the technology installed, to assist in developing the understanding of renewable heat performance and use in the domestic sector.

15. Those availing of the RHPP will remain eligible for any longer term tariff under Phase 2 of the RHI. However, the value of any incentive under Phase 2 of the RHI will be reduced to take account of any RHPP so that all customers are equally incentivised.

16. The RHPP scheme is being administered within DETI Energy Branch. Customers apply direct to the Department where an initial assessment of eligibility is undertaken. Successful applicants are then issued with a voucher guaranteeing the RHPP once the technology is installed subject to terms and conditions. Once the installation is completed it will be inspected and payment made.

## Development of an administrative system

17. The introduction of a NI RHI requires an administrative system capable of managing enquiries and applications, ensuring participants meet ongoing obligations throughout the life of the scheme, processing payments, preventing fraud and providing management information. The Office of Gas and Electricity Markets (Ofgem) has developed such a system for DECC and is already managing the administration of the GB RHI. In addition, it has experience of delivering other large scale incentive schemes such as the Renewables Obligation, (including the NI Renewables Obligation for DETI), and the Feed-in-Tariff.

18. A feasibility study concluded that Ofgem had the operational structures in place to deliver an administrative system. Furthermore, the study provided clear evidence that there were substantial gains (both in terms of efficiency and cost) to be had from utilising the existing GB system. Looking forward, there is the additional advantage that we would only be required to pay our share of any future development or enhancement costs. On the basis that exploiting synergies with the GB RHI will drive down the costs of administering the scheme, whilst maintaining a high quality service to generators, Ofgem has been appointed as the administrator of the NI RHI. Work has already commenced on the development of the systems.

## Next Steps

19. The NI RHI scheme has been approved by the DETI Casework Committee, the DETI Minister and DFP and the EU Commission has indicated that the proposals are compatible with the Guidelines on State Aid.

20. The primary power to enable DETI to make regulations for a NI RHI scheme to encourage renewable heat was incorporated into the Energy Act 2011<sup>7</sup> which was given Royal Assent on 18 October 2011. We now need to lay the Renewable Heat Regulations through draft affirmative resolution procedure in the Assembly.

## Energy Division

June 2012

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<sup>7</sup> <http://www.legislation.gov.uk/ukpga/2011/16/part/3/crossheading/northern-ireland-renewable-heat-incentives>





Mr Jim McManus  
ETI Committee Clerk  
Northern Ireland Assembly  
Parliament Buildings  
Stormont  
BELFAST  
BT4 3SW

28 June 2012

Dear Jim

### **SL1 – RENEWABLE HEAT REGULATIONS (NORTHERN IRELAND) 2012**

- 1.1 The Department of Enterprise, Trade and Investment (**the Department**) proposes to make a Statutory Rule in exercise of the powers conferred by the Energy Act 2011.
- 1.2 The Department of Energy and Climate Change (**DECC**) in GB agreed that an amendment could be made to the Energy Act 2011 that would extend powers for renewable heat, similar to those contained within the Energy Act 2008, to Northern Ireland. For this to be achieved a Legislative Consent Motion (**LCM**) was required. Following Executive approval on 10 February 2011 and ETI Committee support at its meeting on 24 February 2011, a LCM was tabled and passed in the Assembly on 14 March 2011.
- 1.3 The Energy Act makes special provisions for Northern Ireland in terms of renewable heat<sup>1</sup>.
- 1.4 DECC obtained Royal Assent on 18 October 2011 and the Bill became the Energy Act 2011. The Act deems that the Statutory Rule will be subject to the draft affirmative resolution procedure before the Assembly.

### **Purpose of the Statutory Rule**

- 2.1 The Department carried out an economic appraisal of a potential Northern Ireland incentive scheme with the aim to assist in achieving the target of 10% renewable heat by 2020. The appraisal considered various options for incentivising the local renewable heat market, and advised on appropriate tariff levels. It also considered the costs/benefits and the impact of each of the options.
- 2.2 The Department carefully considered the findings of the economic appraisal to reach a view on the proposed design of an incentive scheme for Northern Ireland (NI) and has obtained Ministerial clearance on the proposed way forward.
- 2.3 The Statutory Rule has therefore been drafted based upon equivalent Regulations in GB which are entitled the Renewable Heat Incentive Regulations 2011 (**the GB**

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<sup>1</sup> Sections 113 and 114 of Energy Act 2011 - <http://www.legislation.gov.uk/ukpga/2011/16/part/3/crossheading/northern-ireland-renewable-heat-incentives/enacted>

**Regulations**)<sup>2</sup>. The GB Regulations were approved by both Houses of Parliament and by Scottish Ministers on 10 November 2011.

