RETAIL ENERGY CODE COMPANY

FAO: Ms Ayena Gupta
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

By email only: Smartmetering@ofgem.gov.uk

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Dear Ayena,

RECCo response to DCC Price Control: Regulatory Year 2020/21

We welcome the opportunity to respond to the consultation on DCC's price control submission for the Regulatory Year 2020/21. This response represents the views of the Retail Energy Code Company (RECCo) and we are happy for this to be published on Ofgem's website.

About RECCo

The Retail Energy Code Company (RECCo) was formed as the corporate vehicle for ensuring the proper, effective, and efficient implementation and ongoing management of Retail Energy Code (REC) and to promote innovation, competition, and positive customer outcomes.

RECCo will in due course assume responsibility for overseeing and funding the DCC in its role as Central Switching Service provider. We therefore have a particular interest in the aspects of this consultation relating to the Switching Programme and the transition from programme to operational governance and have therefore focused primarily on the questions relating to switching.

We provide comments on some further aspects of the consultation in the appendix to this letter.

RECCo response

We welcome Ofgem's balanced review of the DCC price control submission and agree with the overall challenges to the costs submitted by DCC. However, we remain concerned at the continued increase in cost over forecast. Whilst a degree of revision is entirely understandable, the overall position is that the revised forecast of £4.4bn for DCC's costs over the 12 year licence term (2013/14 – 2025/26) are 10% greater than just last year, and 125% great than the £1.949bn forecast by Ofgem in November 2014.[1]

[1] Ofgem DCC Price Control Consultation, November 2014.

Although RECCo has not thus far been exposed to any of these costs, we are concerned to ensure that this trend does not continue once we assume responsibility for the CSS operational costs from April 2023. More generally, we question whether this level of cost represents good value for consumers.

Switching Programme

We expect the Central Switching Service to go-live Summer 2022 and for Ofgem to exit the Switching Programme shortly afterwards, with governance transferring to the REC pursuant to the DCC licence and in accordance with the REC version 3.0 provisions to be introduced by Ofgem through the Significant Code Review process. We will assume responsibility for CSS operational costs from 1 April 2023, with the costs of any future change to the CSS being assessed and determined through REC change management procedures. It is in this context that we focus primarily on the following consultation question:

Question 14: What are your views on our proposed position on DCC's costs associated with the Switching Programme?

We note that Ofgem are minded to accept DCC's costs associated with the Switching Programme in 2020/21 as being economic and efficient, but to disallow DCC's forecast costs of £7.053m for 2023/24 due to DCC having provided no justification for them. We agree with the disallowance, but would welcome confirmation that DCC will not be allowed to seek any Switching Programme costs for financial years beyond the end of that programme.

We anticipate that that the programme will not close immediately upon CSS go-live and will extend for a period of post-implementation hyper-care. Prior to transition and as far as practicable, we would be keen to ensure that all programme-related activities have been completed. This should include any immediate changes and/or post-implementation fixes that may be required to address previously unforeseen problems that arise in initial live operations. All costs relating to such remedial activities should appropriately be considered programme costs and recovered through existing mechanisms.

In effect the REC should assume responsibility for governing a fully-functioning CSS that is operating in a steady state, with REC parties bearing only the operational costs and those of any change which are a genuine enhancement to the service and duly approved through REC governance.

Question 15: What are your views on our assessment of Delivery Milestone 2 and Delivery Milestone 3 of the Switching Programme?

To the extent that Ofgem is satisfied that the DCC has met the relevant delivery milestones of the Design, Build and Test phase, then we that it would be appropriate for DCC to retain that the margin that would have been at risk should it have failed to meet those requirements.

Closing remarks

DCCs key function is to manage large contracts with several service providers. We believe there is room for improvement in this regard. RECCo note the thorough review of DCCs price control submission and the challenges that have been highlighted. However, we are concerned that this ex-post approach will not be effective and may not be proportionate once the CSS is operational.

While some of the issues regarding DCC's management of service providers may also apply to its operation of the CSS, we must be able to provide greater certainty to REC Parties and wider stakeholders. We will expect thorough and accurate assessments of the cost and timing of change delivery to inform decision-making on those changes, and for those assessments to be carried out on a timely and efficient basis. To do otherwise will damage confidence and may stymie innovation in the retail sector at a time when it is crucial to meeting the challenge of net-zero and regaining consumer trust in the market.

Through constructive discussions with DCC we have made good progress on a mutually agreeable budget-setting process and look forward to working with DCC, Ofgem and other interested parties to ensure that the change and associated cost is managed in manner that facilitates the achievement of our REC objectives. We will be supported in this by the REC Code Manager, including technical services and the application of effective performance assurance, but may also be dependent upon the availability of necessary data and complementary provisions within the forward DCC price control. We therefore look forward to Ofgem's continuing support on these matters.

If you have any queries, please contact me at: info@retailenergycode.co.uk in the first instance.

