Consultation

DCC Price Control: Regulatory Year 2022/23

Subject	Details
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The Data Communications Company (DCC), or Smart DCC Limited, is the central communications body appointed to manage communications and data transfer for smart metering. It holds the Smart Meter Communication Licence[1] (Licence). Price Control arrangements restrict DCC's revenues to ensure that costs incurred are economic and efficient. The arrangements also place incentives on DCC to counter its monopoly position to deliver higher quality services and performance levels.

DCC submitted its Price Control information (based on the published Regulatory Instructions and Guidance (RIGs[2]) for 1 April 2022 to 31 March 2023) on 31 July 2023. DCC also submitted proposals for adjustments to its Baseline Margin and External Contract Gain Share values.

This document includes our review of the DCC's costs for the 2022/23 Regulatory Year and outlines the scope, purpose and questions of the consultation and how you

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[1] The Smart Meter Communication Licences granted pursuant to Sections 7AB(2) and (4) of the Gas Act 1986 and Sections 6(1A) and (1C) of the Electricity Act 1989. This consultation is in respect of both those Licences. Those Licences are together referred to as 'the Licence' throughout this document.
[2] Regulatory Instructions and Guidance 2022: www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2022

can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at Ofgem.gov.uk/consultations. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

DCC is the central communications body licenced to provide the communications, data transfer and management required to support smart metering. It holds a crucial role in ensuring the successful rollout and ongoing operation of smart metering in the GB energy market. As a monopoly service provider, it is vital that appropriate controls are in place over its costs and that it is subject to an appropriate incentive regime that focuses on providing a good quality service to its customers, which include energy suppliers and network companies. 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 for all, whilst also assuring the organisation delivers an efficient operation.

DCC's Price Control submission for the 2022-23 Regulatory Year (RY22/23) described how DCC continued to connect smart meters to the network. In RY22/23, DCC added 7.3 million meters, with 2.5 million of these being SMETS1 meters, which connected over half of homes in Great Britain. During RY22/23, DCC further developed its 4G Communications Hubs programme and, as part of that, procured new contracts with External Service Providers to upgrade the existing 2G/3G infrastructure in the Central and South Communication Regions.

In comparison to last year's forecast, there has been a material increase in costs. There are several drivers for this, but as with previous years, the main reason for these increases is that DCC has not been able to accurately forecast costs associated with the procurement of new contracts. In addition, unforeseen issues arose throughout the Regulatory Year and previous cost disallowances made through our Price Control determinations caused a zero baseline.

Overall, DCC's total reported costs for RY22/23 are £611m. This is a 24% increase in total costs compared to last year's forecasts. We note an 81% increase in Internal Costs when comparing the reported costs to the RY21/22 forecast. This is due to significant increases in the Finance and Corporate Management cost centres. In comparison to the forecast accepted under last year's Price Control adjusted for inflation, External Costs are 14% higher in RY22/23. Over the Licence term (RY13/14 - RY25/26), total costs are now forecast to be £5.48b, 13% greater than last year's forecast.

Cost Assessment

Ofgem has a regulatory duty to determine that costs incurred during a price control period are economic and efficient. As part of this function and in accordance with the Licence and Guidance document, economic and efficient costs are assessed based on information and evidence that we receive which then inform our decisions. During this process, we cannot assume that DCC's costs are economic and efficient by default. This is particularly important given that DCC operates as a monopoly in a non-competitive environment. We therefore expect DCC to demonstrate that the choices it makes in running its business economic and efficient and represent value for money for consumers. It must therefore evidence that the routes it has chosen for procuring services, including both internal and external are economic and efficient in the circumstances. That burden of proof lies with DCC.

DCC's submission for RY22/23 provided reasonable justification for the majority of the costs that were incurred. However, we have regrettably identified a number of concerns this year which include a continued drop in the quality of the regulatory reporting, and a growing lack of transparency as to how processes have been adhered to, therefore not providing us with the necessary assurances that value for money was achieved. Last year, we made similar observations in relation to the quality of DCC's regulatory reporting under Price Control, and it is disappointing to see that there has been little to no progress in this area this year. We have extensively engaged with DCC throughout the entire cost assessment process to clarify particular areas of scrutiny. Going forward, we instruct DCC to improve the quality of its regulatory reporting, in accordance with the Licence and the requirements that are set out in Guidance. This includes the quality of the reported data as well as the ability to share with us upon request and in a timely manner, any key documentation and supporting evidence that we reasonably require. We will continue to closely engage with DCC to ensure that the relevant requirements and processes are well understood going forward. Our assessment of this year's submission revealed the following key areas of concern:

