Decision

DCC Price Control: Regulatory Year 2021/22

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Overview:

The Data and Communications Company (DCC) is required to report Price Control Information by 31 July each year. It must report in accordance with the Regulatory Instructions and Guidance that we publish.

Each July, DCC can also propose an adjustment to its Baseline Margin (BM) and External Contract Gain Share values (ECGS). We assess these proposals and determine whether any adjustments are justified.

In November 2022, we consulted on our proposals following a review of the report and information submitted by DCC in July 2022 for the Regulatory Year from 1 April 2021 until 31 March 2022.

This document sets out our decisions and the reasons for them on the costs DCC reported under its Price Control for the Regulatory Year 2021/22 and its application to adjust the Baseline Margin and External Contract Gain Share values under the Licence.

Alongside this document we have published notices of our Price Control Decisions and Determinations and Directions relating to the calculation of Allowed Revenue set out in the Price Control Conditions in the Licence.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

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Executive Summary

DCC performs an essential role in the energy market. It is important that DCC receives sufficient funds to perform its role well, and it is equally important that we hold DCC to account for delivering value for money and high-quality services. Through the Price Control, Ofgem is seeking to ensure that DCC continues to be able to make the required investments to deliver a good quality of service, whilst also focusing the organisation on delivering an efficient operation.

These are our[1] final determinations for the DCC Price Control for the Regulatory Year 2021/22 (RY21/22). Our decisions reflect our conclusions on the economic and efficient level of costs incurred in RY21/22 and in the cost forecasts; DCC's performance under the Operational Performance Regime (OPR) and Baseline Margin Project Performance Adjustment scheme (BMPPA); and adjustments to the Baseline Margin (BM) values set out in the Licence and the External Contract Gain Share (ECGS) term. Our final Determination follows from our assessment and November 2022 consultation on DCC's costs and performance; and takes into consideration stakeholder views we have received in response to the consultation.

Cost Assessment

Overall, DCC's total reported costs for RY21/22 are £532.550m. This is a 14% increase in total costs compared to last year's forecasts. Over the Licence term (RY13/14-RY25/26), total costs are now forecast to be £4.75bn, 13% greater than last year's forecast.

After considering all consultation responses, including from DCC, we have determined a total of £6.803m incurred Internal Costs in RY21/22 (including the associated shared service charge) as unacceptable. We have also determined a portion of External Costs incurred in RY21/22 as unacceptable.[2,3] Our determination of Unacceptable Costs comprises of costs that we assessed to have not been justified as economically and efficiently incurred in accordance with DCC's Licence, including a portion of External Costs associated with programme delivery, External and Internal Services relating to the Business Accuracy Programme, the application of shared service charges, as well as contractor benchmarking and activities relating to electric vehicles and innovation. There

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[1] The terms 'we', 'us', 'our' refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority

[2] Please note the total amount of Unacceptable External Costs has been redacted from this document for confidentiality reasons. See Chapter 2 for more information.

[3] As per Licence Condition 37.8(a) of the Smart Meter Communication Licence (or 'DCC Licence'). [Smart Meter Communication Licence]

are also Unacceptable Costs based around the lack of clarity over forecasts, in particular forecasts related to the Network Evolution, SMETS1 and ECoS Programmes.

In our decision, we have carefully considered additional evidence provided by DCC as part of its consultation response to justify some of the costs associated with the expansion of DCC teams, contractor benchmarking, policies surrounding non-competitive procurements and programme delivery costs.

In addition, we have determined a total of £34.596m (including the associated shared service charge) in forecast Internal Costs and £65.787m in forecast External Costs as unacceptable for RY22/23 and RY23/24 due to the level of uncertainty and insufficient justification. We have also determined a total of £133.819m increase in forecast Internal Costs (RY24/25 onwards) and £46.830m increase in forecast External Costs (RY24/25 onwards) as unacceptable. DCC has not justified these costs, and we consider these costs are not sufficiently certain to be included in DCC's future Allowed Revenue.

We encourage DCC to take steps to improve its forecasting and provide clear and transparent cost forecasts for its customers and as part of the Price Control. We expect DCC to be in a position to forecast with more certainty, and to be able to justify costs further into the future.

Performance Incentives

All DCC's BM (which includes adjustments) is at risk against one of DCC's performance regimes. This was the fourth year in which DCC's performance was assessed under the OPR. As there were no projects to be assessed under the BMPPA scheme for RY21/22, there are no decisions to be made.

Under the OPR, DCC missed its targets for the SUM1 and SDM2 system performance measures. We have considered the responses received and our consultation position remains unchanged. This corresponds to a reduction of DCC's BM of £0.531m associated with the Baseline Margin Operational Performance Adjustment (BMOPA) terms SUM1 and SDM2.

For the contract management incentive, we award a score of 1.33 as suggested by the independent auditor corresponding to a BM reduction of £0.338m.

For the customer engagement incentive, we received submissions from both DCC and the Smart Energy Code (SEC) Panel on DCC's performance during RY21/22. After assessing both submissions we award a score of 1.42 to DCC, corresponding to a reduction of DCC's BM of £0.535m.

Baseline Margin Adjustment

The BM adjustment mechanism was included in the Licence to recognise the uncertainty and risk of DCC's Mandatory Business over time. It is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business under the Licence.

DCC applied for a £13.268m adjustment to its BM for RY21/22 to RY23/24 to reflect increases in the volume and complexity of work caused by both new drivers and drivers previously identified by DCC. Following consideration of the consultation responses, we have decided to maintain most of our consultation position. However, we have decided to accept some of the BM activities that we were proposing to reject in our November 2022 consultation, on the basis that DCC has provided additional justification, and we are now satisfied they meet the criteria for a BM adjustment. We have directed a reduced adjustment of £7.435m to reflect:

- The Price Control decisions on Unacceptable Costs
- Parts of DCC's application, where we have not seen sufficient evidence of a material change that could not have been foreseen, or for which the driver does not appear to meet the conditions in the Licence

External Contract Gain Share

The DCC Allowed Revenue formula includes an ECGS term that allows for an upward adjustment to DCC's revenue in recognition of a reduction in External Costs that DCC helped achieve. Between RY15/16 and RY21/22, DCC has secured cost reductions of £249.40m in External Costs based on DCC's ECGS applications and brought benefits including this year's application of £142.2m (57% of total cost reductions) to DCC's customers through lower charges.

This year's ECGS application included forecasted savings which stem from the operation of DCC's in-house test lab service. Following consideration of the consultation responses, our consultation proposal remains the same. We will accept DCC's ECGS Adjustment application of £11.889m relating to the continuation of re-financing arrangements, Communications Hubs (CH) financing and DCC's in-house test lab service but will reject £23.181m of the adjustment relating to forecasted DCC's in-house test lab service savings, and £0.025m relating to a temporary increase in CHs costs.

Switching Programme

Separately to the BM, DCC receives margin on the Switching Programme, which is at risk under a separate performance regime. We have considered responses to the consultation and our position remains unchanged. All forecast costs for RY23/24 to the end of the Licence period will be disallowed due to a lack of justification for these costs. This is a £8.636m cost disallowance along with a corresponding margin disallowance of £1.174m.

The fourth delivery milestone under the Design, Build and Test Phase of the Switching Programme occurred this year in RY21/22. DCC will retain 100% of the margin associated with this milestone as all targets were achieved. The final values this milestone represents in terms of margin retained will be finalised in RY22/23 together with the assessment of the final milestone of the Design, Build and Test Phase.

Over recovery of Revenue

DCC over-recovered revenue from customers by 113% in RY21/22, which is above the 110% threshold. We only partially accept the reasons that DCC has provided and have decided to apply a penalty interest rate against the amount that was over-recovered and for which we received no satisfactory reason. The total amount that we determined not to be justified by DCC in RY21/22 is £28.583m. The penalty for the over-recovery in RY21/22 will be reflected in the RY22/23 Correction Factor, and by extent excluded from the Allowed Revenue in RY22/23.

Allowed Revenue Decision

Our decisions on the various components outlined above results in a total Allowed Revenue over the entire Licence period of £4.256bn[4,5] (including Pass-Through Costs). Please see Appendix 1 for Allowed Revenue as proposed by DCC and the impacts of this year's decision.

[4] Please note that the equivalent figure in the consultation document (Table A3.2 in Appendix 3) was shown in nominal prices, whereas this figure is adjusted by inflation (RY21/22 prices).
[5] Please also note that this figure does not include our disallowance of a portion of External Costs, details of which have been redacted for confidentiality reasons. Please refer to Chapter 2 for more information.

1. Introduction

Context

1.1. DCC is the central communications body licensed to provide the communications, data transfer and management required to support smart metering. It is responsible for linking smart meters in homes and small businesses with the systems of energy suppliers, network operators and other companies. This activity is a designated activity under section 4(1)(e) of the Electricity Act 1989 and section 5(1)(d) of the Gas Act 1986 and cannot be undertaken without a Licence granted under these Acts.

1.2. DCC was awarded a Smart Metering Licence[6] in 2013 to undertake this activity. Under this Licence DCC is entitled to an Allowed Revenue which is the total amount of revenue determined on an accrual's basis in relation to each Regulatory Year in accordance with the Principal Formula set out at Part C of Condition 36 (Determination of the Licensee's Allowed Revenue) after the deduction of Value Added Tax (if any) and any other taxes based directly on the amount concerned.

1.3. Licence Condition (LC) 36, supplemented by LC35-41, sets out how DCC's Allowed Revenue is determined. In particular these conditions enable the Authority to assess whether costs should be excluded from any future calculation of the Licensee's Allowed Revenue under Condition 36 on the basis that they have not been economically and efficiently incurred in the relevant Regulatory Year ("the Unacceptable Costs").

1.4. In determining the Licensee's Allowed Revenue, the Authority is under a statutory duty to do so in a manner that it considers best furthers our principal objective[7] to protect the interests of existing and future consumers. In addition, and specifically when determining the Licensee's Allowed Revenue, it must also have regard to the need to ensure that the Licensee is able to finance the activities which are the subject of the obligations imposed under the relevant Acts and the Licence.

1.5. Under this legislative and regulatory framework,[8] we have a role in ensuring that DCC's costs are incurred economically and efficiently. We review DCC's costs and performance after the end of the Regulatory Year in which the costs were

[6] The Smart Meter Communication Licence, accessible at: www.ofgem.gov.uk/licences-and-licence-conditions
[7] Section 3A, and specifically s3A(2)(b), of the Electricity Act 1989 and section 4AA and specifically section 4AA(2)(b) of the Gas Act 1986.
[8] See Smart Meter Communication Licence, accessible at: www.ofgem.gov.uk/licences-and-licence-conditions

incurred, as well as forecast costs that DCC deem certain enough to include in its forecast Allowed Revenue. This approach is referred to as an 'ex-post' Price Control. DCC must submit Price Control information by 31 July following each Regulatory Year in line with the Regulatory Instructions and Guidance (RIGs).[9] Price Control reporting covering the Regulatory Year from 1 April 2021 until 31 March 2022 was submitted on 29 July 2022.

1.6. Over the Licence term the majority of DCC's costs are incurred by its Fundamental Service Providers (FSPs), comprising of the Communication Service Providers (CSPs) and the Data Service Provider (DSP), who are responsible for delivering the data and communications services to support smart metering, and were appointed through a competitive tender process. One of DCC's key responsibilities is to effectively manage these large external contracts and ensure value for money and good quality service for consumers. The costs incurred by the FSPs are referred to as External Costs within DCC's Allowed Revenue.

1.7. All other costs incurred by DCC in relation to the provision of the service are either Internal Costs, Pass-Through Costs,[10] or costs associated with the Centralised Registration Service.[11]

1.8. In each Regulatory Year an amount of additional revenue, over and above the sum of the Internal Costs and External Costs, is included in the Allowed Revenue – this is the BM. Each July, DCC can propose an adjustment to its BM values. We assess this proposal and determine whether to adjust the values agreed when the Licence was awarded. DCC's BM is at risk against its performance previously under the Implementation Performance Regime (IPR) and now against the OPR and government directed project performance regimes. We determine the outcome of this performance as part of our Price Control assessment.

1.9. Separately, DCC receives a percentage margin for its activity on the Switching Programme. This margin is subject to a separate performance incentive regime.

1.10. DCC also applied to amend the ECGS term of its Allowed Revenue as a result of External Cost savings. The ECGS is a mechanism within the Price Control that

[9] See Ofgem (2022), Data Communications Company (DCC): Regulatory Instructions and Guidance 2022. www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2022
[10] Principally the cost of the Alternative HAN Company and the Smart Energy Code administration secretariat.
[11] Centralised Registration Service refers to the new switching service, introduced as part of the Switching Programme. See the Ofgem website for details: https://www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatory-programmes/switching-programme

allows DCC to apply to increase its Allowed Revenue in recognition of its instrumental role in reducing External Costs.

Our decision-making process

1.11. The DCC Price Control process should be viewed in the wider context of helping to achieve Ofgem's key priorities and principal objective:[12]

- Protecting the interests of consumers, including those that are vulnerable, by regulating the energy sector
- Enabling investment in low carbon infrastructure at a fair price
- Delivering full chain flexibility in how we generate, use and store energy
- Delivering a future retail market that works for all consumers and the planet

1.12. As required by the DCC Licence,[13] our assessment of DCC's costs is grounded in comparing DCC's incurred costs and revised forecast with DCC's Licence Application Business Plan (LABP) and the previous year's forecast. Our guidance document[14] sets out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient.

1.13. We published a consultation in November 2022[15] with our detailed proposals concerning RY21/22, and conducted a stakeholder meeting on the consultation in December 2022. This document sets out our decisions on DCC's:

- Incurred and forecast External Costs for RY21/22 (Section 2)
- Incurred and forecast Internal Costs for RY21/22 (Section 3)
- Performance under the Operational Performance Regime (OPR) (Section 4)
- Application for an adjustment to its Baseline Margin and External Contract Gain Share (Section 5)
- Performance under the Switching Programme (Section 6)
- Over-recovery of revenue (Section 7)

1.14. We received eight responses. There were two confidential responses with the remainder non-confidential. All non-confidential responses are published on our

[12] See *Our Strategy and Priorities:* www.ofgem.gov.uk/about-us/our-strategy-and-priorities
[13] Licence condition 37 of the Smart Meter Communication Licence
[14] DCC Price Control Guidance: Processes and Procedures 2022 | Ofgem
[15] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

website.[16] We have fully considered all responses received to our consultation. We have summarised the key points received from the responses and provide an explanation of the reasons for our decisions.

1.15. Please note that we may provide feedback to DCC directly on the detailed points it raised in its consultation response.

1.16. A Notice of our Price Control decision, determinations and directions accompanies this document. We also include a Notice providing DCC with a direction so that it can reflect our decisions in its next Charging Statement.

1.17. For further context to these decisions please read this document alongside our November 2022 consultation on the RY21/22 Price Control. The consultation document describes how DCC's costs have changed since the previous year and outlines our view on whether we think DCC's explanation in its Price Control submission justifies the cost variances. It also summarises our proposals on whether to accept DCC's application to adjust the BM and ECGS terms.

[16] Ibid.

Related Publications

1.18. The 2021/22 Price Control Consultation Document is at: DCC Price Control consultation: Regulatory Year 2021/22

1.19. The DCC Regulatory Instructions and Guidance 2022 is at: Data Communications Company (DCC): Regulatory Instructions and Guidance 2022

1.20. The DCC Price Control Guidance: Processes and Procedures 2022 is at: DCC Price Control Guidance: Processes and Procedures 2022

1.21. The DCC Licence is at: Licences and licence conditions

General feedback

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

Please send any general feedback comments to stakeholders@ofgem.gov.uk.

2. External Costs

Section summary

Respondents to our consultation, aside from DCC, were supportive of our consultation proposals on External Costs. Stakeholders agreed with our proposed disallowances to DCC's programme costs and forecast External Costs in the context of ongoing concerns over issues in programme delivery, DCC's effective contract management, forecasting accuracy and quality of reporting. Multiple stakeholders expressed disappointment in DCC's performance across these areas. DCC's representation focused solely on our proposal to disallow a portion of costs incurred in the area of programme delivery, with which it disagreed.

Following consideration of all representations, we have decided to accept additional evidence provided by DCC and revise the amount of disallowed costs associated with issues in delivery of one of DCC's programmes. However, our consultation proposals with respect to disallowances of CSP-Central & South (CSP-C&S)[17] price support costs in RY22/23 and forecast External Costs remain unchanged. Equally, we maintain our positions on the issues of Working Capital Charges and quality of impact assessments, both of which will receive focus in next year's contract management audit.