- 2.4 The Statutory Rule will set in place a structured mechanism which will allow a RHI scheme to be introduced which will provide long-term guaranteed financial support for renewable heat installations in Northern Ireland. The Rule will underpin the tariff scheme and will specifically prescribe matters relating to eligibility criteria, obligations for participants of the scheme, methods of payment and accreditation and registration.

### Consultation

- 3.1 The Department went out to consultation on a proposed RHI scheme including the draft Statutory Rule on 20 July 2011, closing on 3 October 2011. A number of consultation seminars were also held over the summer period. In total, 78 formal responses were received, of which two offered no comment. The responses have been analysed and the vast majority of respondents were in favour of the proposals and provided useful comments which the Department considered.
- 3.2 Following the consultation, further economic analysis was carried out considering issues that were raised by stakeholders. This analysis completed in February 2012 and has informed the final policy decision.

### Position in Great Britain

- 4.1 DECC originally legislated for an incentive scheme in the Energy Act 2008 and, following a consultation process, published final proposals on the RHI in March 2011. DECC obtained parliamentary approval of the GB regulations in November 2011.
- 4.2 The Office of the Gas and Electricity Markets (**Ofgem**) is responsible for developing and administering the scheme on behalf of DECC.

### Equality Impact

5. In accordance with the requirements of Section 75 of the Northern Ireland Act 1998, a screening exercise has established that the proposed Regulations do not have any implications for equality of opportunity, and are instead engineered to promote equality of opportunity.

### Regulatory Impact

- 6.1 A draft Regulatory Impact Assessment (**RIA**) has been prepared in respect of these Regulations. The Regulations will support the implementation of the Renewable Energy Directive 2009/28/EC (**RED**) which requires the UK to ensure that 15% of its energy consumption comes from renewable sources including electricity, heating and cooling and transport.
- 6.2 Five options were considered as part of the RIA –
- (a) ***Do Nothing***

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<sup>2</sup> <http://www.legislation.gov.uk/ukdsi/2011/9780111512753/contents>

It was determined that under this option there would be limited deployment of renewable heat, the amount of which would largely be dependent on fossil fuel prices and the understanding of renewable alternatives. It was estimated that by 2020 renewable heat would account for around 7% of heating demand if no financial support was available. This option is not deemed as viable for a number of reasons. Firstly, the target set in the Strategic Energy Framework (**SEF**) for renewable heat would not be met and the funding provided by Her Majesty's Treasury (**HMT**) (discussed under point 7) would not be used. Secondly, the Northern Ireland renewable heat market would be distinctly disadvantaged in comparison to Great Britain and there would be a potential loss of skills and expertise to the Great Britain market.

(b) **50% capital grant**

The option considered would be a 50% grant to cover the capital costs of various renewable heat installations. If a grant scheme is the preferred option then a challenge fund scheme would be the preferred option and would ensure deliver more cost effective renewable heat. Lessons learned from the *Reconnect* scheme would support the view that a competitively awarded grant can be more cost-effective and targeted than an administratively awarded grant.

(c) **A renewable heat challenge fund**

A 'Renewable Heat Challenge Fund' would be a capital grant with the grants being awarded on a competitive basis, rather than 'first come first served'. In this scenario interested parties would be invited to apply for funding and would provide information on the intended installation, expected heat output and required funding (there would be a maximum allowed grant based on % of total cost). Applications would then be ranked based on the cost-effective renewable heat output and grants awarded according to rank. This process would be repeated on either a bi-annual or annual basis.

There are several issues to consider under the challenge fund option. The first to consider is that the administration costs are likely to be prohibitive. Previous experience of running *Reconnect* demonstrated administration costs of £1.48m for a grant scheme worth £10.5m (14%). The *Reconnect* scheme was for domestic customers only, and on a 'first-come-first-served' basis. A challenge fund, dealing with commercial applications and involving complex evaluation metrics, could be expected to be at least as, if not more, costly than the *Reconnect* scheme, equating to potentially £3.5m over the first 4 years. This would not be available within DETI budget.

The scheme could be potentially complicated and would require applicants to have an understanding of their heat demands and most appropriate technology requirements. There would also be a danger that only certain technologies, which ranked highly on the scoring matrix, would be incentivised. This would not support the development of a more diverse market.

The final issue with a 'challenge fund' is that of risk. As the Challenge Fund would be contributing to the capital costs of the installation (rather than the whole life costs under the RHI) a risk would develop that, after a short time, installations would stop generating renewable heat. This could be because the renewable heat fuel is no longer affordable, that a fossil fuel alternative (such as gas) become available or more attractive, that the site is no longer in business etc. In these circumstances

clawback arrangements would need to be initiated, which could be costly and complicated, and the target would be hindered.

