The Future of the Northern Ireland Non-Domestic Renewable Heat Incentive (RHI) Scheme

The Ulster Farmers Union is the largest representative organisation for the land-based sector in Northern Ireland and we have 240 members who availed of the non-domestic Renewable Heat Incentive since 2012. The majority of these are poultry farmers and their farm businesses were adapted to specifically integrate the new heating systems.

Over the past 12 weeks, we have consulted with our members on these proposals, including our Poultry Committee, Renewable Heat Sub Group and our Rural Enterprise Committee.

All Committees voiced their concerns about the spurious Rate of Return data and the misleading "Total Cost to the end of the scheme" which are connected to the 8 options.

Scheme Design

When the scheme was launched, DETI had anticipated 27,000 boilers to be installed, yet the schemes budget creaked when 2,000 were fitted.

Nature of the Consultation – The UFU Policy team have a vast experience gained over the years, contributing to a vast number of Consultations; including devolved and Westminster government and European Commission. During this time, we have become very well versed in what are the essential requirements of a consultation. In this consultation, DfE have presented a series of proposals which are beyond the formative stage and hence this questions the scope and intentions of the whole consultation process. This consultation in its current form does not provide sufficient reasons for the presenting options/proposals. Consequently, DfE are not allowing respondees the opportunity to provide an intelligent nor comprehensive response. As far as the outcome is concerns, the UFU doubt that the product of the consultation will be diligently taken into account, when DfE take the final decision.

We wish to highlight our concerns on key parts of the DfE Consultation.

4.4 - UFU Query "the assumed typical boiler size".

DfE choosing 50kW as "the assumed typical boiler size" is questionable and shows no advanced thinking or actual research. A simple desk-top research exercise would have given the Department a more accurate typical boiler size. The fact that LESS THAN 10% of installations were around the assumed typical boiler size, if not a problem created by the boiler owners rather another failure on the part of the Department and scheme designers.

6.10 and 6.11

The UFU is finding it difficult to understand the assertions contained with paragraphs 6.10 & 6.11 of the consultation. We are unable to understand why DfE might lose the obligation and legal power to make payments to 99 KwH boiler operators. Furthermore, how is it that DfE believes that it would then be unfair to make payment to operators of RHI boilers of other sizes? If DfE have already decided to amend the legislation accordingly in 2019 it could leave the consultation process open to legal challenge.

6.38. Value for money and the Rate of Return

(a) In the DfE questionnaire, Value for money (VFM) is being based on the Rate of Return RoR but with no regard for; carbon saved, jobs created, reduction in fossil fuel usage etc. If this was not part of the calculation in ascertaining VFM, it opens up the credibility and accuracy of much of the Consultation.

(b) Regarding the current GB RHI tariffs, is the taxpayer receiving value for money?

We wish to elaborate upon the GB RHI later in this response as it is very relevant to the Scheme going forward.

6.45. Capital Costs

The consultation highlights deployment figures, which show that Northern Ireland participants have lower capital costs than GB participants. This is based upon a median cost per kW of biomass boilers and are consequently, does not take into account the precise value of each observation and hence does not use all information available in the data.

Disclaimer - The UFU have reservations about the structure and direction of this consultation and subsequently nothing in this response should be taken as consent to compromise the property rights of existing non-domestic RHI Scheme participants, and grandfathered rights and commitments must be honoured.

The Court of Appeal is to consider an appeal by RHANI against the judgement in their action challenging the legality of the 2017 Regulations during September. Nothing in this response should affect that action. In addition. the High Court is to Judicially Review the inclusion of CHP within the 2015 Regulations, in October 2018. Nothing in this response should affect that action.

<u>Consultation Questions and Answers</u>

Question 1 – Do you believe that it is the Departments responsibility to encourage investment in renewable heat?

UFU Response – Yes

UFU Further Comment – Climate Change is recognised as the leading risk to UK civil society and this was reflected in the setting of a series of Renewable Targets for Energy, Transport and Heat over the last decade.