Questions posed at the consultation:

1. What are your views on our proposal to disallow a portion of External Costs associated with programme delivery?
2. What are your views on our proposal to remove from the forecasts all costs associated with 'CSP-C&S price support' from RY22/23? Do you have any views on the issue of Working Capital Charges?
3. What are your views on our proposal to disallow £108.22m of forecast External Costs?
4. Have you got any other views on External Costs?

[17] Communication Service Provider in the Central and South regions

Background

2.1 External Costs form the largest part of DCC's costs at ~71% of total costs in RY21/22. These costs are incurred by DCC's Fundamental Service Providers (FSPs) as well as other Service Providers (SPs) delivering the recent SMETS1, Switching, and Enduring Change of Supplier (ECoS) programmes. We assess both incurred and forecast External Costs on the basis of DCC's annual Price Control submission and any further evidence provided by stakeholders at the consultation stage.

2.2 DCC's submission stated that DCC had incurred External Costs of £398.9m over the course of RY21/22, with a variance on last year's forecast of £39.56m (adjusted for inflation) subject to ex-post justification.

2.3 We consider the majority of DCC's incurred external costs for RY21/22 to have been economically and efficiently incurred. However, we consider a portion of costs associated with programme delivery to not have been economically and efficiently incurred and therefore we determine those costs to be unacceptable.[18]

2.4 We also consider that DCC has not provided sufficient (or, in some cases, any) justification and evidence for a significant proportion of forecast External Costs for future Regulatory Years. As a result, we determine £108.22m of forecast External Costs to be unacceptable.

2.5 As in previous Regulatory Years, there still remain areas for improvement in DCC's contract management, its cost reporting and forecasting and customer engagement, including the quality of impact assessments. We address these issues in further detail in response to stakeholders' representations in this section.

2.6 Due to commercial sensitivity and confidentiality reasons, we agreed to DCC's request to remove certain information, including the amount of our proposed disallowance, the affected area and the service provider, from our consultation in order to help protect DCC's commercial position. We considered that, on balance, this would also protect the interest of DCC's customers. DCC was provided with the details of our proposed disallowance and provided further information in its consultation response. Information related to Question 1 which was redacted from our consultation remains redacted in this decision document.

[18] Unacceptable Costs are defined under LC 37.8(a).

Q1 Programme delivery

Proposal at consultation*: Partial disallowance of costs associated with programme delivery in RY21/22 due to delays and increased costs.*

Decision*: Proceed with disallowance but revise the amount subject to our determination to account for additional evidence provided by DCC.*

Respondents' views

2.7 Overall, five stakeholders agreed with our consultation position while two felt they did not have sufficient information on our proposal to reach a conclusive position.

2.8 Of the five stakeholders who supported our proposal, four provided a shared response which highlighted the area of programme delivery as that of key expectations from industry on DCC. Through this response, stakeholders confirmed having experienced delays, missed milestones, and disruptive programme re-planning, and supported Ofgem in taking firm action in this area to mitigate such issues in future. Stakeholders supported the view that "no costs should be passed through to DCC's users to cover DCC's own failings".

2.9 Furthermore, one stakeholder, who supported our decision, highlighted DCC's contract management as an ongoing area of concern. They stated that DCC need to be able to hold their SPs to account and believed that the proposed disallowance would emphasise this point.

2.10 The two stakeholders who felt they lacked information around our proposals expressed their regret that more transparency could not be provided.

2.11 One stakeholder stated that DCC's customers and energy consumers had a "reasonable right" to understand the details of the proposed disallowance. However, they shared our concern around DCC's performance in programme delivery and supported our proposals on the principle that action should be taken "where DCC or its service providers have contributed to a failure to deliver programme of work on to and to suitably economic and efficient costs." This stakeholder also provided examples of programme delivery issues throughout RY21/22.

DCC's response

2.12 DCC disagreed with our proposal:

- First, DCC argued that the amount considered in our consultation position should be modified to more accurately reflect the issue subject to our disallowance proposal. In particular, DCC argued that a portion of costs in our proposal was not directly associated with the service provider's poor performance; DCC therefore asked that these costs be excluded from the disallowance proposal.

- Secondly, DCC provided a number of arguments against the rationale for, fairness and strategic considerations of the disallowance.

2.13 For confidentiality reasons, we do not detail the specific arguments made by DCC in this document. However, we have addressed these arguments separately and provided a detailed response to DCC.

Reasons for our decision

2.14 Following careful consideration of stakeholders' representations and evidence provided by DCC, **we have decided to proceed with our position to make a partial disallowance in external costs incurred in programme delivery**. However, accounting for additional evidence provided by DCC, **we have decided to revise the amount of Unacceptable costs to be disallowed.** We provide an overview of our reasoning below.

2.15 DCC is responsible for managing its SPs to derive value for money for its customers. This includes ensuring good performance and service delivery by the SPs under its contracts.

2.16 In its price control submission and through subsequent engagement, DCC reported that poor performance by one of its service providers led to material impacts on the delivery of one of its programmes, both in terms of delays to the programme *and* additional costs associated with work required to remedy identified issues.

2.17 A number of DCC's programmes have historically faced challenges due to the complexity of the technical solutions. We recognise that DCC has worked with industry to mitigate these issues. However, equally, as noted in our previous Price Control commentary,[19] we have been concerned about the distribution of risk between DCC (and its contracted parties) and DCC customers (and consumers), who have to date been exposed to increasing programme costs. In this instance, there is evidence that additional costs arose directly as a result of a service provider's failure to deliver contracted service, in particular costs required

[19] See for instance: Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, paragraph 2.43. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021

to extend the programme and carry out remedial action to rectify those failures. We consider that such costs are not economic and efficient and should be returned to customers.

2.18 We said in our consultation that we may modify the proposed disallowance amount to more accurately reflect the proportion of uneconomic costs.[20] DCC clarified that of the variance in costs incurred by the service provider in RY21/22, only a portion was expended for additional programme support in connection with issues resulting from the service provider's poor performance. We received general responses from other stakeholders, however none of those provided concrete evidence to further change the amount to be disallowed. While we remain concerned about the broader impacts of the SP's performance, in this instance, we accept the evidence provided by DCC to quantify costs attributed to the service provider's failures. As a result, **we have decided to revise downwards the amount of Unacceptable Costs to be disallowed**.

2.19 It is up to DCC to effectively exercise its contract management function and hold the SP to account, and we recognise that DCC may be able to recover a portion of these costs at a future date. **We therefore maintain our consultation position that, if successful in pursuing a future claim against the service provider, DCC would be allowed to retain *up to* the disallowed amount.** We would expect any cost recovery above the disallowance threshold to be returned to customers.

2.20 Ofgem does not direct DCC's commercial or contract management strategy. However, we would expect DCC to be able to ensure ongoing delivery under existing contract, while holding the contracted party to account for any underperformance (in a manner of its choosing). If DCC is concerned about the risk of any issues for its price control reporting, we would encourage DCC to engage with us proactively with options under considerations and their impacts.

2.21 We remind DCC that, in line with Licence Condition (LC) 37.8 (a), the Authority may direct that any External Costs, which it does not consider having been economically and efficiently incurred, are to be excluded from the Licensee's Allowed Revenue under LC36. Due to ongoing concerns around programme delivery, we will continue to closely monitor this area in future price control

[20] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraph 2.50. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

assessments. We expect DCC to display better transparency about the impacts of issues on programme delivery, particularly when justifying new costs. We encourage DCC to be proactive in informing us about any ongoing issues and are open to receiving evidence of DCC's management of those issues as part of our bilateral engagements.

Q2 CSP-C&S price support and Working Capital Charges

***Proposal at consultation**: disallow all forecast costs associated with CSP-C&S comms hub price support from RY22/23 onwards and reject the portion of ECGS that arose from the temporary comms hub price increase.*

***Decision**: remains unchanged from consultation.*

Respondents' views

CSP-C&S price support

2.22 All seven stakeholders, who responded to this consultation question, unanimously supported our consultation proposal and reasoning.

2.23 Three stakeholders voiced concern over DCC's agreement to the price support in the context of existing contracts for the financing of comms hubs, specifically:

- One stakeholder acknowledged that there may have been extenuating circumstances in the comms hub supply chain, though expressed disappointment that DCC could not maintain the original contracted price for comms hubs. They also shared our concerns over the controls in place for, and future changes to, comms hub pricing.
- One stakeholder noted the lack of assurances from DCC around the possibility of future price support and stated DCC should demonstrate its assessment of the requestor's ability to absorb cost while also setting conditions for terminating any temporary price increase.
- One stakeholder was of the view that DCC's contracts with the CSPs should protect against comms hub price hikes.

2.24 DCC did not provide any representation or comments.

Working Capital Charges

2.25 Two stakeholders agreed that Working Capital Charges should receive greater focus under the next Operational Performance Regime (OPR) contract management audit.[21]

2.26 One stakeholder shared our concerns regarding the magnitude of Working Capital Charges incurred by DCC on certain change requests and project requests. They also observed that Working Capital Charges can be applied by an SP if DCC fails to meet a payment deadline, yet DCC expects SEC Parties to pay their monthly fixed charges within 5 working days.

2.27 One stakeholder agreed with our consultation view that DCC should demonstrate a minimising of exposure to Working Capital Charges.

2.28 DCC did not provide any views on the issue of Working Capital Charges in its response.

Reasons for our decision

CSP-C&S price support

2.29 With no further evidence provided by DCC, we maintain our consultation position and determine that £4.400m of costs associated with CSP-C&S price support shall be removed from the forecasts from RY22/23. Details of this disallowance are set out in table 1.1 below. We also maintain our decision not to award any External Contract Gain Share (ECGS) on the costs that arose as a result of the temporary price increase.[22]

2.30 As stated in our consultation, we accept DCC's reasoning for entering into a temporary price support arrangement for comms hub financing with CSP-C&S. However, we lack assurances that sufficient controls are in place for the duration of the 12 months of the price support to ensure that no costs are incurred beyond a point when the conditions necessitating its continuation no longer apply.

2.31 As such, we have decided not to accept any costs associated with the price support *ex-ante* in forecasts. Instead, we ask DCC to justify all costs incurred as a result of the price support *ex-post*. Specifically, we expect DCC to provide evidence in its RY22/23 Price Control covering at minimum:

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[21] See paragraphs 2.65 and 4.20-4.40 in our consultation for further information on the OPR contract management audit. [DCC Price Control consultation: Regulatory Year 2021/22]

[22] For further details, including the impact on DCC's RY21/22 ECGS application, please see Section 5 (Question 16) of this document.

- Justification for all incurred costs
- Justification for the eventual endpoint of the price support arrangement
- Controls and reviews in place for the duration of the price support
- Other actions taken to minimise expenditure beyond contractual arrangements

Table 1.1: Forecast costs of the CSP-C&S price support to be disallowed

	RY22/23	RY23/24	RY24/25	RY25/26	TOTAL
CSP-C	0.257	0.758	0.734	0.720	**2.469**
CSP-S	0.199	0.593	0.575	0.564	**1.932**
TOTAL	**0.456**	**1.352**	**1.309**	**1.284**	**4.400**

Working Capital Charges

2.32 Having received no new evidence from DCC, we maintain our consultation positions.

2.33 We confirm that we intend to focus on the issue of Working Capital Charges (WCC) in next year's OPR contract management audit.

2.34 We will continue to monitor this as part of our Price Control scrutiny. Going forward, we ask DCC to report to us, as part of its Price Control submissions, the level of Working Capital Charges incurred in with appropriate justifications for the incurred costs. As set out in our consultation, we may not consider future Working Capital Charges incurred as a result of payment delays by DCC as economic and efficient.

Q3 Forecast external costs

Proposal at consultation*: disallow £108.217m of forecast external costs, comprising:*

- *£13.785m of forecast costs on account of incorrect reporting*
- *£94.432m of forecast costs associated with DSP, CSP North (CSP-N) and three SMETS1 SPs, on account of insufficient justification*

Decision*: remains unchanged from consultation.*

Respondents' views

2.35 All seven stakeholders, who responded to this consultation question, supported our proposals.

2.36 A number of stakeholders expressed concerns over DCC's poor forecasting and the scale of cost disallowance on the grounds of incorrect reporting.

2.37 One respondent noted that accurate forecasting is important for DCC customers' own estimates of impacts of DCC charges on cashflow. They commented on an erosion of customer confidence in DCC's financial forecasting and called for a better alignment of the DCC Charging Statements and invoicing with its Price Control forecasting.

2.38 DCC did not address this question in their consultation response.

Reasons for our decision

2.39 In absence of any justification from DCC, we are proceeding with our consultation position and determine that £108.217m of External Costs are to be disallowed from DCC's forecast. Details of this disallowance are set out in table 1.2 below.

2.40 We are disappointed that DCC did not provide any response to our proposals to disallow forecast External Costs. We share stakeholders' concerns around DCC's incorrect and inaccurate forecasting, as well as the scale of DCC's reporting errors in RY21/22. We expect improvements in DCC's QA (Quality Assurance) processes to minimise such errors in future Price Control submissions.

2.41 Where DCC wishes to re-justify any previously disallowed forecast costs, we expect to see full justification and evidence that the costs meet the required certainty and efficiency thresholds and other principles as set out in our guidance.[23]

2.42 We recommend that DCC work with its customers, for example through existing quarterly finance forums, to restore confidence in its forecasting.

Table 1.2: Forecast External Cost disallowances per Service Provider

Service provider	Area	Disallowance in [£m] per RY			
		RY22/23	RY23/24	RY24/25	RY25/26
DSP	CRs/PRs	16.217	4.590	2.131	1.512
CSP-N	CRs/PRs	1.890	1.890	1.832	0.199
S1SP_1	Enduring costs	1.029	1.058	1.135	1.343

[23] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, paragraphs 2.18-2.24. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

S1SP_3b	Enduring costs	12.643	12.902	12.919	13.124
S1_DCOa	Enduring costs	-5.458	-5.458	-5.458	-5.458
	Commissioning Party Service	12.098	10.579	10.479	10.479
	TOTAL	**38.419**	**25.561**	**23.038**	**21.199**
	GRAND TOTAL				**108.217**

Q4 Other views on External Costs

Respondents' views

2.43 One stakeholder raised concerns over **DCC's contract management**. In particular, in their view, DCC does not manage contract changes or renewals appropriately leading to delays and higher contract costs due to time constraints and greater urgency to deliver projects. They referred to the DSP technical refresh as an example of DCC acting too late to the detriment of its customers and energy consumers.

2.44 Several stakeholders raised points around **cost transparency and quality of DCC's reporting**:

- Two stakeholders expressed concern that Ofgem asked 70 clarification questions as part of its cost assessment, indicating DCC did not initially provide appropriate evidence or justification
- One of these stakeholders stated they would support further action should DCC's reporting not improve in their next submission
- Similarly, one respondent expressed concern over our view that DCC's External Costs submission was lacking in detail, stating it raises questions as to DCC's commitment to the Price Control process
- One stakeholder voiced concerns over lack of ability afforded to DCC customers to scrutinise costs on key DCC programmes, including business planning and SEC modifications.

2.45 Stakeholders also commented on ongoing concerns around **cost increases and system performance:**

- Regarding DCC's costs, one stakeholder stated that DCC's External Costs for RY21/22 being 12% above their forecast from the previous Regulatory Year did not reflect a stable and efficient running of daily operations and core

Mandatory Business, which they would expect at this stage of the Licence term.

- Another respondent described the rise in FSP costs, despite disallowances in previous years, as "extremely concerning". They described DCC's service delivery as "substandard" and unstable despite being operational for many years.
- One stakeholder questioned whether DCC's performance is appropriate for the cost variances seen across the CSP providers.

2.46 Three stakeholders highlighted issues in the **SEC change process** and its associated costs:

- Two stakeholders supported focus on 'quality of impact assessments' in next year's audit. They both noted the findings of the RY21/22 OPR contract management audit, which identified that DCC consistently does not meet the required timescales for producing impact assessments for SEC modifications.
- One stakeholder expressed concerns that costs associated with implementing changes approved through the change process can increase considerably post-approval, highlighting the case of SECMP007 as detailed in our consultation.[24] They questioned how a cost-benefit analysis can be properly conducted as part of the change process if costs change post-approval.

2.47 One stakeholder raised the issue of DCC **over-collecting money from its customers**. They observed that DCC has returned millions of pounds to energy suppliers over the past several years, implying inaccurate forecasting or excessive use of contingency. They also noted that DCC does not appear to face a penalty for holding this money, while DCC customers face charges for late payments on their monthly invoices. They called for greater transparency around the interest DCC may earn on customers' money and suggested that DCC improve the reliability of its forecasting to avoid excessive use of contingency.

2.48 Finally, some stakeholders questioned the suitability of existing *ex-post* Price Control arrangements to continue to provide effective control for DCC costs, with two stakeholders expressing desire for **introduction of an *ex-ante* regime**.

