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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 4th July 2011.

The comments made fell into the following broad categories:

- **Transparency and forecasting of costs**
 - Suggestions that our costs for the RO be independently audited
 - Queries as to why costs were not broken down further and apportioned to individual activities under administering the RO
 - Requests that we provide a forecast of costs for future years
- **Efficiency and value for money**
 - Comments on the possible lack of incentive for Ofgem to keep costs low if all costs are recouped from suppliers.
 - Requests for details of the benchmarking exercise referred to when comparing the overall cost of administering the RO to that of other government schemes.
- **Recovery of costs**
 - Recommendations that we recover our administration costs in phases or look at alternatives to the buy-out fund from which to re-coup them.
 - Concern that only cost relating to the RO should be recovered from the buy-out fund.

This letter will address the comments made.

Transparency and forecasting of costs

Ofgem's finances are routinely audited by the National Audit Office, as is the case for any government organisation; therefore the RO is included in this and subject to independent scrutiny.

The breakdown of costs provided in the consultation reflects only those costs relating specifically to the RO. The team operates flexibly and therefore tasks are allocated

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according to workload and changes to the schemes. The list of activities in the consultation letter is not a definitive list of the administration tasks we perform for the RO, it was intended to give an overview of our activity. The table below sets out the costs attributed to each main activity.

Description	2011-12
IT Support & Development	£928,734
Legal Support	£265,363
RO Operational team budget	£849,403
Overheads	£532,790
Sub total	£2,576,290
RO Sustainability	£895,961
Additional legal costs	£244,903
Prior year (2010/11) under-spend	-£155,189
Total	£3,561,965

The final cost recovered from the buyout fund has changed since the consultation letter was published on 4th July 2011. The additional legal costs set out in the table above reflect legal challenge costs incurred by Ofgem. The details of these costs have not been finalised; an adjustment will be made to next year's administration costs to take account of any change in these legal challenge costs.

Although the overall IT support & development costs have not changed, there has been an adjustment of our figures to reflect when the costs are incurred. £150K of IT maintenance work from 2010-11 has been carried over to this financial year as resources had to be diverted to other projects with more urgent priorities and hence our spend adjusted.

Several respondents felt strongly that we should predict our costs for administering the RO further forward into the future, on a steady state assumption basis if necessary. It is difficult to predict these costs any further forward than a year as government amendments to the RO have an impact on our duties and hence our costs of administration. The RO Sustainability costs have been separated out from the regular costs of the scheme to give an indication of what the total would be on a steady state basis, showing only a modest increase from the regular administration costs of last year. The Ofgem five year corporate plan provides a high level forecast of the cost of running environmental programmes, whereas this letter on the cost of RO is intended to be a true reflection of the actual amount we are withdrawing from the buy-out fund on an annual basis.. To attempt to forecast the RO costs further forward would lead to greater uncertainty as inevitably the predicted financial plan would need to be altered every time the scheme requirements were changed.

Efficiency and value for money

Some respondents raised concerns that there was no incentive for Ofgem to improve efficiency and reduce the cost of their administration if all costs were recovered from suppliers. Ofgem E-serve was created to become a centre of expertise within Ofgem for the delivery of schemes that will help built a low carbon future for UK customers. E-serve team budgets for running environmental schemes come under an internal budget scrutiny process, as with any government department. Teams must justify their budget for the forthcoming year as part of the corporate planning round. As such, demanding targets are set to increase efficiency and reduce the cost of running our ongoing schemes while continuing to provide excellent service.

To our knowledge there is no (externally) published work on benchmarking of government schemes. Ofgem commissioned its own benchmarking exercise during the run up to the introduction of the Feed-in-Tariff scheme. This was not intended for publication due to the

internal nature of the study; it was intended for internal assurance that our predicted administration costs were efficient and competitive. The study showed that other government scheme administration costs ranged from 1% to 54% of the overall scheme value. Therefore we make the statement that 0.22%¹ of the overall value of the RO scheme in comparison represents good value. In April 2011 sustainability requirements were introduced, this and other aspects of increasing complexity of the RO have significantly increased our administration costs. Despite this we have managed to keep the proportion of costs to the scheme low at 0.22%.

Recovery of administration costs

Respondents suggested other ways of recouping Ofgem's administration costs for the RO, such as recovering costs on a phased basis over the year or recovering from an alternative source. Legislation² requires Ofgem to recover its administration costs from the buy-out fund and at one point in the year; it is therefore not possible to phase this over the course of the year. Buy-out payments are made by suppliers before 1st September and then required to be re-distributed by 1st November.

Respondents expressed concern that the RO buy-out fund may be used to pay for the administration of other environmental schemes such as FITs and RHI. Legislation only allows the buy-out fund to be used to recycle payments to suppliers who present ROCs under their RO and to cover Ofgem's administration costs for running the RO. The funding of new schemes is decided by DECC, both the RHI and FIT schemes recover their administration costs directly from DECC.

Yours sincerely,

Keith Duncan
Senior Manager, Governance and Renewables Compliance

¹ The value of the RO scheme is calculated at £1.487 billion by multiplying the estimated supply of electricity in the UK in 2010/11 (310 TWh – DECC UEP prediction) by the obligation level (12.4 ROCs per 100 MWh) and then multiplying by the 2011/12 ROC buy-out price (£38.69).

² Renewables Obligation Order 2009 (as amended) Article 45