(d) **Joining in with the GB RHI scheme**

There are many positives for joining in with the existing GB RHI including the consistency of approach with GB, savings in the cost of administering an NI scheme, and the potential speed with which a scheme could be implemented.

However, it has been concluded that, given the differences between the GB and Northern Ireland heat markets implementing the GB RHI as it is currently devised and using the proposed GB tariffs in Northern Ireland would not be appropriate. The major issue that would arise would be that customers could be potentially over-incentivised and inefficient technologies supported. The GB tariff levels are largely based on the assumption of a household or business switching from gas to renewables. Whereas, given the prevalence of oil in Northern Ireland, tariff levels for a Northern Ireland scheme would need to be set on the assumption of moving from oil to renewables.

(e) **A specifically tailored NI RHI scheme**

The NI RHI option offers the highest potential renewable heat output at the best value. It also would incentivise a wide range of technologies and provide investors with long-term support. Whilst it would only be open to non-domestic market, in the first instance, it would eventually be open to all consumers and therefore provide greater accessibility.

The purpose of the RHI (in GB and NI) is to incentivise people to move from carbon-based heating to renewable energy sources. The 'cost' of the carbon fuel is therefore important and differs in the GB and NI markets. The tariffs for the Northern Ireland scheme are therefore lower as they are based on moving people from a more expensive fuel source, therefore the required incentive to move is deemed to be lower.

Similar to the GB scheme, the NI RHI would be made available to the non-domestic market first, with the domestic market introduced at a later date. The reason for this is difficulties in assessing and monitoring heat demand in domestic dwellings. DECC is currently considering the incentives for the domestic market. The Department's consultation also highlighted a commitment to consider this issue and introduce the RHI to the domestic market as soon as possible.

### 6.3 **Preferred option**

As mentioned in the consultation exercise in July 2011, the Department's preferred option is a specifically tailored NI RHI scheme. This has been determined as the most appropriate method of providing long term support for the local industry, with tariffs developed specifically for the Northern Ireland heat market which will utilise available funding most efficiently. The Department also anticipates that there will be secondary benefits to the development of the renewable heat market other than increased renewable uptake. These associated benefits include a reduction in CO<sub>2</sub> emissions as fossil fuels are displaced, an increase in fuel security as Northern Ireland's dependence on imported heating fuel diminishes and growth for 'green jobs' as companies benefit from opportunities presented by renewable heat.

## Financial Implications

7. HMT has advised that £25m of funding will be made available for a Northern Ireland RHI. This funding is spread over the spending period between 2011-2015, with £2million in the first year, followed by £4million and £7million, with £12million available in the final year. DETI has sought and received approval for the funding profiled for year 1 of the scheme to be made available in year 2. The funding will come from direct Government expenditure and therefore will have no impact on Northern Ireland consumers' energy bills.

## EU Implications

- 8.1 The RED requires the UK to ensure that 15% of its energy consumption comes from renewable sources – for the first time the requirement extends beyond electricity to heating and cooling and transport. This is an important shift in emphasis: almost half of the final energy consumed in the UK is in the form of heat, producing around half of the UK's CO<sub>2</sub>.
- 8.2 The RED is the key driver for the work undertaken by the Department on renewable heat. The requirement to meet the very challenging 15% renewable energy target falls at Member State level, not at Devolved Administration (**DA**) level. However, while energy is a devolved matter for Northern Ireland, each DA is expected to contribute as much as possible to the overall UK target. In light of the obligations within the RED, the Department has undertaken to introduce a renewable heat scheme in Northern Ireland.

## Section 24 of the Northern Ireland act 1998

9. The Department has considered section 24 of the Northern Ireland Act 1998 and is satisfied the proposed Rule does not contravene the Act.

## Section 75 of the Northern Ireland Act 1998

10. The Department had considered section 75 of the Northern Ireland Act 1998 and is satisfied that the proposed Regulations will have no negative implications or possible infractions under Section 75.

## Operational Date

- 11 It is proposed that the Regulations will come into operation in Autumn 2012.

## Briefing paper

- 12.1 To aid your considerations I attach a briefing document outlining the RHI proposals that have recently been approved by the EU Commission.

12.2 I would be grateful if you would bring this matter to the attention of Enterprise,  
Trade and Investment Committee.

Yours sincerely

**FIONA HEPPER**  
Head of Energy Division

cc Human Rights Commission  
Legislative Programme Secretariat