[24] For further information on SECMP007 and DCC's justification see: Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 2.68-2.70 and footnote 47. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

Our actions in response to stakeholders' views

2.49 As noted in our previous determinations, we believe there remain a number of areas for improvement in DCC's contract management. This year we are making a disallowance in connection with DCC's contract management in programme delivery. As of RY21/22, DCC's contract management ability is also incentivised under the revised OPR, where DCC's margin is reduced by £0.338m. In line with our RY20/21 decision, we expect DCC to make continuous improvements to its contract management capabilities and act on, and demonstrate, lessons learnt.[25] Additionally, we invite DCC to study the findings of the independent audit and make improvements in highlighted areas.[26] We note issues raised around DCC's DSP re-procurement. We scrutinised costs associated with DSP extension as part of our cost assessment and will continue to monitor spend in this area going forward. As noted in our consultation, we also expect the DSP re-procurement to be under significant scrutiny in the RY22/23 audit.[27]

2.50 As stakeholders noted, the quality of DCC's reporting has for certain elements of the External Cost's submission fallen below the expected standard, leading to a large number of clarification questions, and increased regulatory burden on both Ofgem and DCC. We have disallowed a substantial amount of forecast costs in this Regulatory Year based on insufficient or erroneous reporting. We would remind DCC that the burden of proof for cost justification is on DCC and that any costs, including incurred costs, may be subject to a disallowance if found unacceptable in absence of satisfactory evidence that they are economic and efficient. We expect to see improvements in the quality of DCC's reporting in the next Price Control cycle and are open to engagement with DCC on how best to address existing reporting issues.

2.51 We acknowledge stakeholders' concerns over continuing issues around service quality and stability. DCC's system performance is incentivised under the OPR. This year, we are reducing DCC's BM by £0.531m because of DCC failing to meet performance targets related to its service desk and core service requests.[28] We encourage DCC to continue to work with its customers on identifying, communicating, and resolving any issues to ensure system stability. In addition,

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[25] Ofgem (2022), DCC Price Control Decision Regulatory Year 2020/21, paragraph 2.29. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021
[26] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 4.29-4.35. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122
[27] Ibid, paragraph 4.39
[28] Ibid, paragraphs 4.9-4.18. See also paragraphs 4.9-4.28 in this document for further context on the system performance OPR and the details of DCC's missed targets.

we would note that while External Costs increased compared to last year's forecast, the overall costs did decrease. A portion of the new variance can be attributed to DCC's re-justification of previously disallowed costs.[29]

2.52 As set out in our consultation, we share stakeholders' concerns over the quality of DCC's impact assessments, especially with regards to SEC modifications. The independent OPR contract management audit identified shortcomings in DCC meeting its SEC obligations with regard to timeliness of delivering impact assessments. Following its findings and the concerns raised through this year's consultation, **we confirm that the quality of impact assessments will feature as one of areas of focus in RY22/23 contract management audit**.

2.53 With respect to the issue of over-recovery, the Licence allows for a penalty interest rate to be applied on revenue that was recovered over and above 110% of its Allowed Revenue, for which we received no satisfactory reason. The total amount that we determined not to be justified by DCC in RY21/22 is £28.583m. The penalty for the over-recovery in RY21/22 will be reflected in the RY22/23 Correction Factor, and by extent excluded from the Allowed Revenue, in RY22/23.

2.54 Finally, we are considering changes to the Price Control arrangements as part of an ongoing work on the future regulatory framework for DCC ('DCC review').[30] As previously noted, issues identified as part of our current Price Control assessment, as well as lessons learnt from previous years, will inform our work in this area.

[29] For more information on the key drivers in a year-on-year variance, please see paragraphs 2.13-2.23 of our consultation document.
[30] In September 2022 we published a consultation concluding the first (scoping) phase of the review. This consultation closed in January 2022. For more details, please see our website: Ofgem (2022), DCC review: Phase 1 Consultation. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

3. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY21/22. We have reviewed all responses and determined a total of £6.803m incurred Internal Costs in RY21/22 (including the associated Shared Service Charge) as unacceptable. Our decision is based on various costs, including those that are linked to the External and Internal Services, the Business Accuracy Programme, Shared Service Charges, contractor benchmarking, and activity relating to electric vehicles and innovation given that this is not part of DCC's Authorised Business.

We have also decided to maintain our position on DCC's forecast costs over RY22/23 and RY23/24 due to a lack of clarity and certainty over forecasts, and in particular forecasts associated with the Network Evolution, SMETS1 and ECoS programmes.

Questions posed at the consultation

5. What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?
6. What are your views on our proposal to disallow costs associated with non-competitive procurements where we have not received satisfactory justification or evidence?
7. What are your views on our proposal to disallow the costs of the Order Management System, Engagement Portal and the Executive Leadership Programme?
8. What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?
9. What are your views on our proposals on the Shared Service Charge?
10. What are your views on our proposal to disallow costs associated with the product management team, DCC's work on EVs and additional products?
11. What are your views on our proposal to disallow forecast cost variances in RY22/23 and RY23/24 in the Corporate Management (including Policy and Markets team), Finance & People, and Operations cost centres, and the Network Evolution, SMETS1, and ECoS programmes; and all baseline forecast costs for RY24/25 onwards?

Q5 Contractor and Permanent Benchmarking

Proposal at consultation*: disallow £0.047m of contractor costs in RY21/22 on the grounds of DCC's failure to demonstrate following an efficient process when hiring above the market benchmark.*

Decision*: remains unchanged from our consultation position.*

Respondents' views

3.1 All respondents, except for DCC, supported our proposals on benchmarking. One respondent recognised DCC's improvement in the permanent-contractor staff ratio. However, stakeholders also raised concerns in this area, which we summarise below.

3.2 One respondent raised concerns about the bonus being excluded from the benchmarking exercise, and that DCC might be spending resources to manage the Licence renewal and cultural change.

3.3 Another respondent was concerned about the increase in headcount numbers without an increase in work demand. A third respondent raised the issue of staff retention levels being low and proposed this could be benchmarked going forward. In particular, the respondent thought that the low retention levels were having a negative impact on the ability for the SEC Panel and Sub Committees to engage with DCC's programmes and projects, due to poor knowledge retention and communication within the organisation.

3.4 DCC broadly welcomed our proposed position but argued that the proposed disallowance was unnecessary given the general position of efficient staff costs.

3.5 In relation to the staff bonuses DCC reiterated its argument that the benchmark exercise on the benefits package carried out in RY20/21 showed its remuneration offerings were in line with the wider market. DCC also argued that its remuneration package was the same as Capita's, therefore, it would be unreasonable to believe DCC's staff bonuses are uneconomic when compared to the wider market given that Capita is a large organisation. Furthermore, DCC said that the terms and conditions of DCC's pay offer were included in the LABP that DECC accepted as the most competitive bid for the provision of its programme.

Reasons for our decision

3.6 We have carefully reviewed the responses we received. We note that DCC has not provided any additional material evidence as part of its response to this question.

We maintain our position on both the contractor and permanent costs benchmarking, including wider benefits package.

3.7 We note the stakeholder's concerns that DCC might be using resources to manage projects outside of the scope of its Authorised Business. We would like to make clear that we expect DCC to deliver value for money and limit its costs, which are borne by its customers and by consumers. DCC should not incur costs which are then charged back to its customers other than for Authorised Business.

3.8 Regarding the concerns raised by stakeholders around the increase in headcount figures and lack of transparency for the drivers behind it, we would like to reiterate what we said in our Decision last year: that we encourage DCC to improve the visibility of its internal resource allocation across programmes to its customers, and we expect DCC to better communicate to its customers how its resourcing policy meets their needs.

3.9 We also note the stakeholder's comment on the issue of staff retention levels being low. Low retention levels can have a negative impact on the efficiency and efficacy in which a corporation runs its operations. For example, by increasing recruitment costs, or by eroding institutional knowledge and reducing the efficiency of its work force. This is a challenge faced by many corporations, and there are different ways in which both the employee turnover levels, and its negative impact can be minimised. For example, by having strong handover processes to ensure knowledge is retained within the organisation and ensuring effective communication within the organisation. We expect DCC to improve in this area while ensuring payroll costs are economic and efficient.

3.10 In regard to DCC's argument that the proposed disallowance on contractor costs is unnecessary given the general position of efficient staff costs: as we said in our consultation, we welcome DCC's continued improvement in this area. However, the benchmarking exercise still shows that there are inefficiencies and room for improvement. We are concerned that DCC failed to provide any evidence that it follows its own internal policy and process for hiring contractors above the agreed benchmark. We expect to see DCC consistently applying its own approach to recruiting. We also expect DCC to be able to provide robust evidence of its internal approvals and decision-making process, particularly when it deviates from the stated methodology on benchmarking.

Permanent staff - wider benefits

3.11 Regarding the stakeholder comment that the whole remuneration package is not benchmarked, we would like to refer to our consultation position on this issue, which remains unchanged.

3.12 In our consultation, we welcomed the additional information around the non-base salary benefits shared by DCC in this year's submission, which, in our view, showed that most non-base salary benefits are economic and efficient. However, we also noted that this analysis was presented as a one-off benchmark exercise, and therefore, we encourage DCC to ensure these costs keep being economic and efficient going forward.

3.13 In relation to the staff bonuses, we expressed our disappointment that no further work was carried out in this area and said we would encourage DCC to review its bonus package to ensure it is economic and efficient, and that this would remain an area of scrutiny.

3.14 In response to DCC's argument that in RY20/21 its submission showed its remuneration offerings (including staff bonuses) were in line with the wider market, we would like to reiterate that the analysis presented last year did not show the bonus policy to be economic and efficient, as we stated in our RY20/21 Consultation and Decision documents. Our long-standing position is that a remuneration up to the median of the benchmark is the economic and efficient approach, while DCC's bonus appears to sit above the average and median quartile, albeit below the upper quartile, across all staff categories. However, we also recognised that the analysis carried out by DCC was limited (e.g., it used a small sample of roles), and that more work was required to properly assess the efficiency of the bonus package. In its RY20/21 submission DCC said that the wider-benefits benchmarking exercise completed that year was an interim approach to provide some additional information to us, and that DCC was currently looking at how best to move to whole-salary benchmarking.

3.15 We are disappointed that DCC insists on this argument despite our specific feedback on the relevance of last year's analysis on the bonus package. We are also disappointed that no more work has been carried out to better assess the efficiency of the bonus package, despite our feedback and DCC's recognition that last year's analysis was an interim approach.

3.16 We also disagree with DCC's argument that the fact its remuneration package was the same as Capita's is proof that it is aligned with the wider market. Our view is that a compelling benchmarking exercise comparing different bonus packages in the wider market would require data from more than one independent market participant, regardless of its size. Because Capita is DCC's parent company, we cannot consider this data as coming from an independent market participant.

3.17 Regarding DCC's argument that that the terms and conditions of DCC's pay offer were included in the LABP, our view is that that does not mean there is no room for improvement, and that we expect DCC to drive payroll efficiencies where they can be found.

3.18 We are also disappointed DCC seems to have departed from its previous stated intention to assess whether to continue to align its policy on bonuses with the parent company.

Q6 Non-Competitive Procurements

Proposal at consultation*: Disallow £3.095m associated with non-competitive procurements where we have not received satisfactory justification or evidence.*

Decision*: Considering the additional evidence received, we have decided to adjust our consultation position, and disallow £2.085m associated with non-competitive procurements for which we have not received satisfactory justification or evidence.*

Respondents' views

3.19 Most respondents supported our minded-to position.

3.20 Two respondents explicitly raised concerns about the relationship between Capita and DCC, particularly with regards to resourcing and service provision.

3.21 Considering DCC's monopoly position, and its core role in contract management and procurement, one respondent called for it to be emphasised that competitive procurement should be the assumed default approach.

3.22 One respondent also requested that they would like to see the procurement activities being further scrutinised in the next Regulatory Year through an Independent Audit.

3.23 DCC expressed concerns around our approach to the disallowance of costs in relation to non-competitive procurements (NCP). According to DCC, Ofgem has misrepresented the obligations that are applicable with regards to the procurement of Relevant Service Capability (RSC).

3.24 DCC argued that LC16.6[31] offers DCC the flexibility to choose the appropriate procurement route for RSC depending on its assessment of what is most economical and efficient, having had regard to the Part B Principles, excluding, notably, Principle 2, which is the principle that RSC must be procured competitively wherever practicable and proportionate. DCC is of the view that there is no basis for interpreting LC16.6 as requiring DCC to demonstrate exceptional circumstances before deciding to award a contract without a competitive procurement. Instead, DCC considered that what is required is that DCC is satisfied that this is the most economical and efficient route having regard to the performance of DCC's functions and the other Part B Principles[32] set out in LC16.8 to LC16.12A (excluding LC16.9).

3.25 DCC further disagreed with Ofgem's view that it is not consistently complying with its own procurement policy. DCC argued that it does not automatically mean that the expenditure is not economic and efficient, or that it has not complied with its Licence if it does not adhere to its internal Procurement Policy and Procedure document. Whilst DCC is required to put in place a Procurement Strategy for RSC, DCC also noted that the Procurement Policy and Procedure document does not form part of the Procurement Strategy, nor does it affect the substance or interpretation of the Licence obligations with regard to procurement that DCC is subject to. DCC argued that the Procurement Policy and Procedure document has instead been voluntarily developed and published to explain in more detail how DCC intends to comply with its Licence obligations.

3.26 DCC further argued that it is incorrect to describe DCC as a "monopoly" in relation to every procurement activity it undertakes. In some cases, DCC must procure services from suppliers that operate in distinct markets where DCC might have little to no buying power.

3.27 Finally, DCC responded that its decision to directly award several contracts in RY21/22 resulted in savings of more than £6.8m. These savings were the result of either negotiated discounts, compared quotes, or in some cases, leveraging unique knowledge and skills to avoid passing on costs to customers. As part of its response, DCC provided additional information against each of the disallowed procurements and why it considered them to be economic and efficient.

[31] LC 16.6 – Part A: Requirements that are imposed on procurement activities
[32] Part B (LC16.7-LC16.12) Principles that are applicable to procurement activities

Reasons for our decision

3.28 We maintain our position and are of the view that for most non-competitive procurements, that were associated with our consultation position, DCC was unable to provide satisfactory evidence and documentation on how it had arrived at the decision that a direct award was the most economic and efficient approach; nor have we received any robust evidence as to why DCC considered it to be not practical and proportionate to run carry out a competitive procurement in these cases.

3.29 In light of the additional evidence, we have however revisited our position in respect of two non-competitive procurements. This was partially on the basis that some degree of evidence had been provided of the services and costs being externally benchmarked. Our decision to allow these costs was further based on the recognition that these procurements sought to secure continuity for business-critical services, as opposed to potentially disrupting them and incurring additional costs by choosing another provider. Notwithstanding the fact that the evidence linked to these procurements was generally incomplete, we have decided to allow these costs, in this instance, but expect DCC to significantly improve the level of evidence going forward.

3.30 The default approach in relation to the obligations that apply to procurement activities is set out in LC16.4. It states that "t*he Licensee must (subject to paragraph 16.6) procure Relevant Service Capability from External Service Providers on a competitive basis and under arrangements to be known as External Service Provider Contracts that are compliant with the principles established by Part B below ("the Part B Principles")".*

3.31 Whilst we agree that DCC can deviate from that rule, under LC16.6, it should be noted that this should only be the case if it is in the interest of all stakeholders not to do so. More specifically, LC16.6, requires DCC "…*to be satisfied that it is either the most economical and efficient option, or that the value is immaterial"*.

3.32 DCC is subject to a proportionate degree to manage its costs appropriately and ensure that the best possible outcomes for consumers are achieved. The burden of proof for determining whether an approach is the most economical and efficient option lies with DCC; failure to do this adequately may result in us determining that these costs were not incurred economically and efficiently and that they are therefore Unacceptable Costs.

3.33 The Guidance sets out the principles, methods of assessment, and types of criteria that are likely to be applied when considering whether certain costs were economically and efficiently incurred. A non-exhaustive set of criteria within the Guidance that DCC is required to provide evidence of include:

- Due diligence for procuring services, for example the provision of criteria for evaluating and shortlisting bidders
- Consistent sourcing strategies and clear justifications as to why a different procurement strategy had been chosen
- the evaluation processes and criteria used, including sufficient justification for discounting shortlisted bidders and for award recommendations
- Taking account of customers' views
- Clear explanations of governance arrangements where its parent company is involved in any procurement process
- Consideration of alternative solutions, for example, whether it would be more economic and efficient to carry out activity in house
- Delivering value for money, for example, by demonstrating savings achieved
- Robust benchmarking

3.34 These same principles for determining and demonstrating whether a cost is incurred economically and efficiently are also reflected in the Procurement Strategy for RSC, which DCC is required to comply with under LC16.22. It re-iterates the default procurement approach being the use of a competitive process, unless it is in the interest of all stakeholders not to do so.