- **Quality of regulatory reporting and evidence -** The quality of DCC's Price Control submission forms an essential part of the Price Control assessment. DCC is under an obligation within the Licence[3] to collect and provide Price Control Information in such

[3] Licence Condition 32 – Reporting of Price Control Information

manner as will (amongst other things) ensure that the Authority is provided with such information on a consistent basis in respect of each Regulatory Year of this Licence, which can be assessed by Ofgem to determine whether DCC's costs are economic and efficient. As per last year, we have identified errors and inconsistencies in both the reported data as part of the submission as well as during the clarification process. Going forward, we require DCC to improve the quality of its regulatory reporting and expect it to be able to evidence its decision-making and provide all required documentation to Ofgem as required under the Price Control.

- **Planning, scoping, and resourcing of projects –** As a monopoly provider, it is important that DCC achieves value for money through the services that it procures. In RY22/23 we have identified an over-reliance on utilising external consultants as opposed to providing evidence that alternative, more economic and efficient, options have been considered. This is particularly important given this year's peak in Internal Costs variance (£64m), of which more than half (£34m) went towards funding non-resource activities, including External Services. We expect DCC to make improvements in this area through better planning. We will continue to apply close scrutiny to this type of expenditure in future Regulatory Years.

- **Procurement** – DCC operates using an outsourced service model, and procurement is core to its role in efficiently delivering its services. A large proportion of External Services were procured non-competitively in RY22/23, and we have not seen sufficient evidence that DCC made the necessary assessments to consistently follow a non-competitive route with the use of direct awards. In RY21/22, we were concerned about procurement within Internal Costs. This year we are additionally concerned with the re-procurement of Fundamental Service Capability (FSC) contracts. We expect DCC to demonstrate that the most economic and efficient route was chosen for procuring all costs, including both Internal and External. This will continue to be an area of significant scrutiny.

- **Contract management -** With ~70% of DCC's costs being attributed to External Costs, DCC's key role is to effectively manage and handle the large number of External Service Providers (and contracts) that make up the infrastructure of the smart metering and switching services. Based on this year's assessment, we still have concerns about the costs that have been incurred as a result of poor performance and issues within control of DCC's service providers. We also have concerns about the new 4G Comms Hubs & Networks programmes, which in some instances did not follow competitive procurement; nor did we receive satisfactory evidence that the costs of one of these contracts were economic and efficient. We have instructed DCC to make improvements in these areas so that best practice in contract management is followed going forward. This is essential to ensure that not only value for money is maximised but also that contracts, and any future contractual changes, are effectively managed. We will continue to apply scrutiny going forward.

For the cost assessment itself, subject to further evidence, our position is that **£12.482m from DCC's Internal Costs incurred in RY22/23 are Unacceptable Costs**. This comprises costs associated with inefficiencies in the planning and resourcing of activities, the procurement of various External Services, additional spend on the Business Accuracy Programme, Shared Service Charges, contractor benchmarking, as well as continued activity relating to non-mandated activities. This also comprises £1.914m of resource costs due to a lack of justification for the extra resource, particularly in the Security, Design and Assurance and Corporate Management cost centres.

Subject to further evidence, our position is that **up to £6.834m from DCC's External Costs incurred in RY22/23** associated with SMETS1 supply chain and service **are Unacceptable Costs**. In addition to this, we are further considering costs associated with 4G Comms Hubs & Networks procurements and, contingent on additional evidence, **propose to disallow *up to* the full amount of costs incurred by DCC in RY22/23 in respect of one of its newly procured contracts**.

Furthermore, we are minded-to disallow a total of **£57.872m in forecast Internal Costs** for RY23/24 and RY24/25, and a further **£102.184m** increase in its baseline forecast Internal Costs over RY25/26 (the remaining term of the Licence) due to lack of sufficient justifications for these costs. We are also minded-to disallow **£87.541m in forecast External Costs** (including £31.082m in forecast CRS External Costs) until the end of the Licence period due to reporting errors and insufficient justifications.

If DCC is able to provide further evidence and justifications as part of its consultation response, we are open to revising downward the proposed disallowance at the decision stage. Any costs that we ultimately decide were not economically and efficiently incurred may either be excluded from the future calculation of Allowed Revenue or be subject to an undertaking about DCC's future management.

