

Sent by email to: DCCregulation@ofgem.gov.uk

19th Dec 2022

Dear Ayena,

Re: Ofgem DCC Switching Incentive Regime Statutory Consultation

This response represents the views of the Retail Energy Code Company (RECCo) and is not confidential.

The Retail Energy Code Company (RECCo) is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the Retail Energy Code (REC) arrangements. The REC has the broadest coverage of energy industry market constituencies and stakeholders, and seeks to promote trust, innovation and competition, whilst keeping positive consumer outcomes at its heart. It sets out the rights and responsibilities of industry parties for the consumer facing processes, data and systems it manages. We are committed to ensuring that RECCo is an “intelligent customer”, ensuring efficacy and value-for-money of the services that it procures and/or manages on behalf of REC Parties.

RECCo supports the introduction of a Switching Incentive Regime into the regulatory framework for Switching, as this will:

- bring the day-to-day operation of the CSS more effectively within scope of the performance assurance processes of the REC, as overseen by the Performance Assurance Board (PAB);
- provide an incentive to deliver services to the required qualitative and quantitative standards,
- enable an effective framework for incentivising prompt resolution of service performance issues,
- ensure service providers are financially accountable for under-performance, and
- enable Ofgem to focus on the value of DCC’s performance adjustment each regulatory year

Our detailed response to each of the consultation questions are set in the appendix to this letter. We are happy to discuss any of the points raised in further detail.

Yours Sincerely,

Jon Dixon
Director, Strategy and Development,
Retail Energy Code Company

Appendix A: Ofgem Statutory Consultation – DCC Switching Incentive Regime

Chapter 3. Establishment of the DCC Switching Incentive Regime

Question 1: Do you support the establishment of the Switching Incentive Regime (SIR) in the Licence as the mechanism for assuring the Switching element of DCC's Price Control

RECCo fully supports the establishment of a Switching Incentive Regime in the Data Communications Company (DCC) Licence, to assure their performance as the Central Registration Service (CRS) Provider. Successful operation of the CRS is vital to delivering consumers faster, more reliable switching, that can support and adapt to innovation and new market models, an essential condition for effective competition.

We manage code services on behalf of REC Parties, being either newly procured or existing services taken over by RECCo upon the Retail Code Consolidation. RECCo are responsible for the effective management of the services, ensuring performance meets agreed service levels and utilising contractual remedies where they are not. This can generally include service credits that are passed back through to service users.

In the absence of a standalone contract for its services, it is appropriate that the REC sets out DCC's obligations for the performance service levels and that it contains the appropriate incentives for fulfilling them. As the DCC switching service is a regulated monopoly and not subject to the usual competitive pressures, or regular market testing (including period procurement), a performance framework provided through the REC will go some way to emulating the normal commercial levers to incentivise strong service delivery and ensure the prompt resolution of any issues that may arise.¹

As reflected in the consultation, RECCo and the REC Code Manager have been working closely with Ofgem and DCC to develop a proposal to implement a REC performance scheme for the CRS Provider, to support the Service User Measure of the SIR. We are encouraged that Ofgem considers that the core features proposed in the REC Change Proposal [R0025 - Service Provider Performance Charges \(DCC\)](#) solution is the right approach.

One such feature is the operational performance and incentivisation of the CRS Provider being managed day-to-day by the REC Performance Assurance Board (PAB), with Ofgem retaining overall responsibility for overseeing the SIR. We believe this model is appropriate to ensure that operational issues can be resolved within the appropriate governance framework, without regular escalation and intervention being required from the regulator. Moving the day-to-day operational assurance under the REC will enable Ofgem to focus its oversight and engagement around the value of DCC's performance adjustment each regulatory year.

[R0025 - Service Provider Performance Charges \(DCC\)](#) is progressing through the final stages of the change process, with the intention that the Final Change Report will be referred to the Authority for decision in January 2023. We believe it is important that the changes required,

¹ This would also align with the model of financial incentives previously consulted upon by Ofgem: "The Retail Energy Code – proposals for version 1.1", October 2020

to the licence and the REC, are implemented in time for a new price control regime to commence on 1 April 2023, coterminous with the REC taking over from the Smart Energy Code (SEC) responsibility for funding the switching services. Given the extensive engagement of the DCC, Ofgem and REC Parties in the development of R0025, and the fact that it does not propose to place any measures or obligations on the DCC beyond those that were previously set out in Design Baseline 4 and REC Version 3, we are aware of no legitimate reason why the solution could not be given effect by 1 April 2023.