3.35 This is also in line with the Government's response to the 2014 consultation on the Procurement Strategy for RSC and Statement of Service Exemptions. In response to that, and consistent with the relevant Licence Conditions, DCC committed to retaining all key procurement documentation and making this available to Ofgem.

3.36 In line with the requirements that are set out in the Procurement Policy and Procedure document, the Procurement Strategy for RSC further requires that alongside any procurement evidence is provided of:

- Approved sourcing strategy outlining the requirement, procurement process, evaluation methodology and suppliers to be invited
- Documented Request for Quote (RFQ) or Request for Proposal (RFP)
- An award report detailing the procurement outcome and recommendation for approval

3.37 We do not agree with DCC's view that the Procurement Policy and Procedure document carries a voluntary status. Notwithstanding the Procurement Policy and Procedure is an internal document, LC16.22 requires to take all appropriate steps within its power to comply with the provisions of the Procurement Strategy for RSC. In turn, the Procurement Strategy for RSC document[33] explicitly requires that "*any procurement activity must be undertaken in alignment to the latest approved version of the [Smart] DCC Procurement Policy and Procedures*". In other words, by not doing so, DCC is not complying with the requirement.

3.38 In some cases, DCC has also referred to the fact that a particular service had been procured using a "call-off contract", meaning that the selected SP had previously been competitively recruited and added to a framework agreement. In accordance with DCC's own Procurement Policy and Procedure, a framework agreement has been established after conducting a competitive procurement process to determine a list of pre-qualified suppliers with predefined services, costs, and contract terms. We do not consider the use of framework contracts appropriate other than for the procurement of frequently purchased goods and services. Also, for the avoidance of doubt, the use of a framework contract does not exempt DCC from having to benchmark and evaluate SPs, nor does it exempt DCC from following the level of due diligence and governance as described above.

3.39 As per our consultation position, we are concerned that DCC may not be consistently complying with the relevant procurement obligations in the Licence, and by extent the Procurement Strategy for RSC as well as the Procurement Policy and Procedures document. We intend to continue to closely monitor this area in the future.

Q7 Order Management System, Customer Engagement Portal, and Executive Leadership Programme

Proposal at consultation*: disallow the costs associated to the Order Management System (OMS), the Customer Engagement project (CEP) and the Executive Leadership programme, amounting to £0.882m in RY21/22, and £0.0395m in RY22/23 for the OMS and the CEP.*

Decision*: remains unchanged from our consultation proposal.*

[33] Section 4.3 – The Procurement Process and Regulatory Compliance

Respondents' views

OMS and CEP

3.40 Most respondents supported our minded-to position.

3.41 Two respondents explicitly raised concerns that customers had not seen any benefits from either the OMS and the CEP, despite both programmes running for years and continuing to incur costs.

3.42 In its response, DCC re-iterated the strategic importance of the OMS and explained that the decision to stop the OMS and CEP was appropriate considering the rising costs and increased complexity of both programmes. DCC further explained that the costs incurred for both programmes in RY21/22 related to ongoing legacy costs of licences.

Executive Leadership Programme

3.43 All respondents except DCC were supportive of our consultation position.

3.44 One respondent commented that the Executive Leadership Programme appears to be an area which should be covered under the Shared Service Charge to Capita. They also observed that DCC had attended several staff events at external facilities and consider these events could have been hosted at Capita facilities instead.

3.45 One respondent suggested that it was not right for DCC Users to pick up costs for training programmes. Another noted that there had not been sufficient evidence that the programme was providing value for money.

3.46 One respondent also noted their surprise at the scale of DCC's leadership team, given DCC's headcount of circa 600 Full Time Equivalents (FTEs).

3.47 DCC did not agree with our consultation position. DCC stated that Ofgem's view, that it lacks sufficient justification that DCC assessed its requirements for senior leadership training prior to signing the contract, is not a question of efficiency and economy. DCC also considered that this amounts to Ofgem determining what its leaders should be trained in, which DCC stated is inappropriate and limits DCC's autonomy.

3.48 DCC also stated that as the service is subscription-based, and therefore fixed price, it was difficult for DCC to understand how Ofgem could disallow the cost on the grounds of inefficiency.

3.49 DCC further explained that its staff had benefited from the training. DCC provided full-service description documents alongside its consultation response, which set out what each staff member receives access to as part of the programme.

3.50 DCC also suggested that Ofgem should instead review how DCC uses this service in RY22/23, given the payment was in advance for services to be provided in RY22/23.

Reasons for our decision

OMS and CEP

3.51 We reviewed all consultation responses and maintain our position that these costs are not economic and efficient. As per prior to the consultation phase, DCC has provided no satisfactory explanation of what it had done to mitigate or prevent the risk of these projects being paused. Nor did DCC provide any more evidence or information around the legacy Licence costs.

Executive Leadership Programme

3.52 After reviewing the consultation responses and additional evidence from DCC, we are maintaining our consultation position to disallow the cost of the Executive Leadership Programme.

3.53 We do not discourage training for DCC staff, and we consider its staff should receive appropriate training and learning & development opportunities. We also do not expect to determine what DCC's staff should be trained in. However, we do expect DCC to ensure any learning offerings are providing value for money and any expenditure is economic and efficient, and for DCC to evidence this under the Price Control.

3.54 We understand it may sometimes be challenging to fully quantify benefits in certain cases. However, as set out in our Price Control guidance,[34] we expect that in such cases DCC should provide evidence of all considerations made at the point of DCC's decision-making, for example a business case explaining the issue to be resolved, any constraints, options considered, and steps followed to arrive at the most cost proportionate and efficient option including assessment of both quantitative and qualitative factors. We do not consider that we have received sufficient evidence in response to our consultation. We note that we requested

[34] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

evidence of assessments DCC had made prior to procuring this service - for example, cost benefit analyses or options analysis - at the Cost Visit.

3.55 DCC's additional evidence provided at consultation explained the level of content members would have access to as part of the Executive Leadership Programme subscription and included a variety of resources. We also recognise that DCC stated it was unable to negotiate a discount due to the service being fixed price. However, we do not consider this argument is sufficient in demonstrating economy and efficiency - we do not have evidence of alternatives DCC considered and their respective costs and service offerings, which led DCC to decide that this programme would be the most economic and efficient option and provide value for money. If this option were to be more expensive than alternatives, we also do not have evidence of any trade-offs DCC may have considered in terms of cost or quality.

3.56 We disagree with DCC's view that there is not a question of economy and efficiency. We consider that if there is not sufficient evidence that DCC has assessed requirements prior to procuring any service, then we do not have assurance that the expenditure is needed or that DCC has incurred the cost economically and efficiently.

3.57 We note that DCC's Learning and Development (L&D) team has expanded, including roles specifically targeted at providing L&D activities. We also note that training is provided in the overhead Shared Service Charge to Capita. Given that DCC's executive leaders should already be well-equipped for delivering DCC's activities, we expect DCC to provide clear and strong rationale for training at senior level, particularly where the associated costs deviate from industry benchmarks, setting out how benefits will be realised and over what period. We also expect DCC to look at what it is getting from Capita under the Shared Service Charge and ensure it is delivering value for money.

Q8 Business Accuracy Programme

Proposal at consultation*: reject all costs (£2.56m) associated with the Business Accuracy Programme (BAP) on the grounds of insufficient evidence of benefits realisation and concerns related to lack of transparency in customer engagement and overlap in scope and Shared Service Charge*

Decision*: remains unchanged from consultation proposal.*

Respondents' views

3.58 Most respondents supported our minded-to consultation position.

3.59 One respondent supported our proposal on the basis that costs in this area were being duplicated elsewhere. Another respondent listed the BAP as an example of a programme where costs had been/may have been incurred without governance or appropriate oversight from DCC Users.

3.60 Two respondents specifically commented that customers had insufficient visibility around the details of the programme, and in particular, information on how benefits would be realised.

3.61 DCC responded that the expenditure that Ofgem has categorised as BAP includes a wide range of Business As Usual (BAU) Change Management activities that were performed for DCC under a different contract (DCCT0296 – Change Management), totalling £1.7m. DCC argued that the bulk of these activities were needed to fill significant gaps in headcount. DCC noted that the focus of the Change Management work relates to:

- Training and supporting the Finance team
- Reviewing the existing Business Planning processes, designing, and delivering an improved framework
- Design, Build and Test of new systems and reporting architecture
- Training and onboarding of staff
- Reviewing and updating Change Delivery Methodology (CDM) and Business Case production

3.62 DCC commented that the work on the BAP nonetheless seeks to deliver robust process, system and data improvements across key business functions including Finance, Commercial, Portfolio and Risk.

3.63 DCC further added that the cost of the BAP in RY21/22 was £0.87m, and that the supporting analysis and model did not include any of the £1.7m Change Management costs. For that reason, DCC argued that if Ofgem wishes to disallow the costs of the BAP because of a lack of cost benefit analysis, it must exclude from the disallowance all Change Management costs under DCCT0296. DCC also noted that DCCT0296 predated the work on the BAP, for which the final scope was only settled in January 2022.

3.64 Following the consultation, DCC submitted a proposed Undertaking for the costs that it considered as being part of the BAP, £0.87m. In summary, the Undertaking proposed by DCC included a commitment:

- Not to spend more than £6.03m on BAP between RY21/22 and RY23/24

- To provide evidence that the BAP activity has provided at least £6.03m of efficiency savings by the end of the current Licence period
- Where achieved efficiency savings by the end of the current Licence period are lower than the incurred costs, to refund the difference to customers
- To report the costs and benefits at a disaggregated level on an annual basis alongside DCC's Price Control submission, describing in detail the actions DCC took to achieve these savings

3.65 As part of the Undertaking, DCC also included a high-level methodology setting out DCC's plans to identify and measure the reductions in the costs of DCC's RSC, leveraging the BAP. DCC noted that the methodology was for measuring the efficiencies and savings was a draft, and that it was willing to work with Ofgem to agree the final methodology by the end of March 2023.

Reasons for our decision

3.66 As part of its consultation response, DCC provided insufficient information or evidence to address our concerns in regard to the BAP costs being not economically and efficiently incurred.

3.67 Following the closure of the consultation period however, and in accordance with LC37.9(a), we consulted with DCC separately to consider whether to accept an Undertaking.

3.68 LC37.8 explicitly allows Ofgem to either:

- *"(a) direct that any External Costs and Centralised Registration Service External Cost or Internal Costs and Centralised Registration Service Internal Cost that it considers were not economically and efficiently incurred…are to be excluded from any future calculation of the Licensee's Allowed Revenue …"; or*
- *"(b) accept an undertaking given by the Licensee with respect to the Unacceptable Costs on terms that relate to either or both of:*
    - *(i) the Licensee's future management of those costs, and*
    - *(ii) the Licensee's future procurement of Relevant Service Capability.*

3.69 During that consultation, we actively engaged with DCC to review and advise on the required content of an Undertaking and test it against the conditions that are set out in the Licence. LC37.9(a)-(d) prescribes the terms and conditions that are relevant for the acceptance of the Undertaking; this is further complemented by the content and factors, as set out in our Guidance.[35] In accordance with those terms and conditions, the Undertaking was required to address the following points:

- The extent to which DCC was able, or should have been able, to control or otherwise influence the occurrence of the Unacceptable Costs, taking due account of the DCC's role in procuring any RSC giving rise to those costs as per LC37.9(b)
- Consider the likelihood that DCC will be able to recover any of the Unacceptable Costs through its future procurement of RSC as per LC37.9(c)
- Consider the likelihood that through appropriate future management actions DCC will be able to avoid, prevent, or mitigate a further occurrence of the same or any similar costs as per LC37.9(d)

3.70 In reviewing the proposed Undertaking from DCC, we concluded that it did not meet the requirements set out under LC37.9. In particular, the Undertaking, and as part of that the methodology for tracking the projected benefits, did not sufficiently set out how and when DCC would be able to recover any of the Unacceptable Costs through its future procurement of RSC.

3.71 We came to the decision that the content of the Undertaking did not meet the conditions in the Licence and therefore was not accepted and as such, we direct that these costs are unacceptable and shall be excluded.

3.72 In respect to DCC's arguments around Change Management, under DCCT0296, we are of the view that evidence strongly suggests that the scope of the work in this area was closely intertwined with that of the BAP. At several points in the process, before as well as during the consultation phase, DCC confirmed the scope of Change Management, including key deliverables such as:

- Refresh of Change Delivery Management (CDM) tools
- Design, Build and Test of a new reporting architecture
- Review of the business planning process
- Training and onboarding of finance staff

3.73 These same activities were presented to customers at various quarterly DCC finance forums (i.e., Q1 and Q2 in 2022, respectively in April and June 2022,

[35] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, paragraphs 3.8-3.9. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

notably after DCC stated it had finalised the scope of the BAP in Jan 22), as part of updates on the deliverables of the BAP. It is also worth noting that the scope of DCCT0296, as explicitly set out in the RY21/22 Price Control submission, included deliverables such as a roadmap for the BAP together with two contract amendments to provide additional PMO support for the BAP.

3.74 Claims from DCC that the costs under DCCT0296 did not form part of the financial model for BAP are for that reason a concern considering the importance of transparency; we expect customers to have full visibility of the total spend and scope of a large investment, such as BAP. Considering these above, we remain of the view that the costs associated to Change Management, under DCCT0296, in RY21/22, are not economic and efficient.

3.75 Going forward, we welcome initiatives that lead to business improvements and cost efficiencies. However, as and when initiatives in these areas are set up, we expect DCC to ensure that the scope of such projects is clearly defined and that customers are presented with a robust cost benefit analysis that supports the investment.

Q9 Shared Service Charge

Proposal at consultation*: Reject Shared Service Charges on non-resource costs for additional baseline activities as well as test lab services.*

Decision*: Reject Shared Service Charges on non-resource costs for additional baseline activities as well as test lab services. Adjust the Shared Service Charge in line with the unacceptable Internal Costs. The revised total disallowance amounts to £0.667m in RY21/22 and £12.094m in forecast costs to the end of the Licence term.*

Respondent's views

3.76 The majority of respondents supported our minded-to position.

3.77 Two respondents raised explicit concerns regarding cross-subsidisation amongst affiliated or related undertakings, and the importance of DCC actively ensuring that it is achieving value for money and not duplicating services which it should be receiving from Capita under Shared Services.

3.78 One of the respondents emphasised that procurements from the parent company, and transfer pricing between connected companies, require special attention and transparency. To improve this area in the future, one respondent suggested that procurements are independently audited, and that future programmes are made subject to greater oversight from DCC Users i.e., via the Panel.

3.79 DCC accepted the reductions of Shared Service Charges from cost disallowances. DCC, however, disagrees that there is a difference in eligibility for Shared Service Charges between baseline and additional baseline activities. According to DCC, the LABP clearly provides for Shared Service Charges on additional baseline activities.

Reasons for our decision

3.80 We have reviewed the responses we received and have not received any justification on why Network Evolution Programme (NEP) non-resource costs should be treated differently from other additional baseline activities' non-resource costs. In previous years, DCC chose to exclude Shared Service Charges on non-resource costs for additional baseline activities such as SMETS1, SMKI (Smart Metering Key Infrastructure), and the Parsing and Correlation Service. We are of the view that the same approach should be followed for NEP and ECOS (Enduring Change of Supplier). We have for that reason decided to maintain our consultation position and reject these charges.

3.81 We disagree with DCC's argument that the LABP provides for Shared Service Charges on baseline and additional baseline activities on the same basis. The LABP makes no explicit reference to that effect.

3.82 As per our position in previous years, we agree with stakeholders' comments that DCC should ensure that the Shared Services Charges deliver value for money. We too expect DCC to actively ensure and evidence that it is achieving value for money from the Shared Service Charge applied to both baseline and additional baseline activities. It is important that there is no 'double counting' between services provided by DCC and equivalent services that should be provided under the Shared Service Charge. We will continue to engage with DCC to ensure the Shared Service Charge delivers value for money.

Q10 EVs and additional products

Proposal at consultation*: to disallow £0.199m (50%) of the costs associated with the product management team in RY21/22, and all forecasts associated with the team, amounting to £0.482m over RY22/23 and RY23/24.*

We also proposed to disallow costs associated with innovation projects and activity relating to EVs in RY21/22. We proposed to disallow £0.150m associated with the development of an EV proof of concept, £0.184m associated with the Living Pillars project, and a residual cost of £0.030m linked to EV engagement work that was procured previously and disallowed in RY20/21.