The European Commission set a mandatory target at 15% of energy to be generated from renewable sources by 2020. This was set by Directive 2009/28/EC3 on the promotion of the use of energy from renewable sources (thereinafter known as "the Renewable Energy Directive") and is a legally binding target.

Consequently, the NI Executive introduced the Strategic Energy Framework (SEF). For Northern Ireland-specific targets being incorporated into local Energy Policy and was to be overseen by DETI and set renewable targets and tasks for each of the NI Government Departments. Dr Andrew McCormick, the former Permanent Secretary, confirmed in September 2017 that the NI Strategic Energy Framework remains the extant public policy document and that it should be acted upon.

The NI Executive set a target of 10% for renewable heat, our contribution to the UK objective which was set overall (heat, electricity and transport) at 15% and the NI target for renewable electricity is 20%. The Northern Ireland Renewable Heat Incentive (NIRHI) scheme was to contribute to the achievement of the UK's objectives through a gradual switch to heating generated from renewable sources.

The SEF expires in 2020, and the UFU are currently engaging with DfE Energy Division on what the future policy should look like. We will be highlighting that the under-achievement of these targets should be added to the public policy targets for the next period.

Questions have been raised as to the impact of not meeting the renewables targets and it has been mentioned that an interim target might apply (combination of heat, electricity, transport etc). Prior to Brexit, failure to meet renewable targets would have left the UK open to legal action, and legal action would have led to the possibility of a fine. The likelihood of European Commission legislation being transposed post-Brexit means that fines could still be handed out. Republic of Ireland press at the end of 2017 indicated that they faced a fine of €600 million per annum for failing to meet their renewable targets. It is assumed that the NI contribution to any fine will come from the Block Grant.

Fines being levied at a sector which is already under severe financial pressure due to the reduced tariffs is laughable were it not so serious.

Added to this, failure to meet renewable targets will reflect badly upon our Government and Civil Service, and make a mockery of our attempts to tackle climate change. As 80% of the fossil fuels imported into Northern Ireland are burnt to generate heat, this sector represented the most easily identifiable and most effective way to reduce the consumption of fossil fuels. Before the non-domestic RHI was launched, it was estimated that the scheme in NI would lead to the displacement of about 6.86 million tonnes of CO2 emissions and to the production of about 17,440 additional GWh of heat from renewable sources over a 29 year period, from 2012 to 2040.

£100m-£300m in carbon savings was mentioned at the time and surely this should be mentioned in the context of the bigger picture of rates of return etc Such savings are now a long way off.

The reduction is fossil fuel use will lead to the reduction in air pollution, a reduction in the generation of greenhouse gases and the improvement in air quality, all of which are appropriate and credible public policy objectives. However, this will not be achievable when a start-stop policy is adopted by DfE. There was an undoubted start made with the adoption of renewable techniques, but this policy failure on the part of DfE could see many boiler owners reverting back to fossil fuels and turn the renewables targets on their heads. It must be remembered that whilst RHI boilers might be using less renewable heat as a consequence of the tariffs changes, they will still have a heat requirement, especially poultry farmers and they will switch back to LPG.

Seven of the eight tariff options would serve to promote a return to the use of fossil fuels.

There is clear evidence of bad faith on the part of Government. In 2012, the Government urged farmers to sign up to the scheme to assist in meeting the 10% of heat coming from renewable sources, with the drive to displacing the use of fossil fuels with wood for example. At a DETI seminar we attended in September 2011, the fact that there was 10% reliance on heating oil, compared to 78% here in Northern Ireland, is an example of the push that the Government placed on the need for a renewable heat scheme. Government officials sold this scheme to farmers on the basis of a 20 year guaranteed payment, and farmers entered into the agreements in good faith, only for DfE to pull the rug on it in 2017 with no consultation.