We welcome continued engagement with Ofgem and encourage early feedback on the solution to ensure this fully aligns with the proposed SIR.

Question 2: Do you agree in principle with the revocation and replacement of the May 2019 Direction, in the event that we establish the SIR?

Yes, in the event that the Switching Incentive Regime is established we support the revocation and replacement of the May 2019 Direction with a new Direction,. We also agree that it is sensible that there is flexibility for the Authority to issue new or replacement Directions in future years of the SIR. The Centralised Registration Service (CRS) is a new service, introduced with the specific intention to support and react to innovation, and new market models. As the retail energy market evolves, particularly to support the transition to a decarbonised energy system, the CRS must also evolve, along with the accompanying service assurance and incentivisation regime.

Subject to the implementation of R0025, the REC PAB will be able to use what it learns from the operation of the proposed Performance Charge scheme to provide insights for Ofgem, informing its consideration of any future Directions. Moving to a faster, more responsive assurance model, applying liquidated damages more closely to the point of failure will also allow for faster learnings on the success and effectiveness of the scheme. RECCo and the Code Manager will be happy to share any learnings that may support Ofgem's considerations for future changes to the SIR.

Question 3: Do you agree with the definition of the four categories of measure identified that will constitute the SIR?

We agree in principle with the four measure categories identified. However, we seek further clarification in future SIR guidance to confirm which measures are included in each category and where they are utilised. Without this definition it is difficult to determine the expected scope of each category. For example, it is not clear what the difference between the Service User Measure and Service Delivery Measure will be. Measures in both categories mainly relate to quantitative system performance under the equivalent Operational Performance Regime.

One of RECCo's goals is to develop a forward-looking change roadmap that aligns with a set of strategic aims, thereby providing a clear pathway for development of the REC and REC Services. Where the Development and Improvement Measure is considered for inclusion in future forms of the SIR, we would recommend that the use of this measure is only used where the output will deliver value for money and tangible benefits for consumers. We welcome the opportunity to work collaboratively with Ofgem and DCC on any projects that are considered

for use under this measure, to ensure this is aligned with other strategic change programmes and investment is focused on measures that will deliver positive outcomes for consumers.

We understand that the equivalent Value for Money Measure in Smart Metering is measured through an Ofgem survey issued by SEC Administrator and Secretariat (SECAS), and that there are considerations of a similar arrangement for Switching, whereby RECCo would issue the survey. We currently operate similar surveys for other REC Service Providers and would be happy to support Ofgem in relation to the measure of this category.

Chapter 5. DCC margin on Switching activity from RY 23/24 onwards

Question 4: Do you agree with our proposal that DCC should be able to earn a margin somewhere in the range of 6 – 9% of its economically and efficiently incurred internal costs under the enduring Switching arrangements (equating to a range of 6.4 – 9.9% in terms of return on costs)?

We note the difficulty with finding a direct comparator for DCC's enduring role in switching, and Ofgem's rationale for suggesting the proposed 6-9% margin for the operation of the service. The CRS is unlike other services normally operated by a regulated monopoly under a price control regime, including the DCC's role in Smart Metering. We agree that the risk profile of switching is significantly less than those examples, in terms of both its scale and nature, not least as it should require a far less complex technical architecture with lower requirements of management, maintenance and investment of physical infrastructure than the smart metering network. The financial exposure in respect of switching is a small percentage of those in smart metering. It would therefore not be appropriate to maintain a similar margin to that associated with the mobilisation of the service or equivalent operation of the smart metering service on that basis.

As the service operates under a price control regime where the DCC are entitled to recover reasonable costs for the operation of the service, DCC do not carry the risk of operating at a loss when providing this service. This means the only value at risk through any form of incentivisation is the allowed margin. This is an important factor in determining the appropriate margin for this type of service, as it should be commensurate to the level of risk associated with the ongoing operation of the service. The nature of this service and the risk level associated with its operation would suggest that an appropriate margin would sit at the lower end of the proposal, between 6 - 7%. We believe a higher margin would only be appropriate, for this type of service, if a greater proportion of revenue was at risk for underperformance or mismanagement of the service. We also note that the margin proposed is higher than most other licensed parties, such as Offshore Wind Transmission Operators that operate with a higher risk profile.