***Decision**: remains unchanged from consultation position.*

Respondents' views

3.83 All respondents except DCC agreed with our consultation position.

3.84 Four stakeholders considered DCC should be focusing on the core services. One stakeholder noted that the core services are not yet stable and providing a quality service to DCC Users. The stakeholder considered DCC should focus on delivering high quality mandatory services before spending resources on additional activities. Another stakeholder further suggested that DCC would need to fully justify its Electric Vehicle (EV) activities and associated costs to relevant industry governance forums before deviating from the core service.

3.85 Two stakeholders noted that this work is not a mandated requirement in the Licence, and there has not been appropriate instruction or justification for this work.

3.86 One stakeholder commented that DCC should be more cautious of using its monopoly position to gain from a competitive market, especially when there has been no mandate from government or the Authority.

3.87 DCC did not agree with our consultation position. DCC explained that it engaged extensively with senior government colleagues to examine considerations and constraints with widespread domestic charging of EVs, and further discussions regarding load control opportunities. DCC stated this work produced several DCC EV white papers, Proof of Concepts, and propositions to review the interoperability benefits of the use of common systems. DCC stated this work was delivered to government and formed part of the foundations of the subsequent 2022 BEIS industry consultation into the development of a smart and secure electricity system.

3.88 DCC also strongly argued that Ofgem is not interpreting DCC's Licence Conditions correctly in categorising this expenditure as not forming part of the Mandatory Business.[36] DCC then further stated that DCC's General Objectives comprise both the Interim General Objective and the Enduring General Objectives – i.e., not the Interim General Objective alone. DCC stated the Second Enduring General Objective includes the requirement for DCC to carry on its Mandatory Business in the manner that is most likely to facilitate such innovation in the design and

[36] DCC response to Ofgem's Price Control Consultation RY21/22, page 26.

operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation.[37]

3.89 DCC explained how all its work on innovative products in RY21/22 focused on how smart metering infrastructure might be used to support government policies in relation to EV smart charging and Smart Meter Enabled Thermal Efficiencies Ratings, which in DCC's view is what the Licence envisaged DCC should undertake as part of the operation of its Mandatory Business.

3.90 DCC noted that as significantly less than 0.1% of DCC's total expenditure in RY21/22 relates to "innovation", it does not consider there is any validity in arguments that DCC is prioritising such activity over other parts of the Mandatory Business.

3.91 DCC also noted it committed to customers it would keep expenditure on EVs and related activity less than £1m, which DCC stated it did not exceed.

Reasons for our decision

3.92 After assessing consultation responses, we are maintaining our consultation position.

3.93 We note DCC's comments on the interpretation of the Licence. DCC's Licence contains General Objectives which describe how DCC must carry out its Mandatory Business.[38] The Second Enduring General Objective requires DCC to carry on the Mandatory Business in the manner that is most likely to facilitate:

a) effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy under the Principal Energy Legislation;

b) such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation; and

c) the reduction (by virtue of benefits arising from the provision of Value Added Services) of the charges payable for Mandatory Business Services.

Therefore, facilitating innovation in the design and operation of Energy Networks

[37] Licence Condition 5.10(b).
[38] Conditions 5.4 and 5.5 in the Licence describe the Interim General Objective. Conditions 5.9 and 5.10 outline the First and Second Enduring General Objectives respectively.

would be the result of DCC carrying out its Mandatory Business.[39] This does not give scope for DCC to carry out activity which is not part of its Mandatory Business to meet Part (b) of the Second Enduring General Objective.

3.94 The Licence states it is the duty of DCC to carry on the Mandatory Business at all times in accordance with the General Objectives.[40] In addition, the Licence also requires that, in discharging that duty, DCC must have regard to the General Objectives in the round, weighing them as appropriate in each particular case.[41] Regarding DCC's comments that it is not prioritising this activity over the Mandatory Business, we remain concerned that DCC appears to be placing undue focus on innovation activity and the development of new products and proof of concepts, whilst its core service, delivery of critical core projects, and delivery of the First Enduring General Objective[42] is not at a standard its customers require. We expect DCC to focus on the delivery of the Mandatory Business before expanding into exploring additional areas of activity.

3.95 As DCC's incurred costs are recouped through charges to its Users, we do not consider it appropriate that DCC is engaging in exploratory work, which is being charged back to its customers, where there are not defined mandated requirements upon DCC. However, we recognise that DCC may expand into areas past the core service in future. As stated in our RY19/20 Price Control decision, if DCC reaches an appropriate level of maturity and service performance, it may seek opportunities to develop and offer products and services to new customers.[43] Should this be the case DCC must ensure it has appropriate funding models in place to ensure that the costs of developing these products do not fall upon its existing customers.

3.96 We also recognise that EV policy requirements may become part of DCC's business in future. However, work in this area is currently not part of the Authorised Business. We note that the evidence we have seen of government

[39] As defined in Licence Condition 1, the Mandatory Business comprises (i) the Core Communication Services, (ii) the Elective Communication Services, and (iii) the Enabling Services, (iv) the Interoperability Checker Service, (v) Incorporation, delivery and provision of the Centralised Registration Service (Condition 15) in each case as operated or provided by the Licensee in accordance with the relevant provisions of Condition 17 (Requirements for provision of Services)

[40] Licence Condition 5.11.

[41] Licence Condition 5.12.

[42] The First Enduring General Objective requires DCC to carry on the Mandatory Business in the manner that is most likely to ensure the development, operation, and maintenance of an efficient, economical, co-ordinated, and secure system for the provision of Mandatory Business Services under the Smart Energy Code and where relevant the Retail Energy Code.

[43] Ofgem (2021), DCC Price Control Decision Regulatory Year 2019/20, paragraph 3.66. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201920

requests were based around understanding what DCC's system was currently capable of and did not initiate work or the development of products such as the EV proof of concept or the Living Pillars. We do not expect that responding to government requests requires dedicated product staff or the development of products and can be carried out as part of BAU activity by its existing regulatory or operational functions.

3.97 The Licence requires DCC to prepare a Development Plan, identifying factors likely to affect the future development and performance of its business, and the opportunities likely to be available for developing the infrastructure, systems, and processes in place for the provision of Services.[44] In this respect, we recognise that EVs and network reuse may be such activity which could affect the business. However, we do not consider this alone authorises DCC to carry out or initiate significant activity in this area, or justifies dedicated resource and procurement in this area where it is not a mandated requirement. Should DCC conduct work relating to EVs or network reuse, as a result of government request or otherwise, we expect the work to be proportionate to the request, with clarity around arrangements for review, sign-off and funding. We would also expect DCC to be able to provide evidence of such requests.

3.98 While we note DCC has stated it committed to customers to keep innovation costs under £1m, we scrutinise all DCC's costs under the Price Control to ensure they have been incurred economically and efficiently.

Q11 Forecast costs

Proposal at consultation*: to disallow the cost of the Policy and Markets team, amounting to £0.507m in RY22/23 and £0.480m in RY23/24.*

We also proposed to disallow forecast variances associated with unjustified or uncertain costs in RY22/23 and RY23/24 in the Corporate Management, Finance & People, and Operations cost centres (£6.551m), and the Network Evolution, SMETS1, and ECoS programmes (£24.998m). We also proposed to disallow all baseline forecast costs for RY24/25 onwards (£133.819m).

Decision*: remains unchanged from consultation position.*

Respondents' views

3.99 All stakeholders other than DCC supported our consultation position.

[44] Licence Condition 14

3.100 Stakeholders were generally concerned with DCC's headcount and recruitment of senior roles. Two stakeholders commented that they had concerns over DCC continuing to recruit into senior roles against projects which do not contribute to core services. One stakeholder further commented how DCC continues to recruit heavily into senior management roles, especially across customer engagement and regulatory functions, without DCC Users fully understanding the need for these roles and what benefit they provide. One stakeholder commented that they would like to see headcounts and recruitment against each project.

3.101 One stakeholder raised their concerns that DCC was employing a team to lobby for access in competitive markets. Two raised concerns that DCC was hiring roles in readiness for the Licence review process, which in one stakeholder's view should be funded by Capita - and not paid for by DCC customers (and ultimately energy consumers).

3.102 Stakeholders also commented on DCC's forecasting. One stakeholder raised concerns that DCC is still predicting increases in baseline forecast costs to the end of the Licence term, where in fact they would expect to see reductions. Another commented that DCC consistently overestimates costs against programmes and SEC modifications, eroding confidence in DCC's forecasting. They noted they would welcome closer alignment of the DCC Charging Statements and invoicing with its Price Control forecasting.

3.103 One stakeholder noted that they are supportive of DCC improving customer engagement. However, they expect to see significant improvements in customer engagement to justify the new roles relating to Strategic Customer Engagement in the Corporate Management cost centre. They would expect to see improvement in how DCC collects and acts on feedback from customers regarding business planning and developing SEC modifications.

3.104 One stakeholder commented that the forecast variance on DCC-led programmes had each encountered delays and issues due to factors within DCC's control and agreed with disallowing the forecasts. Another noted that due to volume effects and/or experience curve that costs should generally be reducing, though recognised that other cost drivers may be relevant.

3.105 DCC did not agree with our disallowance of the forecasts for the policy and markets team. DCC stated its interpretation of Ofgem's position was that Ofgem disagrees that DCC should have these skills in the organisation, rather than proposing a disallowance on the grounds of DCC choosing an uneconomic route to bring such resources into DCC.

3.106 DCC argued that Capita's original Licence bid contained provision for resources related to strategy and innovation, and that DECC[45] anticipated and accepted that permanent resources should be devoted to strategy and innovation. DCC further explained that the scope of this activity outlined in the tender bid included horizon scanning of drivers for development. The Licence bid also included that the strategy manager would monitor forthcoming changes in regulations and technological advancements to ensure DCC supports Service Users in meeting their requirements. DCC noted its disappointment that over time the scope of DCC activities has been narrowed.

3.107 DCC pointed to its Second Enduring General Objective[46] and the related SEC Objective,[47] which requires DCC to carry on the Mandatory Business in the manner which is most likely to facilitate such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation.

3.108 DCC also explained that Licence Condition 14 requires DCC to prepare and maintain a Development Plan, which annually sets out DCC's business development objectives for the next five-year period. DCC states it is therefore required to review the main changes in the market, and also engage with SEC and REC parties to determine market trends.

3.109 DCC stated these requirements are resourced and discharged through the Policy and Markets team, and the increase in the pace and development in the energy sector has created a significant increase in the number and variety of enquiries from existing and new/potential market participants.

3.110 DCC did not comment on the remaining proposed forecast disallowances across the cost centres and programmes.

Reasons for our decision

Policy and Markets team

3.111 After reviewing consultation responses, we are maintaining our consultation position and disallowing the forecast costs of the Policy and Markets team across RY22/23 and RY23/24 (noting there were no incurred costs in RY21/22).

[45] Department of Energy and Climate Change, who awarded the Licence to DCC
[46] Licence Condition 5.10(b)
[47] The Fifth General SEC Objective – part D 22.15

3.112 We have not received sufficient justification for the creation of the team, nor why DCC was unable to respond to stakeholder requests with existing resource. We noted in our consultation that we requested DCC to provide evidence of the level of requests DCC was previously receiving, and evidence of how they had increased such that DCC decided it necessary to create a team dedicated to this area. We did not receive further evidence as part of DCC's consultation response.

3.113 We note the original Licence bid contained capacity for a strategy role, and the Licence requirement for DCC to prepare and maintain a Development Plan. Therefore, we do expect that as part of its regulatory team DCC would have staff to carry out the horizon-scanning activities and ensuring DCC continues to meet User needs. In fact, we note that DCC already has existing staff who carry out these activities as we would expect - DCC has been preparing a Development Plan annually since 2014, in line with Licence Condition 14, which includes carrying out the horizon-scanning activities outlined in the Licence. We have not received justification on why this activity now requires an expansion in DCC's headcount.

3.114 We scrutinise DCC's hiring practices such as recruitment costs and benchmarking, ensuring DCC hires at an appropriate benchmark. We also scrutinise increases in headcount and justification for additional roles to ensure any expansion is justified as economic and efficient, and in particular justification for new senior roles. We consider that DCC already has staff within its organisation who engage with government and wider stakeholders and are able to hold conversations about what the DCC system may be capable of and have not received evidence to contradict this. We are concerned that DCC is expanding its resource such that incurred costs are beyond what would be required and what would be considered as being economically and efficiently incurred. We remain unconvinced of the reasons for this and urge DCC to ensure any increases in headcount are properly justified under its Licence.

Forecast costs in cost centres and programmes, and baseline forecast costs

3.115 The majority of stakeholders explicitly supported our position, and we are maintaining our consultation position to disallow the unjustified forecast costs in the cost centres (£6.551m) and programmes (£24.998m), and baseline forecast costs to the end of the Licence term (£133.819m). We did not receive additional evidence from DCC to further justify the forecast cost variances in Corporate Management, Finance and People, and Operations cost centres. We also did not receive additional evidence for forecast cost increases in the SMETS1, Network Evolution, and ECoS programmes. We note there is significant ongoing uncertainty in the programmes and will continue to scrutinise this area in upcoming Price Controls.

3.116 We note DCC has taken steps to improve customer engagement and increased the FTE in its Strategic Customer Engagement team. We expect to see improvements in customer engagement next year to justify this increase in the team and will keep this area under review.

3.117 We also note that DCC created a document writing unit to prepare business cases in line with H.M. Treasury guidance. While we would expect that DCC should already be producing high-quality business cases with its current staff, we understand this increased capacity may be necessary due to the insufficient quality of business cases it was developing previously. However, we expect to see clear evidence next year that business cases are of appropriate quality and have been produced in a timely manner, thus justifying the requirement for the team in future years.

3.118 We did not receive sufficient justification that the forecast variances in the People team or the Commercial Finance team were economic and efficient, or sufficiently certain.

3.119 In general, while we recognise DCC and stakeholders would wish to align the forecast costs in the Price Control with the forecasts in the Charging Statement, we note that these processes serve different purposes, and we expect to apply certainty criteria to forecasts under the Price Control. We therefore expect DCC to ensure that forecast variances meet the certainty threshold.

3.120 Regarding baseline forecast costs, we note that DCC usually provides justification for two years of forecasts and does not attempt to justify any costs it expects to incur after these two years. This is because costs may become more uncertain the further into the future they are. We historically disallow these forecast baseline costs until the end of the Licence term due to the lack of justification. However, in line with the points raised by stakeholders, we would also expect DCC to be committed to finding efficiencies and delivering value for money. We also expect DCC, as part of its BAU activity, to provide greater certainty over its forecasts and communicate these costs effectively to customers.

4. Performance Incentives

Section summary

This section covers DCC's submission of its performance under the Operational Performance Regime (OPR), which includes System Performance, Contract Management, and Customer Engagement Incentives. There are no decisions to be made on the Baseline Margin Project Performance Adjustment schemes (BMPPA) for RY21/22.

In our consultation we proposed to make a reduction to the Baseline Margin (BM) associated with the Baseline Margin Operational Performance Adjustment (BMOPA) terms SUM1 and SDM2 as DCC missed its targets for these system performance measures.

For the contract management incentive, an auditor assessed DCC's performance against the National Audit Office (NAO) framework according to the scope set out in the OPR Guidance. After assessing the auditor's final report, we award a score of 1.33 as suggested by the auditor, corresponding to a BM reduction of £0.338m.

For the customer engagement incentive, we received submissions from both DCC and SEC Panel on DCC's performance during RY21/22. After assessing both submissions we award a score of 1.42 to DCC, corresponding to a reduction of DCC's BM by £0.535m.

Following consideration of the consultation responses our position for all sections of the OPR above remain unchanged.

Questions posed at the consultation

12. What are your views on our proposed position on DCC's System Performance?
13. What are your views on our proposed position on DCC's Contract Management?
14. What are your views on our proposed position on DCC's Customer Engagement?

Background

4.1 All DCC's BM (including adjustments) is at risk against one of DCC's performance regimes.[48]

4.2 This is the fourth year in which DCC's performance is being assessed by the OPR.

4.3 In RY21/22 there were no projects to be assessed under the BMPPA regime. R2.0 was finalised in RY20/21 and there were no relevant milestones for the SMETS1 and ECoS programmes.

[48] See Part C of LC 38 of the Smart Meter Communications Licence.

4.4 Separately to the BM, DCC receives margin on the Switching Programme. This switching margin is at risk under a separate performance regime, which is covered in Section 6 of this document.

Operational Performance

Background

4.5 We became concerned, following DCC's submission of its performance under the OPR for the RY18/19 Price Control, that the OPR metrics may not be providing the best incentives to DCC. We asked stakeholders in our DCC Price Control RY18/19 consultation for their views on how the OPR could be modified and improved. All respondents, including DCC, agreed with our concerns and supported a review of the original OPR framework.