On the back of these targets, a new industrial sector has developed in Northern Ireland and it was actually beginning to thrive, with many local higher education establishments promoting courses which created a respected knowledge base which was globally sought after. The Northern Ireland Executive, as a part of the Programme for Government had promoted Northern Ireland as a centre of excellence for renewable energy. Yet now because of mismanagement of RHI, that sector is in rapid decline and fewer than 30% of registered installers and engineers remain. We do not need to remind you that the Service sector is essential to the economy of Northern Ireland.

When the GB scheme was announced, the RHI was lauded as a way of stimulating the rural economy, and it was expected by DECC to raise £4.5 billion in green investment by 2020, and the same (albeit at a lesser amount) would be the same in NI. This is unlikely to happen now.

The RHI debacle has damaged the entire renewable sector and much of what DfE are proposing will damage it irreparably. Ironic considering it is the Department for the Economy.

Renewable Heat is supported across the whole of the UK. The majority of the options within this consultation will create a comparative disadvantage by proposing to operate a scheme in Northern Ireland which is less favourable to those elsewhere in the UK.

The UFU are adamant that this should not be allowed to happen.

Question 2 – What rate of return on capital investment in biomass boilers do you think is a reasonable rate of return?

UFU Response – The only acceptable Rate of Return (R-o-R) at the very least, is the one that boiler owners signed up to in the first place when they joined the scheme.

UFU Further Comment - The UFU cannot understand why five out of the eight options proposed in this consultation are outside of what is permitted under EU State Aid parameters. Are DfE prepared to stand over these if any of the 5 are implemented, this is highly unlikely. Breaching State Aid rules means that they will never see the light of day surely.

The 2017 Regulations have resulted in a negative cash-flow for many businesses and our further comment will focus on this.

The UFU note that Ricardo have failed to use the standard cash-flow viability index EBITDA (Earnings Before Interest Taxation Depreciation and Amortisation). The pyramid of ratios, creditor and debtor days have influenced usage within the RHI Scheme.

The 8-22% R-o-R is an average to be achieved across the whole cohort of Scheme participants. At no point was 12% rate of return meant to be a ceiling. Different farming businesses will have different load factors and capital costs, such is the nature of our businesses. Consequently, it is entirely reasonable that a point assessment is used (see above).

In business, capital asset expenditure is depreciated over 2-5 years to zero value and at a flat-line rate of 20% -50%. DfE has evidence from CAFRE that the cost of maintaining RHI boilers grows exponentially after year 4 and asset finance agreements are typically over 2 – 5 years.

Annuitisation calculations take various forms. There is no industry standard, yet the Ricardo paper appears to make no mention of amortisation, depreciation or annuitisation calculations.

RHI support payments are treated by HMRC as a component of the individual/company net income, which means individuals/companies are taxable. This must be acknowledged within the ‘total cost to Government’ figures quoted within the consultation documents.

With support payments paid quarterly and in arrears, this impacts upon cash flow. Also, there are cash flow implications, within the 2017 Regulations, by setting the “initial” 1,314 hrs per annum from the anniversary of installation as well as impacting upon creditor-days and upon business solvency.

Cash-flow problems arising from the 2017 Regulations have driven many of members to use fossil fuels, and under such arrangement, the credit period can be up to 60 days.

Ricardo has also omitted income tax and corporation tax revenues from their data.

This all raises questions in relation to the Rates of Return and DfE/Ricardo assumptions surrounding them.

Question 3 – Should funding for the NIRHI scheme be limited to, at most, funding available from the UK govt without impacting on the NI block grant?

UFU Response – No

UFU Further Comment – The NI Executive-approved targets for renewable heat might not have been deliverable or agreed had DETI fully understood the significance of these funding arrangements. We are led to believe that almost 40% of the Scheme participants admitted when DfE operated the RHI Scheme without financial approval, the “irregular spend” is attributable to a breakdown in financial governance within DfE.

The UFU shall not comment on this further, as these matters are being discussed in the on-going Public Inquiry.

Question 4 – Please outline the impacts on your business of the tiered tariff and cap under the 2017-2018 legislation

UFU Further Comment – The Ulster Farmers Union are best placed to provide a response on behalf of the whole poultry industry in Northern Ireland and we shall do so under Question 4.