We would also note that due to the design of the DCC's price control regime, the DCC are able to earn a margin on some externally contracted costs that are currently classified as 'internal costs'. Some of these costs relate to staff contracted from the DCC's parent company, Capita, to the DCC to provide administrative services. We understand that those services already include a margin, allowing profit to be earned within the group for their provision. We

are concerned that treating these intra-group transfers as 'internal costs' for the purpose of calculating the allowable margin is not reflective of their true nature, and in effect allows margin to be added twice, duplicating remittances to the parent company and increasing cost to consumers.² We would suggest that going forward such services should be treated as external costs for the purposes of calculating the allowed margin on DCC switching activity.

As noted in our response to Question 2, we consider that it would be sensible for there to be flexibility for the Authority to issue new or replacement Directions in future years of the SIR. These could appropriately include a revision to the application margin if circumstances subsequently demonstrate the risk profile to be materially different to previous assumptions. However, this flexibility should not extend to consideration of the DCC's ability to manage that risk efficiently, as that could of itself create perverse incentives to perform well in the early years of operation.

Chapter 6. Incentivisation of DCC's margin in RY 22/23

Question 5: Do you support either of the options we have identified for incentivising DCC's margin in the early post- go live period of Switching? Are there any other options you think should be considered?

We do not consider that financial incentives will be effective if implemented retrospectively, as the opportunity to influence decisions and behaviours has passed. Therefore, of the two options proposed we believe that option 1 is more appropriate for incentivising DCC's performance during RY 22/23. While this would not be a true reflection of the CRS Provider's performance during this period, it would allow some means of incentivisation for the early period of operation without introducing the commercial complexities of wholly retrospective application.

As the future Switching Incentive Regime is proposed, in part, to operate through the REC Performance Assurance Framework (PAF), this option would need to consider how this approach would be managed under the REC for the period through to 31 March 2023 when the operation of the CRS will continue to be funded by SEC parties. While RECCo will be happy to work with Ofgem to support this if it is chosen as a preferred option, we note that the additional complexity may result in disproportionate effort to implement this option.

Furthermore, the current proposal to introduce the performance charge regime in the REC is based on the CRS Provider's performance against operational service levels (subject to a decision being made on Change Proposal R0025). While we consider this to be the right means of measuring and incentivising operational performance on an enduring basis, we are mindful that there may reasonably be a period of underperformance against these measures in the initial operation of the service after go-live. Therefore, applying these measures retrospectively in this period may not provide the DCC with a reasonable prospect of earning its margin for RY 22/23.

² In the half-year to 30 June 2022 DCC paid Capita £53.3m for administrative services.

Chapter 7. Licence change

Question 6: Do you agree that the proposed Licence drafting appropriately reflects the policy intent of our proposal to establish the Switching Incentive Regime

RECCo agrees that the proposed Licence drafting appropriately reflects the policy intent.

We note that there are references in the Licence drafting to the 'REC Panel' (36.10B, 35.10B(a) and the definition for CRSMt). In the REC there is no concept of a 'REC Panel' and no new definition has been included in the drafting of the licence.

The requirements of the 'panel' as reference in Standard Condition 11B of the Electricity Supply Licence and Standard Condition 11B is in practice delivered by the *Change Panel*. However, we also note that it is Ofgem and the government's intention to replace code panels as part of Energy Code Reform.³ We would therefore suggest that the licence drafting include a future-proofed reference, for instance to "*the Panel, or such other body as may be constituted under the REC pursuant to Condition 11B of the Electricity Supply Licence.*" (and/or Condition 11 of the Gas Supply Licence, as the case may be). This would provide a clear interpretation of the intent of this reference.

We also note that some terms in Condition 36.10 (CRSPct, CRSCAt, CRSPAt, CRSPTct, CRSECGSt and CRSVASct) refer to consultation with the SEC Panel, SEC Parties and REC Parties, but not to the REC Change Panel or equivalent. We believe this relates to legacy drafting, where funding of activities during the Switching Programme were funded by SEC Parties. We recommend a review of these definitions to ensure they appropriately reflect the intent of the Authority. RECCo have no objection to the need to consult with the SEC Panel (while such body may continue to exist) and SEC Parties in addition to the REC Parties if this remains appropriate.

³ ["Government response to the consultation on Energy Code Reform"](#), April 2022, and ["Energy Code Reform: Call for Input"](#) December 2022.