4.6 Following consultation, in October 2020 we published our decision[49] to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management. As part of our decision, we also implemented a Licence change to enable Ofgem to publish guidance, regarding the process, procedures, and criteria of the OPR.[50]

4.7 In March 2021, we published the OPR Guidance to enable implementation, and published a revised OPR Guidance document in March 2022.[51] This included setting the performance levels and values for the system performance penalty mechanisms, and detailed processes for the customer engagement and contract management incentives. We did a trial run in RY20/21 for customer engagement, without margin attached, for the incentive to come into effect with margin attached in this regulatory year RY21/22. While we were unable to conduct a trial for contract management, we set out in our RY20/21 Price Control decision[52] that the incentive would come into effect with margin attached to this regulatory year as originally intended. We decided to implement a 12-month grace period ("Transition Year") for system performance measures this year, for the new regime to come into effect in RY22/23.

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[49] Ofgem (2020), DCC Operational Performance Regime Review: October 2020 Decision. www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision
[50] The relevant changes were made to Licence Condition 38.9
[51] The original and revised OPR Guidance documents can be found at: Ofgem (2021), Decision on OPR Guidance March 2021. www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021
[52] Ofgem (2021), DCC Price Control Decision Regulatory Year 2020/21. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021

4.8 The total BM at risk for RY21/22 is £6.76m. In accordance with the OPR Guidance, 70% of this margin is associated with system performance, 15% is associated with customer engagement, and 15% with contract management.

Q12 System Performance

***Proposal at consultation**: Under the OPR, DCC missed its target performance levels for the SUM1 (DCC service desk), and SDM2 (Core service requests) system performance measures. In light of this, we proposed that DCC should only retain partial margin associated to these measures in application of the OPR Guidance. This resulted in a proposed Baseline Margin (BM) reduction of **£0.531m**.*

DCC also missed its targets for SUM2a (delivery of communication hubs), however DCC applied for three OPR Exceptional Event requests with industry, which were approved by the SEC Panel. We proposed to accept the SEC Panel assessment, resulting in DCC achieving the OPR target for this measure.

***Decision**: remains unchanged from consultation proposal.*

Context

4.9 RY21/22 was a Transition Year, which was set out in the original OPR Guidance (March 2021)[53]. Under this transitional regime, DCC was assessed on its system performance against a version of the original OPR. The revised OPR will come into effect for system performance in RY22/23.

4.10 The original OPR consists of five performance measures: two Service User Measures (SUM) and three Service Delivery Measures (SDM). These were equally weighted in the original OPR, however for the Transition Year the weighting has been amended, and SDM1 (DCC Wan coverage) has been dropped from the measures as it was fully achieved in RY20/21 (so is now defunct). Table 4.1 lists the four measures and subdivisions for the Transition Year.

Table 4.1: Operational Performance Measures

Measure	Area of reporting	Metric	Weighting
SUM1	DCC service desk	Percentage of incidents resolved within Target Resolution Time	17.5%

[53] The original and revised OPR Guidance documents can be found at: Ofgem (2021), Decision on OPR Guidance March 2021. www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021

Measure	Area of reporting	Metric	Weighting
SUM2a	Communication hubs	Percentage of Communications Hubs delivered on time	8.75%
SUM2b		Percentage of Communications Hubs accepted by customers	4.375%
SUM2c		Percentage of Communications Hubs not faulty at installation	4.375%
SDM2	Core service requests	Percentage of service responses delivered within Target Response Time	17.5%
SDM3	Service/System availability	Percentage availability of Data Service, User Gateway, Service Management System and Self Service Interface	17.5%

4.11 These OPR performance measures are composed of a selection of the performance measures reported to the SEC and described in DCC's Performance Measurement Methodology.

Respondents' Views

4.12 Four respondents disagreed with the proposal that DCC should retain any level of margin associated with the SUM1 performance measure due to this service not being satisfactory. For example, one respondent explained that for most months during RY21/22, industry was updated with reports of multiple Target Service Level failures that had a detrimental impact on DCC Users' systems and operations which, in many cases, resulted in a poor experience for consumers.

4.13 One of these respondents who disagreed with our position, also raised concerns that the CH (Communication Hubs) delivery deferrals had not been correctly reported and therefore DCC would not be completely covered by the SEC Panel exemptions in relation to SUM2a.

4.14 Two respondents also reiterated concerns raised last year that the RIGs template does not capture DCC's performance in the same way as the Performance Measurement Report (PMR) and allows DCC to hide poor performance in average calculations. One of them requested Ofgem to provide transparency on the data reported by the DCC, and which elements of the SUM1 had resulted in DCC missing their milestone. Another respondent also raised the continued DCC performance challenges faced in the CSP-N and argued that it was not acceptable that DCC was allowing a service disparity between CSP-N and CSP-C&S to persist over several years.

4.15 Two respondents (excluding DCC) supported our proposal to make a reduction to the BM associated with the SUM1 and SDM2 measures. Another respondent provided insight of the DCC user experience of DCC systems and operational services but did not explicitly support or reject our proposed position. However, they acknowledged the need to treat this RY as a transition period.

4.16 DCC accepted our assessment of its operational performance in RY21/22.

Reasons for our decision

4.17 We have reviewed all the responses received. Whilst we acknowledge all comments made in relation to the system performance values provided by DCC, we consider that there is insufficient evidence for us to change our consultation position.

4.18 We understand respondents' views that the service measured by SUM1 was not satisfactory for DCC customers, and note their feedback that DCC should, therefore, not retain any margin associated with this measure.

4.19 In our consultation we acknowledged that DCC did not meet its target performance levels for the SUM1 measure. We therefore proposed a reduction of the associated margin consistent with the default position of the OPR of £0.305m (this is a 26% margin reduction).

4.20 After considering stakeholders' responses to the consultation, we do not have enough evidence to revisit our consulted position. We have reached this decision based on the following arguments:

- References to customer detriment or harm due to poor service were generally vague and/or not quantified.
- We were proposing a reduction to DCC's BM associated with measure SUM1.
- RY21/22 was an interim year for OPR. We are aware the OPR metrics do not fully reflect customer's experience on some occasions, and as a result we are implementing a new OPR regime from RY22/23. Our long-standing position is that our preferred approach to address disparities between customer's

experience and OPR outcomes is for DCC to work with its customers to find viable alternatives to the existing OPR. Departing from the OPR as part of our Price Control decision should only be used as a last resort mechanism under exceptional circumstances.

4.21 Our view is that we need to have sufficient evidence that applying the OPR as it stands would result in an unreasonable position, to justify moving away from it. In light of the above, we remain of the view that our consultation position – a reduction of the associated margin in line with the default position of the OPR – is a reasonable outcome.

4.22 In relation to the concerns around the potential misreporting of the CH delivery deferrals, it is our position that the overview of DCC's reporting of technical data to industry as part of the PMR is outside of the scope of the Price Control mechanism. We would encourage industry members to raise any issues in relation to the PMR reporting with SEC OPSG or any other relevant industry forum as soon as these issues come to their knowledge, so that the data from the PMR that is used for the purposes of the OPR is as accurate as possible.

4.23 A successful application was granted from SEC which authorised DCC to achieve its targets. As a result, we are unable to move away from our consultation position as SEC followed standard procedures before reaching the final decision.

4.24 Regarding the stakeholders' comments that the Annex 1 RIGs Reporting Template[54] used by the DCC to report its performance level to us for the purposes of the OPR does not capture DCC's performance in the same way as the PMR, and allows DCC to hide poor performance in average calculations, we would like to highlight the following:

4.25 DCC completed its OPR performance levels in line with our Regulatory Instructions and Guidance (RIGs)[55] and associated guidance document[56], using the spreadsheets provided in our Annex 1 RIGs Reporting Template.[57] DCC is required to populate its performance values in relation to the various performance measures as described in Annex 1 RIGs Guidance. We are satisfied that the

[54] Ofgem (2022), Annex 1 RIGs Reporting Template. www.ofgem.gov.uk/sites/default/files/2022-06/annex_1_rigs_reporting_template_quality_of_service_information.xlsx
[55] Ofgem (2022), Data Communications Company (DCC): Regulatory Instructions and Guidance. www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2022
[56] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[57] Ofgem (2022), Annex 1 Quality of Service Information. www.ofgem.gov.uk/sites/default/files/2022-06/Annex%201%20RIGs%20Guidance%202022.pdf

performance measures calculations in Annex 1 RIGs Reporting Template correctly apply the general formulae defined in the OPR Direction[58] and the methodology set out in the RIGs guidance documents. Appendix 2 of our RIGs Annex 1 document[59] describes the measure methodology as modelled in the Annex 1 RIGs template. This provided us with the relevant values to interpret DCC's performance in relation to the OPR.

4.26 The current OPR framework was initially agreed through consultation with stakeholders in 2017.[60] However, in RY18/19 we noted this framework did not fully reflect customer experiences as the measures solely focused on a narrow range of DCC's technical outputs. There were also concerns that the current OPR did not effectively incentivise DCC. It is vital that DCC is incentivised appropriately to ensure it is operating effectively and delivering better outcomes for customers.[61]

4.27 As a result, we have revised the OPR measures and are implementing a new OPR framework which aims to better capture DCC's performance in future regulatory years.

4.28 To conclude, as there are no changes to our consultation position, the BMOPA term in relation to System Performance Measures is calculated to be -£0.531m.

Q13 Contract Management

Proposal at consultation*: award a score of 1.33 to DCC, as awarded by the auditor in its report, corresponding to a £0.338m reduction of margin.*

Decision*: remains unchanged from consultation position.*

Context

4.29 RY21/22 was the first year the contract management incentive came into effect with margin attached.

4.30 An independent auditor assessed DCC's performance in contract management and procurement, in accordance with the OPR Guidance. The auditor produced a final report on the findings and awarded a score of 1.33 out of a possible 2 to

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[58] See, Ofgem (2021) OPR Direction, section B.
www.ofgem.gov.uk/sites/default/files/docs/2021/03/opr_direction_0.pdf
[59] Ofgem (2022), Annex 1 Quality of Service Information, Appendix 2.
[60] Ofgem (2017), Decision on DCC's Operational Performance Regime.
www.ofgem.gov.uk/publications/decision-dccs-operational-performance-regime
[61] Ofgem (2020), Operational Performance Regime Working Paper.
www.ofgem.gov.uk/publications/dcc-operational-performance-regime-working-paper

DCC, using the scoring framework set out in the Guidance. The auditor also provided a set of recommendations for improvement.[62]

Respondents' views

4.31 Respondents were broadly supportive of our consultation position, with four providing explicit agreement. No stakeholder disagreed with our position.

4.32 One stakeholder raised their concerns that DCC had not competitively procured contracts, as highlighted by Ofgem's Price Control assessment, and noted the gap in the contract management audit between reviewing the FSPs and smaller contracts which were not competitively procured.

4.33 One stakeholder considers that a new approach would be needed to give DCC a clear incentive to deliver against all recommendations made in the report. They commented that there would be six months from DCC seeing the auditor report until Ofgem decides on the Price Control, during which time DCC could implement or make significant progress on defined action plans to deliver the recommendations. The stakeholder suggested that if DCC made no progress then the full £1.014m margin available should be disallowed.

4.34 One stakeholder commented they would like to see procurement activities receive greater scrutiny in the next audit. They also provided several suggestions as to what other activity should be included in the next audit, such as measures to track shortfalls in contract management and service quality needs, Working Capital Charges, SEC mod impact assessments and demonstration that DCC has taken steps to improve following auditor recommendations.

4.35 DCC expressed its disappointment that there had been no trial year for contract management but accepted Ofgem's position.

4.36 DCC explained how it had implemented improvements following the first-year audit, including strengthening leadership of the commercial function, implementing a revised lessons learned process, and development of commercial strategies. In addition, DCC stated it has started implementation of its commercial transformation programme.

[62] For the auditor's findings, see: Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 4.24-4.35. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

Reasons for our decision

4.37 After assessing consultation responses, we are maintaining our consultation position and awarding a score of 1.33 to DCC. This corresponds to a £0.338m reduction in margin, out of an available £1.014m.

4.38 We note stakeholders' concerns around DCC's contract management and procurement practices and discuss our own concerns in paragraphs 3.55-3.63.

4.39 We welcome that DCC expects to make improvements to its contract management following the auditor's report. However, we expect DCC to ensure any costs incurred as a result are economic and efficient. All of DCC's incurred costs including those made as part of transformation activities will be subject to Price Control.

4.40 We consulted on changes to the contract management scoring framework in the OPR Guidance and expect to publish our decision at the end of March. We considered three options to amend the scoring, which we expect should increase flexibility in awarding a score to DCC and increase the auditor's ability to take poor, improved, satisfactory and good performance into account. We expect that additional areas mentioned by stakeholders for further scrutiny fall within the existing scope of the audit, and these areas may receive greater focus in the second-year audit.

4.41 We also expect that the second-year audit will be able to provide a more in-depth view of areas identified as concerns in the first year and may include assessing how DCC has improved against the recommendations provided.

Q14 Customer Engagement

Proposal at consultation*: based on the submissions from both DCC and SEC Panel, we recommend an overall score of 1.42, corresponding to a £0.535m reduction of margin.*

Decision*: remains unchanged from the consultation proposal.*

Context

4.42 For the first time, DCC's customer engagement is financially incentivised under the new OPR. DCC's performance in this area was assessed based on qualitative submissions received from both DCC and SEC panel. The assessment covered 3 sections: timing and frequency of engagement; quality of information provided by DCC; and accountability of customer views.

4.43 The three sections under customer engagement each have three assessment questions with relative weightings. The individual weighting for each assessment question is calculated as one third of its section weighting, with the overall score calculated using a weighted average of the scores specified for each question. For full details on the scoring methodology please refer to our guidance.[63]

4.44 To inform the scoring, we received submissions from both DCC and SEC Panel on DCC's performance during RY21/22 against the criteria set out in the OPR Guidance. We considered both the submissions and evidence provided to assess DCC's customer engagement performance in RY21/22.

Respondents' views

4.45 Of the eight responses we received to our consultation, three respondents agreed with our score of 1.42 for DCC's customer engagement under the revised OPR. The remaining 5 respondents felt DCC's score should have been lower and more in line with the scoring of SEC Panel.

4.46 One respondent acknowledged that DCC's customer engagement is slowly improving but remains 'mixed'. They highlighted areas where the end consumer's experience, or impact, is an 'afterthought' particularly in project delivery. This respondent also raised concerns at the expanding customer engagement team. They have also had great difficulty in seeing feedback represented in DCC's decision documents or consultation responses. One suggestion was that DCC should summarise feedback by large/small energy suppliers, network owners, other users, consumer groups etc for a greater understanding.

4.47 Another respondent outlined that DCC's performance needs to improve, particularly on their CSP-N performance. Whilst this respondent has seen some improvements in the DCC engagement with the DNO community in the last year regarding operational matters, they feel feedback is ignored or not addressed by DCC. This respondent felt that when DCC disagrees with feedback provided, it typically remains silent and proceeds 'without explanation or justification'.

4.48 One respondent highlighted that whilst additional cost transparency is provided through the Quarterly Finance Forum (QFF), there is no granular level of cost information provided. This respondent feels customers should have access to lower levels of cost information to offer an informed view about DCC spend. They

[63] Ofgem (2022), Revised OPR Guidance (March 2022), section 4: www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021

also highlighted that although a DCC email address is provided for correspondence, queries are often not answered within an acceptable timeframe.

4.49 One respondent supplied recent examples of poor stakeholder engagements within the Business Plan and the SEC modification refinement. They have concerns that DCC's customers have not been able to fully scrutinise costs on these key programmes. They also requested Ofgem further investigates how DCC engages with users regarding their annual business planning and stated in the future that DCC should work with SEC parties collaboratively in refining SEC modifications.

4.50 Another respondent raised concerns that DCC has continued to 'recruit heavily in senior management roles' without DCC Users fully understanding the need for these roles and what benefit they provide to DCC Users.

4.51 Some respondents mentioned that they believe the scoring system for Customer Engagement is flawed and should be revised. Two suggested it should increase to a score out of 5, with 5 being excellent and 1 being very poor. These respondents think that this new scoring range would give increased granularity and might help to provide a more flexible and accurate score.

4.52 Respondents generally acknowledged that DCC is making some efforts in seeking improvements within the customer engagement space, but there are still inconsistencies with the level of customer engagement delivered to stakeholders. There were examples of DCC having good engagement with papers delivered on time, whereas there were other examples where papers were provided late or withdrawn at short notice.

4.53 DCC responded by saying the trial year was a useful learning experience and it worked hard to act on the findings and to improve their submission to Ofgem. DCC stated it is analysing the feedback from customers, SEC Panel and Ofgem and will work on improving its performance. DCC accepted Ofgem's assessment of its performance in RY21/22.

Reasons for our decision

4.54 We have reviewed all the responses received. We have considered all sides and we consider there is not enough additional evidence to alter the scores. We maintain our consultation position of assigning a score of 1.42 for DCC's customer engagement for RY21/22.