During the last two years, the impact of the amended tariff structure on poultry producers has featured as the main agenda item on the UFU’s poultry committee at every committee meeting. It currently sits alongside UK Retailers transition to cage-free egg production by 2025 as the main issue negatively impacting poultry producers and is the biggest issue negatively affecting broiler producers. The decision to amend the tariff structure has frustrated any immediate business decisions and investment over the past 18 months due to the uncertainty created by this entire debacle. Furthermore, the fact that the RHI scheme in Great Britain remains open and continues to make payments to participants with no prospect of retrospective cuts to the tariff has left Northern Ireland poultry producers at a commercial disadvantage to producers in Great Britain.

Since the amendment to the tariff, producers have been experiencing severe business cash flow issues. Given that producers had signed up to a scheme that ensured a guaranteed income for 20 years, many producers made additional investments in their businesses. When the tariff structure was amended, the payments for these additional investments still needed to be paid. However, the businesses incomes have been significantly reduced. This has put many businesses under severe financial pressure in order to maintain repayments. Many businesses have already reported having to restructure finance agreements or sell of other business assets in order to meet financial commitments. This pressure has increased given the rise in the cost of wood chip pellets since the tariff structure was reduced. It must be noted that the single largest barrier to joining these scheme in the first instance was obtaining finance from banks to purchase the boilers. It was only due to the tariffs on offer at the time of purchase and the 20-year, inflation linked guarantee of these tariffs that facilitated access to finance. Had the 2017 tariffs been offered at the time of purchases, significantly different business decisions and cash flow projections would have been taken. Many projects would not have commenced at all if these tariffs were on offer at the time. It is worth noting that the credit ratings to many individuals and businesses have been put at risk due to cash flow issues as a result of the amended tariffs.

In addition to the above, the Department for Economy appears to have disregarded the original intention of the scheme, which was to encourage a move away from the use of fossil fuels. At present, we are aware that the amended tariff structure has resulted LPG becoming the more financially viable method of providing hot water heating for poultry units. As such, some producers are transitioning away from renewable heat sources back towards fossil fuels.

We have also had concerns raised to us that the 400,000kw cap has unfairly disadvantaged genuine participants with a high heat load. In its inception, the scheme encouraged boilers to be utilised to heat more than one building and as such, many boilers have no option but to work at a higher work load factor than the CEPA assumptions. Additionally, we are aware that due to the new tariff structures in order to try to stay below the new tariff cap, some producers are heating their houses to suboptimum levels. This is reportedly having a negative impact on bird welfare, bird performance and environmental emissions from the production chain.

Finally, producers have expressed extreme indignation due to the process surrounding the amendment of tariffs. It was extremely disingenuous of the Department to encourage uptake of a scheme based on one set of tariffs only to retrospectively lower these tariffs once a significant number of businesses have committed to the scheme, particularly when the proposed cuts are due to the lack of budgetary planning by departmental officials and Ministers which is not the fault of genuine scheme users.

Question 5 - Which biomass tariff option do you support for the long term future of the NIRHI Scheme?

UFU Response – Option 3 **-** Revert to original tariff. However, in our response we will need to emphasise our overarching objection to the structure of the Consultation. By choosing Option 3, our choice must be considered without prejudice in light of the ongoing legal challenge being carried by another organisation representing boiler owners (many of whom are our members).

UFU Further Comment – The Ricardo report is fundamentally flawed and many of the assertions would fail to stand up to legal challenge.

Fundamental flaws include;

- **Assumed pellet prices of £150/tonne -** £150/tonne applied until late 2017 when a shortage of supply has in fact caused prices to rise rapidly to £175/t. Prices remain at £175 and are projected to either remain at this level or possibly rise in the foreseeable future. The increase is possible, as 45% of Northern Ireland's supply is imported from EU Baltic states and is denominated in Euro.

