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Dear colleague,

Response to comments made on the 'Consultation on Ofgem's costs for administering the Renewables Obligation'

We received five responses to our consultation letter concerning the costs of administering the Renewables Obligation scheme that was published on 3 June 2010.

The comments made concerning the consultation document fell into three broad categories:

- **Breakdown of costs**
 - Respondents requested that a detailed breakdown of costs for 2010/11, previous years and predictions for future years are made available to participants who fund the RO scheme through buy-out payments
- **Clarity on how new schemes will be funded**
 - Assurance that setting up and running costs for new schemes such as FITs will not be recovered from the RO buy-out fund
- **Efficiency and Value for Money**
 - Assurance that Ofgem is striving for increased efficiency in its RO administration activities
 - Visibility of performance metrics pertaining to administration of the RO
 - Concern that the quality of administration of the RO will suffer as Ofgem's resources are stretched with the administration of new schemes

This letter will address the comments made.

Breakdown of costs for 2010/11

A table showing the breakdown of costs that make up the total for 2010/11 is provided in table 1.

Table 1 Breakdown of administration costs for the RO in 2010/11¹

Description	2010/11
IT (development)	£899.6K
IT (consultancy)	£193.4K
IT (support)	£202K
Legal Support	£134K
Renewables and CHP team budget	£1,066K
Overhead (excluding IT)	£396K
CCL Revenue	-£482K
NFFO Revenue	-£60K
Total	£2,349K²

Due to a change in the method of accounting that has happened recently within Ofgem it is not possible to compare the costs of administration from 2009/10 directly with the costs for 2010/11. Under the previous accounting regime certain aspects of our IT costs were attributed to Ofgem's central overhead. These IT expenses were recovered from the licence fees as was the general RO budget.

In September 2009 Ofgem created Ofgem E-Serve as a new business unit for delivery of the government's Environmental Programmes. Ofgem E-Serve is now charged for all IT costs as mentioned above. The previous administration costs of the RO did not capture the full costs.

It is difficult to predict the cost of administering the RO in future years because Government amendments to the RO will have an impact on our duties and hence cost of our administration. In future Ofgem will aim to improve the quality of service at a cost that represents value for money to participants in the scheme. We will also aim to improve our budget forecasting in future years.

Clarity on how new schemes will be funded

Respondents expressed concern that the fund would be used to pay for the administration of other new environmental schemes, such as FITs and the RHI. Legislation only allows the RO buy-out fund to be used to recycle payments to suppliers who present ROCs under their RO and to cover the administration costs of Ofgem. The funding of new schemes will be decided by DECC. The cost of administering FITs is met directly by DECC, and the funding for the administration of the RHI will be decided in the future. Neither of these developments is funded from the RO buy-out fund.

Efficiency and value for money

Ofgem constantly strives to improve the efficiency of its administration of all environmental programmes. Internally Ofgem has recently reorganised to create 'Ofgem E-serve' which has become a centre of expertise within Ofgem for the delivery of schemes that will help to build a low carbon future for UK customers.

Ofgem sets itself demanding KPIs for the accreditation of generators and issue of ROCs. Ofgem has also recently set up a working group with the REA to discuss the accreditation and ROC issue processes. Historically Ofgem has made prompt recycle payments to suppliers well within the timescale required by legislation providing financial benefits to the

¹ These costs relate to Ofgem's costs in administering the renewables obligation for England & Wales, Scotland, and Northern Ireland. NIAUR have their own costs of £13,104.47 for administration for the NIRO for 2010/11, which are not included in the listed Ofgem costs, but will be recovered from the RO buy-out funds.

² This figure has increased from the original figure in our consultation letter. As explained above our method of accounting has changed this year, and an additional amount of spend has been identified that we will have to recover.

suppliers presenting ROCs. The overall percentage cost of administering the RO is 0.18 %³ of the cost of the scheme; this is a figure that Ofgem will concentrate on driving down in future years, but is already substantially below benchmarks for the cost of administering government schemes.

During the 2009/10 RO period Ofgem issued over 20.5 million ROCs compared with just over 19 million in 2008/9. The number of generating stations accredited under the RO increased dramatically from 750 in the 2008/9 period to 2200 in the 2009/10 period (largely driven by a rush of microgeneration applications prior to the introduction of the Feed-in Tariff scheme). During the 2008/9 RO period the recycle payments from the buy-out fund were made within one month as opposed to the two month requirement in legislation.

In 1 April 2009 the banding of ROCs was introduced. This has significantly increased the administration tasks required. It has also, however, increased the potential of challenge to the process resulting in a significant increase in the budgeted costs.

In the near future Ofgem, as with all government departments, will come under increased scrutiny to deliver even better value for money in every part of its business. While we recognise that there are work-flow pressures and conflicting priorities on the participants of the RO, they themselves have a role to play in achieving a reduction in our administration costs. A small minority of suppliers and generators provide Ofgem with out of date and inaccurate information which Ofgem must then spend a disproportionate amount of time and resource clarifying. If these issues were reduced then it would help to reduce our administration costs.

Some respondees raised concerns about the cost and quality of Ofgem's IT systems. Our costs for developing and supporting the Renewables & CHP system have been benchmarked against comparable industry costs. They have been found to be highly cost competitive, representing good value for money for turning round legislative change requirements in extremely short timescales.

Comments made by the respondents state that it would be fitting for participants in the RO to have a say in our budget setting since the administration costs are recovered from the buy-out fund. Ofgem disagrees with this point of view. Ofgem is a regulatory body and has a duty to regulate the participants of the RO as well as providing an administration service. Ofgem believes it would be inappropriate for a supplier to set the budget for a body that it is being regulated by.

Yours sincerely,

Charles Hargreaves
Head of Environmental Programmes

³ The value of the RO scheme is calculated at £1.296 billion by multiplying the estimated supply of electricity in the UK in 2010/11 (315 TWh) by the obligation percentage (11.1%) and then multiplying by the 2010/11 ROC buy-out price (£36.99)

ANNEX

List of respondents to the letter of 3 June 2010

Brian Tilley (E.ON)
Fiona Shepherd (Scottish Power)
Gaynor Hartnell (REA)
Alex Young (New Earth Energy)
Nigel Cornwall (Cornwall Energy)