4.55 Whilst there is evidence of some improvements with DCC's timely engagement and closing the feedback loop, we are aware of some inconsistencies and customer frustrations. We encourage DCC to continue to engage in the appropriate forums and to take feedback on board. We also encourage DCC to produce more granular levels of cost information, which will be useful for stakeholders to better understand DCC's spend.

4.56 We note concerns about the increases in DCC's Strategic Customer Engagement team. As noted in our consultation, we expect to see improvements in DCC's customer engagement next year to justify the increases in this team and would not expect DCC to expand further. We encourage DCC to provide greater clarity on the roles of their expanding customer engagement team and how these new roles will benefit the customer.

5. Baseline Margin and External Contract Gainshare

Section summary

This section summarises DCC's application for adjustments to its Baseline Margin and External Contract Gain Share.

The BM will be adjusted to reflect changes to DCC's Mandatory Business. After consideration of consultation responses, we have decided to maintain most of our consultation position. However, we have decided to accept some of the BM activities that we were proposing to reject in our November 2022 consultation. In addition to this, we have also adjusted the BM to reflect changes to Internal Costs disallowances. We have directed an adjustment of £7.435m.

The ECGS will be adjusted to reflect the costs the cost savings DCC has achieved through refinancing and its in-house Test Labs Service. After consideration of consultation responses, our consultation position remains unchanged. The total awarded ECGS Adjustment amounts to £11.889m.

Questions posed at the consultation

15. What are your views on our assessment of DCC's application to adjust its Baseline Margin?
16. What are your views on our assessment of DCC's application to adjust its ECGS?

Q15 Baseline Margin

Proposal at consultation: *adjust DCC's Baseline Margin by £6.969m (in RY21/22 prices) for work being performed between RY21/22 and RY23/24.*

Decision*: revised in light of further clarity from DCC on how certain BM activities that we were proposing to reject, now meet the criteria for a BM adjustment. This represents an upward adjustment of £7.435m.*

Context

5.1 The BM adjustment mechanism allows DCC to apply for a Relevant Adjustment to the Baseline Margin values specified in Appendix 1, LC36. The adjustment mechanism is detailed in Appendix 2, LC36.

5.2 The BM adjustment mechanism was included in the Licence in recognition of the uncertainty of the nature and risks of DCC's Mandatory Business over the Licence term. The adjustment mechanism is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business – including the volume, characteristics, risks, and timescales of these activities. Greater detail on the conditions and requirements for a BM Relevant Adjustment can be found in the RIGs[64] and the processes and procedures document.[65]

5.3 DCC's BM (including adjustments) is subject to DCC's performance regime under which its BM may be reduced for poor performance. 100% of the BM is put at risk under the OPR and by a Baseline Margin Project Performance Adjustment Scheme, as directed by the Secretary of State.

Respondents' views

5.4 All the respondents that answered this question (except DCC) supported our consultation proposal for the BM adjustment.

5.5 One stakeholder noted our comments in the Consultation document that DCC's initial submission was not of the right standard.

5.6 Whilst DCC supported our proposals for BM adjustment, it contested our proposal to reject BM adjustment for activities and grounds that we thought were not properly justified or that did not meet the conditions in the Licence. DCC also noted that a significant proportion of the proposed reductions were the direct result of disallowances of forecast costs.

5.7 DCC disagreed with the following three grounds under the Operational Change driver that we proposed to reject:

- Ops – Moving Beyond ITIL
- Ops – Scope of Support and
- Operational Resilience – Early Life Support

5.8 DCC argued that:

- There were no non-resource costs in its application (when in our consultation position, we proposed to reject the BM adjustment for both the resource and non-resource costs under these grounds)
- It provided a detailed description of the reasons for these activities in the submission

[64] Ofgem (2022), Data Communications Company (DCC): Regulatory Instructions and Guidance. www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2022
[65] Ofgem (2021), DCC Price Control Guidance: Processes and Procedures. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

- These costs were accepted in the past and there has not been an underlying change, therefore, rejecting the margin for these costs now would not be rational

5.9 In regard to the rejection of margin related to the activity HMT Business Case Development, DCC contested our proposal on the basis that:

- DCC does not accept our view that "DCC should have been applying a robust methodology to ensure its procurement policy delivers value for money in prior years" for two reasons: a) DCC argued the reason BEIS introduced the provisions for DCC to deliver HMT compliant business cases was because it wanted to hold DCC to a much higher standard than previously; and b) the licence changes were specifically related to the increase in new programme activity that DCC was expected to deliver. DCC did not have the dedicated resources in post to formulate MHT compliant business cases in any prior year.
- DCC rejected our view that it has missed the application window because the grounds arose in May 2020 when the Licence was changed. DCC thought that our position here is inconsistent with our stated position on ECGS[66] which uses the same wording in the Licence as the BMA provisions. In particular, DCC argued that applying the same approach to the BMA, the grounds would first arise when DCC had signed a contract with the contractor, which happened during RY21/22, and hence the Application Window had not been missed.

5.10 In relation to the activities under the drivers: Security Driven Change, Facilitating Additional Relevant Services, and Resource Planning and Management, which we considered to be allocated to unrelated drivers and poorly justified, DCC argued the following:

- that its policy on allocating certain expenditure types to drivers matches previous applications that we have approved, which DCC considers to be a reasonable approach in the absence of more detailed guidance. For example, IT-related costs have always been assigned to the Security Driven Change driver.
- In regard to Facilitating Additional Relevant Services, DCC argued that the margin associated with Brabazon accommodation costs was approved in

[66] DCC referred to our statement in RY20/21 Price Control decision. Ofgem (2022), DCC Price Control Decision Regulatory Year 2020/21, paragraph 5.24. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021

RY20/21 under this driver, and that this year they have simply adopted the same approach. Therefore, this is the correct ground to make its application. DCC also did not believe that for ongoing cost items such as these, it was appropriate to make a full and comprehensive submission justifying every item of spend in detail as if it had been raised for the first time.

- In relation to Resource Planning and Management costs, DCC reiterated its argument that it has evolved into a multi-programme organisation with more concurrent programmes than at any stage during its existence. Therefore, DCC has needed to adapt and evolve its business processes, planning, monitoring, and reporting.

5.11 Finally, DCC raised concerns that there was an inconsistent understanding of how the BMA mechanism works and what it is designed to do, and it would appreciate further engagement with Ofgem during the remainder of the reporting year.

Reasons for our decision

5.12 We have considered the responses we received, including DCC's representations.

5.13 The three grounds related to the Operational Change driver were rejected in RY20/21 on the basis of a lack of justification received from DCC. Furthermore, while DCC provided some justification for the overarching Operational Change driver, no specific justification was provided for these three grounds. Notably, DCC did not address how these grounds meet the Licence criteria for a BM adjustment of a material change in volume, complexity and/or timescales. No further justification was provided as part of DCC's response to our consultation. In light of the above, our position remains unchanged. We confirm, however, that only resource activities were included in the BM adjustment application for these three grounds, and these are the activities we are rejecting.

5.14 In relation to HMT Business Case Development, we do not agree with DCC's arguments:

- We do not accept that the alignment of certain procurement processes to the HMT Green Book ("Green Book") appraisal standards is considered a material change. It does not constitute a material change in either the total volume and/or the characteristics of the activities. We expect DCC to already run a well organised and documented procurement process to a high standard in any event. The Green Book is guidance issued by HM Treasury on how to appraise policies, programmes and projects by government and the wider public sector and applies to all proposals that concern public spending[67]. It is, therefore, concerning that DCC seems to think the standards set out by the Green Book guidance are "much higher" than the standards it has been applying to their procurement process prior to the Licence Change. We do not consider this as reasonable justification for a BM adjustment.

- We also reject DCC's view that the BMA and ECGS should apply the same definition for when a ground first arises. Both mechanisms serve different purposes and are very different in nature. In our view, the application of DCC's interpretation would imply a departure from the current BM adjustment model as it has been applied by both DCC and us. For example, it could result in the rejection of all BM adjustments that are associated to forecasted costs for which contracts have not yet been signed. Furthermore, we would like to note that DCC also missed a second potential Application Window a year later in July 2021.

5.15 In relation to the IT activity applied under the Security Driven Change driver (Workspace Agility): we acknowledge that in the past we have accepted BM adjustments for IT related costs applied under this driver. We also recognise that there is an overlap between IT or technology driven change and Security Driven change since new technology can indeed increase the security of the network. For example, some important IT programmes within DCC have been driven by security concerns (such as Enterprise IT). Therefore, we recognise that in this case DCC might have had a reasonable expectation that it was applying for a BM adjustment under the appropriate driver. Considering the above we have reconsidered our position and have decided to accept the BM adjustment related to this activity.

5.16 However, it is apparent that the scope of the Security Driven Change driver has broadened over the years and that some IT related costs applied under it are not driven by security concerns.

5.17 In relation to Facilitating Additional Relevant Services, we note that this driver was initially used (and approved by us) in relation to Brabazon House costs, such as the Test Labs. For RY21/22, DCC however applied for a BM adjustment for several activities under this driver that either do not have any relation to Brabazon House, or for which no justification was provided. As we noted in our

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[67] HMT (2022), The Green Book. www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent/the-green-book-2020

November 2022 consultation, when DCC applies for BM adjustment for activities under existing drivers or grounds, it should be clear how those activities are relevant to them. If the activities are unrelated to any existing drivers or grounds, then DCC should be able to demonstrate how they meet the Licence criteria for a BM adjustment.

5.18 More specifically, in its submission DCC distinguished between "Brabazon House / Test Lab Operator" related activities and "other activities facilitating additional relevant services." For the avoidance of doubt, we have decided to reject the BM adjustment that is related to "other activities" only; that is for those activities which DCC was unable to demonstrate how they met the relevant Licence criteria on their own merit (this is, not relying on previous justifications for the Facilitating Additional Relevant Services driver). These activities are:

- PA Capability Maturity Assessment
- Deloitte Tech Strategy
- HMT Green Book

5.19 In light of the above, our position on Facilitating Additional Relevant Services driver remains unchanged.

5.20 In relation to the activity under the Resource Planning and Management driver (CMMI reporting), we are now satisfied that DCC has provided enough justification for a BM adjustment. This results in an upward BM adjustment of **£30k**.

5.21 Finally, we expect DCC to provide clear justification for each BM adjustment, in line with the criteria that are set out in the Licence, for each submission. This is also applicable to drivers and grounds that were approved in previous years, especially when DCC is applying for margin related to new activities under these drivers and grounds. It is also important that these activities are allocated to the correct drivers and grounds, and that where new grounds arise, these are clearly explained and justified.

5.22 We also note DCC's comments around these issues, for example around the precedent set by previous decisions on the type of activities that can be allocated to certain drivers, even though they might now seem unrelated. We recognise that the separation between drivers and activities may have become less clear over the years as DCC application for BM adjustment has grown in magnitude and areas, nonetheless we are satisfied that the current BM model can reflect DCC's

BM application. We will, however, work together with DCC to explore any improvements to the model with the view of simplifying it.

Q16 External Contract Gain Share

***Proposal at consultation**: direct an adjustment to DCC's External Contract Gain Share of £11.89m across RY23/24 to RY25/26 based on approximately £32m of savings from the continuation of re-financing arrangements for the CSPs, financing of Communication Hubs (CHs) and the operations of DCC's in-house test lab service. Reject £23.18m ECGS Adjustment related to forecasted DCC's in-house test labs service savings, and £0.03m related to the temporary increase in CHs costs, on the basis that the application did not meet all the relevant conditions.*

***Decision**: our consultation position remains unchanged.*

Context

5.23 The formula for DCC's Allowed Revenue includes an ECGS term, which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the Fundamental Service Provider (FSP) contracts as detailed in Condition 39 of the Smart Meter Communication Licence.[68] This is so that DCC has an incentive to seek and achieve cost savings in the FSP contracts. This term is zero unless DCC applies for a Relevant Adjustment to this term.

Respondents' views

5.24 Most respondents were supportive or did not oppose our proposals.

5.25 However, while not opposing our proposals, two respondents raised the following concerns:

- That the test labs savings might be inflated if DCC is basing its calculations on test-lab use from previous years. This is because test lab use associated with DCC's core mandatory business activities have reduced significantly over the last year or two.
- That the test lab service could be offered by DCC on a commercial basis. For example, it could be explicitly charged based on usage by external parties, except if related to service incident fixes or CH defects. One respondent urged us to work alongside DCC to understand if this would be an option and argued

[68] Smart Meter Communication Licence, accessible at: www.ofgem.gov.uk/licences-and-licence-conditions

that this would allow DCC to recoup some of the test lab set-up costs, and to meet its ongoing operational costs.

- Lack of transparency around expected CH rental costs. One respondent said DCC was unable to explain why expected CH rental costs vary so much on a quarterly basis between RY21/22 and RY23/24. Another respondent explained that they have frequently asked DCC's Finance team to explain the increases in SBCH and DBCH rental charges (CH fixed), and why the 10-year rental of CHs is significantly higher than the redeployed cost within the same charging statement. They clarified that, to date, they have not received a satisfactory explanation, except that an error occurred in a previous year and financing over a smaller volume.

5.26 Another respondent, while overall agreeing with our proposal, said that they expected DCC to be looking for wider savings within its contractual arrangements to ensure DCC Users benefit from a range of potential savings. They added that it was not clear to them from the detail in the consultation that this is the case and suggested that this could be an area of further focus by the Independent Auditor under the OPR contract management incentive.

5.27 DCC recognised our minded-to position to reject the ECGS adjustment relating to forecasted DCC's in-house test lab services savings but reiterated its view that it had saved industry and customers a further £77.8m until the end of the Licence period. DCC welcomed our statement that DCC may reapply for gainshare on these savings in future years once they are realised or certain.

Reasons for our decision

5.28 We have reviewed the responses we received and decided to maintain our consultation positions.

5.29 In relation to the methodology used by DCC to calculate the test lab service savings, we revised it as part of last year's Price Control exercise and made the following amendments:

- We included Shared Charges in DCC's in-house test labs service costs to accurately reflect the savings seen by DCC's customers.
- We excluded office costs from the counterfactual ('do nothing' scenario). Our position was that ECGS savings should be calculated by comparing the costs in the original Fundamental Service Provider contracts against the new total costs.

- We rejected the proposed 50%-50% gainshare split and applied a 62.5%-37.5% split instead.

5.30 However, as we said in our RY21/22 Consultation,[69] our position is to only accept Relevant Adjustments to the ECGS term for net savings that are certain. For example, when they are realised or certain to be achieved. Therefore, we are rejecting the ECGS application for forecasted test labs service savings on the basis that DCC was not able to evidence its certainty at this time. DCC will be able to reapply for ECGS Relevant Adjustment related to these savings when and if they become certain in future years. We expect DCC's ECGS application on certain savings to accurately reflect customers savings based on real data and not on estimates or forecasts. This will remain an area of scrutiny in future years.

5.31 We are grateful for stakeholders' feedback and suggestions around the future of test labs service, and in particular on whether it could be offered by the DCC on a commercial basis. We will consider this input as part of our ongoing work on the new regulatory arrangements for DCC ('DCC Review').[70]

5.32 Finally, we are disappointed to learn that DCC users have been struggling to get clear information from DCC on the expected CH rental costs. We encourage DCC to engage meaningfully with its customers. For example, by providing as much clear and relevant information explaining the drivers behind its costs as possible, especially when it has specifically been requested by customers. We understand that there might be contractual and commercial sensitivity constraints to the level of detail DCC can share with third parties, but we would expect DCC to clearly communicate these constraints if relevant.

[69] See Ofgem (2022), DCC Price Control RY21/22 Consultation, paragraphs 5.41-5.44. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

[70] For more information, please see: Ofgem (2022), DCC Review: Phase 1 Consultation, esp. chapter 5: Future role of DCC. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

6. Switching Programme

Section summary

This section covers our assessment of DCC's costs associated with the Switching Programme in RY21/22 and the forecasts to the end of the Licence period.

This section also gives our decision on the fourth incentivised delivery milestone of the Design, Build and Test phase of the Switching Programme: Delivery Milestone 4 (DM4).

We proposed to disallow DCC's forecast costs of £8.636m for RY23/24 onwards as DCC did not provide any justifications for these costs.

This year all associated milestones (DM4) were achieved. We therefore proposed that DCC should retain all margin associated with this milestone.

Following consideration of consultation responses, which supported our proposal, our positions remain unchanged.

Questions posed at the consultation

17. What are your views on our proposed position on DCC's costs associated with the Switching Programme?
18. What are your views on our assessment of Delivery Milestone 4 of the Switching Programme?

Q17 Switching Costs

Proposal at consultation: disallow all forecast costs for RY23/24 to the end of the Licence period, £8.636m. Disallow the corresponding margin (which is calculated as a percentage of internal costs), an additional £1.174m.