- **Use of Kerosene -** LPG is the predominantly alternative fuel source. LPG systems account for 40% of Scheme participants by number and close to 60% by capacity. The largest group of RHI Scheme participants have access to bulk supplies of LPG @ 24p per litre. A standard conversation rate of 1 litre produces 7.1 Kws of heat, applies. This equates to a cost of production of £0.038/Kw.

  Ricardo, using kerosene as a counter-factorial, determine the counterfactual cost of production per kilowatt as £0.0414. The cost of production of heat using wood pellets (corrected to £175/tonne) is £0.038. The margin of difference between biomass and LPG is £0.000 and between biomass and kerosene is £0.0034.

- **Impact of Fuel Purchasing Agreements** – Ricardo have not taken into consideration the fact that LPG supplied under the collective purchase contracts. This is on 60-day credit terms and payment is taken from pre-tax income. Those businesses suffering cash-flow difficulties may have to revert to fossil fuel as the strain of paying bank loans and purchase of wood pellets (which are 28-day credit). This is obviously for many of our members unsustainable.

- **RHI in Republic of Ireland -** The RHI system in the Republic of Ireland is expected to increase demand for fuel and may result in price rises.

- **Page 46 (3.6) -** The UFU refute Ricardo comment on page 46 (3.6), that there is only anecdotal evidence of participants switching back to fossil fuels. Under the current tariffs, the additional costs of operating and servicing a biomass system make it, for many participants, unattractive and unaffordable to operate when compared to use of LPG to operate beyond Tier 1. Under

Tier 2, the cost of operation, servicing and financial costs exceed income to such an extent that most operators have had to revert to fossil fuels.

Finally, the UFU wish to reemphasise that it was catastrophic that DETI/DfE failed in their duty to perform periodic reviews during the short life of the RHI scheme.

Question 6 – what measure, if any, should the Department use for inflationary uplifts?
Option 1 – No change
Option 2 – Replace RPI with CPI
Option 3 – No inflationary uplift

UFU Response – The UFU believe that this question is confusing. The 2012 Regulations set the inflationary index that is to be used and that is what we wish to see retained. However, it should be noted that in January this year, Mr Justice Zacaroli ruled that BT could not use the CPI measure of inflation instead of RPI when determining pension payments. Also, currently in GB, Water Utility Companies use RPI when uprating charges.

Question 7 – what are your views on a compulsory buy-out of the Scheme?

UFU Response – Not in favour

UFU Further Comment - Any compulsory buy-out would have to take into account the whole of life cost and whole of life benefits. Reaching an agreed formulation for an equitable buy out, taking "duress" into account, will therefore prove to be a complex and possibly fruitless exercise. It also be an expensive option. The UFU have noted that there is currently is no legislative framework for such a proposal.

Please also refer to our comments in Question 1 on targets and climate change. Any buy-out scheme, whether compulsory or voluntary will push renewable targets further away from being met.

Question 8 – Do you support the principle of a voluntary buy-out?

UFU Response – Not in favour

UFU Further Comment - The proposed terms suggest that for many, the "buy-out" will result in a small sum. That sum is likely to be much smaller than the balance of the remaining bank or finance agreement. This proposal is subject to budget and the UFU struggle to understand, that after reading the context of the proposal, where the money will come from.

Again, there is currently no legislative framework for such a proposal

Question 9 – Would you support the introduction of a further tariff within the 20-99 kW range?

UFU Response – No

Question 10 – Do you support the principle of a cap being set at 300,000kWh

UFU Response - No

UFU Further Comment - The 2012 Regulations under which about 1,700 Scheme participants entered the Scheme, had no such limitation and there is no cap within the GB scheme. Any cap, including the current 400,000kw cap is discriminatory. A cap discriminates against the genuine participant who has a high usage and against those who installed a boiler under the 2012 scheme with the intention to use it to heat more than one building. Just as the scheme promoted doing.

Question 11 - Please identify any other issues relating to other technologies which would be relevant in any tariff evaluation. Please provide any evidence you may have that the costs of running small heat pumps are higher than the tariffs.

UFU Response – The UFU have no view on this.