Yours sincerely,

Jon Dixon

Director, Strategy and Development

Appendix: General comments

Costs Assessment

We note Ofgem's concern that DCC have not fully justified forecast costs and contract management. Although changes in the Smart Meter roll out programme and uncertainties around DCC's activities may have been a driver of costs beyond those original forecast, the management of programmes may also be a key cost driver. For instance, we note the previous over-reliance on Letters of Instruction to commission work, pending contracts being placed. While such instruments may on occasion be an expedient necessity, this has cost implications both in terms of the process and through the diminution this may have on the DCC's ability to negotiate effectively.

DCC is largely insulated from any sub-optimal arrangements that technically meet it delivery milestones and therefore secure its margin, while passing risk through to funding parties. The absence of effective risk-sharing with service providers was a key issue highlighted in Ofgem's call for evidence and subsequent workshop earlier this year reviewing the DCC regulatory arrangements. We consider that there should be a clear requirement for DCC to make improvements in this regard, rather than it simply being something Ofgem would like to see. While we recognise that Ofgem faces a number of challenges at the moment, we would welcome confirmation that the review of DCC regulatory arrangements will nonetheless be completed in sufficient time to inform the licence renewal process.

We agree with Ofgem's rationale to disallow:

- £1.38m from DCC's total cost in RY20/21 for the cost assessment itself, which comprises expenditure on recruitment costs; inefficiencies in contractor benchmarking; and activity relating to electric vehicles
- a total of £69.67m in forecast costs for RY21/22 and RY22/23, and
- a further £246.75m increase in its baseline forecast costs over RY23/24 to RY25/26.

External costs

We note that Ofgem is minded to disallow:

- the variance in the enduring operational costs of S1SP_3b from RY22/23, totalling £33.803m and
- the variance in the User Integration Testing forecast costs of DSP in RY21/22 to the value of £5.60m, and thereafter from RY22/23 to the end of the Licence term to the full value of £12.50m/p.a. (£55.60m in total).

Managing large contracts with external providers is DCC's fundamental role and responsibility. As part of this, DCC should be forward looking, planning requirements and deliverables and seeking to introduce risk-sharing mechanisms to help improve performance. We are therefore concerned to note that DCC are unable to provide sufficient justification for some service providers beyond the contract period.

Internal costs

We note that the Shared Service Charge formed part of the competitive bid when the Smart Meter Communication licence was originally put out to tender and subsequently awarded to the Smart Data Communication Company Ltd. We also note that these Shared Service Charges are set at 9.5% of DCC baseline costs, rather than being cost-reflective of the actual services provided.

As noted above, DCC costs over the duration of licence have more than doubled, which all being equal will mean that it is returning more than twice the expected amount to its owner for Shared Services. Whilst we note Ofgem's expectation that the services DCC obtains from Capita should provide value for money, we consider that these should be subject to the same scrutiny as external costs and/or benchmarked rather than charges being pegged to overall costs.

We note the improvements in some areas, such as contractor to permanent staff ratio, that have led to some cost efficiencies. We also note that Ofgem are minded to disallow a number of costs where resource allocation does not appear to be economic and/or efficient, including:

- all forecast variance associated with the SMETS1, Network Evolution, and ECoS programmes, amounting to £17.844m over RY21/22 and £9.115m over RY22/23.

We also note a number of potential disallowances in respect of the work undertaken by the product management team, namely:

- £0.167m of the cost variance in RY20/21, corresponding to the 50% proportion of the team's time spent on work relating to EVs and reuse.
- the forecasts of £0.982m over RY21/22 and RY22/23.
- the costs of the EV engagement procurement and its associated forecasts, amounting to £0.192m in RY20/21 and £0.280m in RY21/22.

Although DCC is permitted to undertake such activity, in line with the second general obligation as set out in the Smart Meter Communication Licence, this is should not be at the expense of mandated business. Specifically, Licence Condition 5.13 states:

The Licensee must not carry on any activity, or any combination of activities, under or pursuant to the Permitted Business in a manner that prejudices or impairs, or would be likely to prejudice or impair, its ability to carry on the Mandatory Business at all times in accordance with the General Objectives of the Licensee.

While DCC may be naturally inclined to shift its focus to future activities, in line with LC5.13 it should first ensure that it is delivering its core services in a timely manner, that they are well managed, and cost effective. Deviating from these inevitably raise questions on the DCC priorities and create potential conflicts. Deploying resources to potential future work, with year on year forecast increases and variances, may detracts DCC's attention from the Mandatory Business that remain its core Licenced activity. Therefore, we support this disallowance.

We also question whether it is appropriate for DCC to be able to cross-subsidise activities in what is now a better established and growing EV market, using funds from a mandatory monopoly service. The issue of permitted business and use of price controlled revenue to develop business in potentially contestable activities should be reconsidered as part of Ofgem’s review the DCC licence arrangements.

Baseline Margin Adjustment

We note and agree with Ofgem’s assessment to reduce the requested £15.33m adjustment to its Baseline Margin by £8.08m. In line with this assessment, we would wish to see DCC improve efficiencies to better manage the volume of work so that complexity is reduced and work is delivered to well-planned and managed timelines.