Decision: remains unchanged from the consultation proposal.

Context

6.1 The Switching Programme has been established to improve consumer's experience of switching between energy suppliers. DCC plays a central role in delivering this programme.

6.2 The costs and performance of the Switching Programme are dealt with separately from the rest of DCC's business.

6.3 For the Switching Programme all costs must be justified as the Business Plan was not competitively tendered, and therefore cannot be considered innately economic and efficient.

Respondents’ views

6.4 All respondents who commented agreed with our proposal for DCC to lose all forecast costs related to the Switching Programme due to a lack of justification for these costs.

6.5 One respondent felt they did not have enough transparency of DCC’s report to confirm if they agreed with Ofgem’s assessment or not.

6.6 Another stakeholder felt that there should be a separate regime for the Switching Programme and would support a switching specific OPR type review.

6.7 One stakeholder provided evidence of a recent example of poor customer engagement regarding the DCC production of their Switching Address Quality Management plan. This stakeholder stated they have taken reasonable steps to support DCC with their planning by providing written feedback to DCC on their year 1 plan and have met with DCC to review a sample of address data. They also recommend that DCC engages with the DNO community and other impacted parties as soon as possible on the proposed year 2 plan and strongly encourage DCC to progress as a collective activity to ensure that viewpoints from all REC Parties are taken into proper consideration.

6.8 One stakeholder recognised that the DCC Licence contained provisions for a central switching service but highlighted that as the Retail Energy Code Company (RECCo) has been established and is a legal entity, Ofgem should consider transferring away the responsibilities for the switching services from DCC to RECCo.

Reasons for our decision

6.9 The response in general and DCC's specifically do not justify a change from the position we consulted on, and we will therefore not allow/ disallow forecast costs on Switching to the end of the RY23/24 period, along with the margin.

6.10 We have been working on implementing a financial incentive regime for DCC in their roles under the enduring Switching arrangements, which we have called the DCC Switching Incentive Regime (SIR). We recently published our decision on the Licence changes required to establish the SIR, under which DCC’s entire

Switching margin (7.5%, see below) will be put at risk against defined performance measures.[71]

6.11 We are currently consulting on the content of a Direction and associated guidance required to populate the terms of the SIR.[72] We have proposed that 80% of DCC's margin be incentivised against operational performance, and 20% against customer engagement performance. We anticipate publishing our decision on the SIR Direction and guidance in late March 2023, with the SIR then commencing from 01 April 2023 in tandem with the start of the new regulatory year.

6.12 As part of that recent January 2023 decision on Licence changes we also set out that DCC will be entitled to earn a margin of 7% on their Switching business from 01 April 2023 onwards, which translates to 7.5% return of costs through the calculation method we apply.

Q18 Switching Performance

Proposal at consultation: allow DCC to retain all margin associated with DM4 which equates to 10%.

Decision: remains unchanged from the consultation proposal.

Context

6.13 We published our decision on an incentive regime for DCC's role in the Design, Build and Test (DBT) Phase of the programme in May 2019.[73] Please note, this is a separate regime from the Operational Performance Regime and Baseline Margin Project Performance Scheme (discussed in chapter 4).

6.14 The first of the delivery milestones under the DBT Phase occurred in RY19/20. Delivery Milestone 1 (DM1) required DCC to develop the Centralised Switching Service (CSS) interface specifications and the CSS Integration Approach (CSSIA). Due to the extent of the delays with DM1, DCC lost all associated margin. The second and third of the delivery milestone occurred last year in RY20/21. Delivery Milestone 2 (DM2) required DCC to successfully complete the initial pre-

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[71] See Ofgem (2023), Decision on policy and statutory consultation to establish the DCC Switching Incentive Regime. www.ofgem.gov.uk/publications/decision-policy-and-statutory-consultation-establish-dcc-switching-incentive-regime
[72] Please see Ofgem (2023), DCC Switching Incentive Regime: Consultation on Direction and associated guidance.www.ofgem.gov.uk/publications/dcc-switching-incentive-regime-consultation-direction-and-associated-guidance. The consultation closes on March 17th, 2023.
[73] Ofgem (2019), Decision on margin and incentives for DCC's role within the Design, Build and Test Phase of the Switching Programme. www.ofgem.gov.uk/publications/decision-margin-and-incentives-dccs-role-within-design-build-and-test-phase-switching-programme

integration testing of the CSS. Delivery Milestone 3 (DM3) represented the successful completion of the planning and preparation activities for System Integration Testing (SIT). Delivery Milestone 4 (DM4) required DCC to complete the Programme-led End to End Testing which was achieved in February 2022.

6.15 All margin on internal costs relating to the successful delivery of the DBT phase is at risk against the DBT milestones, with 30% against DM1, 20% at risk against DM2, 25% against DM3 and 10% of the total margin at risk against DM4. DM5 the final milestone which will be taking place next year represents 15%. The final values that this represents in terms of margin retained will be finalised when all delivery milestones under the DBT phase have been assessed.

6.16 Note, the margin and incentives for the Switching programme are entirely separate from the BM and the BM adjustment process.

Respondents' views

6.17 Five respondents including DCC supported our proposal for DCC to retain all margin at risk against DM4 as the milestone was achieved.

6.18 One respondent highlighted they do not have enough transparency of DCC's report regarding its achievement of DM4 as to be able to confirm if they agree with Ofgem's assessment or not.

Reasons for our decision

6.19 We have reviewed the responses we received and consider there is no evidence for us to change our consultation position.

7. Over-Recovery of Revenue

Section summary

DCC over-recovered revenue from customers by 113% in RY21/22, which is above the 110% threshold. We only partially accept the reasons that DCC has provided and have decided to apply a penalty interest rate against the amount that was over-recovered and for which we received no satisfactory reason. The penalty for the over-recovery in RY21/22 will be reflected in the RY22/23 Correction Factor, and by extent excluded from the Allowed Revenue, in RY22/23.

Questions posed at the consultation

19. What are your views on our proposal on DCC's over-recovery of revenue?

Proposal at consultation*: The ratio of Regulated Revenue (£563.9m) to Allowed Revenue (£499.7m) for RY21/22 was 113%, which is above the 110% threshold as set out in the Licence. Prior to the consultation phase, we received insufficient justification from DCC for the RY21/22 over-recovery and proposed on that basis to apply the penalty interest rate against the amount that has been over-recovered.*

Decision*: remains unchanged from consultation position. We only partially accept the reasons from DCC regarding the RY21/22 underspend and have decided to apply the penalty interest rate against the proportion for which we received no satisfactory justification. In accordance with the Licence, the penalty for the over-recovery in RY21/22 will be reflected in the Correction Factor, and by extent excluded from the Allowed Revenue, in RY22/23.*

Respondents' views

7.1 Most respondents supported our minded-to consultation position.

7.2 Two respondents raised specific concerns around DCC's ability to better predict its forecast costs. One respondent commented that, as a business operating with more certainty, DCC is expected to improve the accuracy of its forecasting.

7.3 Two respondents expressed specific concerns about DCC's statement that it has allowed the cumulative Correction Factor to grow to manage potential spending peaks and is therefore likely to hold more cash from customers going forward.

7.4 One respondent questioned the accrual and return of interest to customers on monies that are not used by DCC and subsequently returned. Another respondent questioned the application of the prudent estimate by DCC considering this is not a defined term under the Licence but merely some advice to produce a conservative estimate and avoid in-year changes to Service Charges.

7.5 DCC noted that it had taken active steps to return cash to customers when it became clear that the RY21/22 costs would be lower than expected. DCC explained that this had been specifically the case following the reforecast of the programme spend at the end of 2021, after which it decided to return £80m to customers in the form of reduced charges.

7.6 DCC however claimed that it would be unfair to apply a penalty interest rate on events and/or drivers that that had led to an underspend, but that were either outside of its control, or not known at the time of the (re)forecast. DCC listed down the following key factors for the underspend in RY21/22:

- Slower than expected migration of SMETS1 meters in late 2021
- Delays to internal change programmes such as Enterprise IT and Business Accuracy
- Delay to in-life Change programme because of contract signature delays

7.7 DCC also responded that the governance process for reopening the Charging Statement, which includes a three-month notice period, is lengthy and makes the return of cash to customers late in the year difficult. DCC requested to that effect that Ofgem reviews this process to allow the return of cash to customers with less notice after an underspend is identified.

7.8 DCC further noted that the Allowed Revenue includes the cumulative Correction Factor, which in RY21/22 was circa £48.583m. The cumulative Correction Factor comprises the total amount of funds that was over-recovered in the previous regulatory years, adjusted following indexation to the Average Specified Rate (ASR).[74] According to DCC, the calculation of the over-recovery threshold should exclude the cumulative Correction Factor as it is required to maintain a healthy cash balance. DCC explained that if had returned to the customers the entire cumulative Correction Factor in RY21/22, its cash balance would have been just within the lower limit of a healthy cash balance (which ensures it can timely pay

[74] The Average Specified Rate (ASR) is defined in Licence Condition 35.5 as the equivalent to the average value of the Official Bank Rate of the Bank of England during the period in respect of which the calculation falls to be made

all its suppliers) at a range of £25m-£53m. DCC explained that it had set this range as a target to manage fluctuations in costs.

Reasons for our decision

7.9 We reviewed the additional evidence and explanation from DCC in this area and partially accept the reasons that were provided for the RY21/22 underspend, notably those in relation to the functional (Enterprise IT and Business Accuracy) and programme (SMETS1 and In-Life programme) delays.

7.10 We disagree however with the view that the penalty interest rate should not apply to the Cumulative Correction Factor as, DCC argues, this is the only means available to DCC to ensure that it has a healthy cash balance. Licence Condition 36.20 explicitly states that the penalty interest rate is calculated, based on the total difference between the Regulated and Allowed revenue which we consider has not been justified. More importantly, we note that the Cumulative Correction Factor is within DCC's control, and DCC has full discretion for returning these monies to customers or offsetting these against future charges.

7.11 Regarding DCC's argument of having to maintain a healthy cash balance, we agree that there may be situations that can lead to spending peaks. However, Licence Condition 36.5 already accounts for this by allowing a prudent estimate of the Allowed Revenue, to ensure that the Service Charges do not need to be amended over the year other than in exceptional circumstances. For instance, DCC included to that effect a £20m prudent estimate into the Charging Statement for RY21/22;[75] this, however, contradicts the £25m-£53m healthy cash range that DCC stated in its consultation response, but has failed for provide a rationale for.

7.12 The penalty interest rate is an incentive for DCC to improve the accuracy of its forecasting, however we also recognise the necessity for having an effective contingency and so we have decided to exclude the £20m prudent estimate from the amount that was over-recovered and for which we have not received a satisfactory reason. We will engage with DCC to understand what a reasonable prudent estimate should be going forward.

7.13 Given customers' concerns in this area, we are minded-to review this in more detail in the future, including the frequency of returning cash to customers, the

[75] DCC (2022), Charging Statement for Service Charges. www.smartdcc.co.uk/media/6935/charging-statement-ry2122-issue-30.pdf

appropriate level of over-recovery, as well as the return of any accrued interests. This would be in line with the recent development of policies elsewhere to ensure that energy suppliers do not accrue and use customers' payments as working capital. The total amount that we, therefore, determine not to be justified by DCC in RY21/22 is £28.583m. In accordance with the LCs 36.18, 36.19 and 36.20,[76] the penalty for the over-recovery in RY21/22 will be reflected in the Correction Factor, and by extent excluded from the Allowed Revenue, in RY22/23.

7.14 In response to DCC's request to streamline the governance process for reopening the Charging Statement, we refer to Licence Conditions 19.10-19.11. These allow DCC to either request for a shortening of the notice period for amending the Service Charges or for re-opening them more than once in a regulatory year provided that DCC can justify to the Authority why this is necessary and why it did not consider these factors when originally giving Notice. Whilst restrictions around the governance process seek to minimise the level of uncertainty around charges in the interest of customers, we have historically accommodated several requests from DCC to expedite this process, often at short notice, where appropriate.

[76] More specifically, Licence Condition 36.20, states that the penalty amount will be determined by applying the penalty interest rate of 3% above the ASR against the amount that has been over-recovered and for which we have received no satisfactory justification.

Appendices

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Appendix 1 Determination Allowed Revenue (AR)

Table A1.1. Allowed Revenue for each year to the end of the Licence term, in £m (RY21/22 prices)

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
LABP - AR[77] (21/22 prices)	253.789	250.285	257.354	265.719	112.386
Previous year - AR (21/22 prices)	436.771	443.402	399.646	437.348	221.770
Submitted AR RY21/22	**499.664**	**470.597**	**513.281**	**556.476**	**372.072**
Cost Disallowances					
External costs					
Programme costs - incurred	[redacted] *.***[78]	0.000	0.000	0.000	0.000
DSP – forecast	0.000	-16.217	-4.590	-2.131	-1.512
CSP-N - forecast	0.000	-1.890	-1.890	-1.832	-0.199

[77] Please note that the AR figures in the consultation document (Table A3.1 and Table A3.2 in Appendix 3) were shown in nominal prices, whereas these figures are adjusted by inflation (RY21/22 prices).
[78] Please note that due to commercial sensitivity and confidentiality reasons, the amount of Unacceptable External Cost disallowance has been redacted. For more information, please see chapter 2.

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
CSP-C - forecast (comms hubs)	0.000	-0.257	-0.758	-0.734	-0.720
CSP-S - forecast (comms hubs)	0.000	-0.199	-0.593	-0.575	-0.564
S1SP_1 - forecast	0.000	-1.029	-1.058	-1.135	-1.343
S1SP_3b - forecast	0.000	-12.643	-12.902	-12.919	-13.124
S1_DCOa - forecast	0.000	-6.640	-5.121	-5.021	-5.021
Total External Costs disallowances	[redacted] *.***[79]	***-38.875***	***-26.913***	***-24.347***	***-22.483***
Internal Costs					
Baseline forecast Internal Costs	0.000	0.000	0.000	-58.425	-64.362
CRS forecast Costs (Switching)	0.000	0.000	-2.895	-2.895	-2.846
Benchmarking- payroll	-0.047	0.000	0.000	0.000	0.000
Business Accuracy Programme (BAP)	-2.560	0.000	0.000	0.000	0.000
Commercial Finance - forecast	0.000	-0.888	-1.001	0.000	0.000
Customer Engagement - forecast	0.000	-0.209	-0.875	0.000	0.000
Document Writing Unit - forecast	0.000	-0.443	-0.299	0.000	0.000
ECoS - forecast	0.000	-2.438	-1.469	0.000	0.000

[79] Please note that due to commercial sensitivity and confidentiality reasons, the amount of Unacceptable External Cost disallowance has been redacted. For more information, please see chapter 2.

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
ES & IS - Executive Leadership Programme	-0.262	0.000	0.000	0.000	0.000
ES & IS - Planning	-0.620	-0.195	-0.200	0.000	0.000
ES & IS - Procurement	-2.085	-0.120	0.000	0.000	0.000
EVs and Product Management	-0.562	-0.241	-0.241	0.000	0.000
Network Evolution - forecast	0.000	-7.725	-5.680	0.000	0.000
People team - forecast	0.000	-0.484	-1.428	0.000	0.000
Policy and Market - forecasts team	0.000	-0.507	-0.480	0.000	0.000
Service Desk - forecast	0.000	0.000	-0.924	0.000	0.000
SMETS1 - forecast	0.000	-4.385	-3.302	0.000	0.000
Shared Service Charge	-0.667	-0.416	-0.645	-5.247	-5.785
Total Internal Costs disallowances (includes Switching costs)	***-6.803***	***-18.051***	***-19.439***	***-66.567***	***-72.993***
Total Cost (Internal and External) disallowances	***-6.803***[80]	**-56.926**	**-46.351**	**-90.914**	**-95.476**
Performance Adjustment Reductions					
OPR	-1.404	0.000	0.000	0.000	0.000

[80] Please note that this figure does not include our disallowance of a portion of External Costs, details of which have been redacted for confidentiality reasons. Please refer to Chapter 2 for more information.

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
CRS performance	0.000	0.000	-0.394	-0.394	-0.387
Decision AR excluding BM and ECGS adjustments	491.456[81]	413.671	466.536	465.168	276.210
Baseline Margin and ECGS adjustments					
BM adjustment (21/22 prices)	0.000	0.000	2.804	1.091	3.540
ECGS adjustment	0.000	0.000	10.691	0.413	0.785
Decision AR with BM and ECGS adjustments	**491.456[82]**	**413.671**	**480.031**	**466.673**	**280.535**

[81] As above, this figure does not include the proportion of Unacceptable External Cost.
[82] As above, this figure does not include the proportion of Unacceptable External Cost.