Table 1: Summary of proposed cost disallowances [£m]

	Incurred costs: RY22/23	Forecast costs: RY23/24 - RY25/26
Internal Costs proposal	12.482	160.056
External Costs proposal *(excl. 4G CH&N procurement)*	6.834	87.541
Total disallowance proposals	**19.316**	**247.598**

Performance Incentives

All of DCC's margin is at risk against its performance, either through the Operational Performance Regime (OPR) or any of the Baseline Margin Project Performance Schemes (BMPPAS). This is the fifth year in which DCC's performance is being assessed under the OPR, and the second year in which both customer engagement and contract management are incentivised against the revised OPR, which came into effect in April 2021. This is also the first year it is being assessed by the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS).

We are proposing that £11.232m of DCC's Baseline Margin should be retained, out of the available £19.057m.[4] This corresponds to a reduction of £7.825m, and comprises:

- A reduction of £0.381m as a result of DCC's performance in customer engagement, corresponding to a total score of 2 awarded (out of a possible 3) for the customer engagement incentive.
- A reduction of £0.489m due to DCC's performance under the contract management incentive, corresponding to a score awarded of 1.71 (out of a possible 3). DCC's contract management performance was assessed by an independent auditor against a modified version of the National Audit Office (NAO) contract management framework, as well as the scope set out in the OPR Guidance

[4] This includes £11.268m of Baseline Margin that was at risk until RY22/23 under the SMETS1 BMPPA; and £7.618m of core Baseline Margin that was at risk in RY22/23.

- A reduction of £6.955m due to DCC's performance in the SMETS1 Project between RY18/19 and RY22/23

In respect of the SMETS1 BMPPAS, we received a request from DCC to distribute the Baseline Margin (BM) reduction over a three-year period. We are however minded to not accept DCC's request based on the restrictions set out in the Licence to reduce margin when a project is first completed. We therefore propose that value of the BMPPA term for RY22/23 should remain unchanged as £6.955m.[5]

Baseline Margin Adjustment

The Baseline Margin adjustment mechanism was included in the Licence to recognise the uncertainty when the Licence was granted over the nature 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.

This year DCC has applied for a £24.02m adjustment to its BM for increases in the volume and complexity of work, changes to timescales, or increased cost certainty of activities. DCC identified 12 drivers this year, 11 all of which were identified by DCC in previous submissions. One of the grounds was raised for the first time in this year's application; it sat within an existing driver (supporting a changing business) i.e., increase in Customer Service Expectations.

We are minded-to adjust DCC's application to reflect the Price Control decisions on Unacceptable Costs. We are also minded-to reject some parts of DCC's application, unless we receive further sufficient information, for the following reasons:

- Where we have not seen sufficient evidence that the activity meets the criteria under which the driver is reported
- Where we have not seen evidence of a material change which could not have been foreseen
- Where the driver does not appear to meet the conditions in the Licence

[5] In total, DCC faces a margin reduction of £8.184m against the SMETS1 BMPPA scheme.

Taking all these disallowances into account, we are minded-to amend DCC's application to an adjustment of £10.424m between RY22/23 and RY24/25, a decrease of £13.597m from the application. A significant proportion of BM reduction is due to forecast cost disallowance for RY23/24 and RY24/25. If these forecast costs are justified in future Price Control submissions, DCC will be able to keep the BM associated with these costs.

External Contract Gain Share

The formula for DCC's Allowed Revenue includes an External Contract Gain Share (ECGS) term which allows for an upward adjustment where DCC has secured cost savings in its Fundamental Service Provider (FSP) contracts. This is so that DCC has an incentive to seek and achieve cost savings. This term is zero unless DCC applies for an adjustment.

DCC has applied for a Relevant Adjustment of £5.208m across RY22/23 to RY25/26. This adjustment relates to the continuation of re-financing arrangements across Communication Service Providers (CSPs) and industry savings as a whole, with £8.412m being returned to customers, reflected in an External Costs reduction.

We propose to accept DCC's ECGS Adjustment application relating to re-financing arrangements; however, we are proposing to reject £0.051m which corresponds to some of the savings relating to the financing of Tranche 2 Comms Hubs due to the temporary increase in Comms Hubs unit prices.

Between RY15/16 (DCC's first ECGS Adjustment application) and RY22/23 (including this year's application), DCC has secured cost reductions of £263.42m relating to savings in the FSP contracts, Comms Hubs financing and DCC's test labs; and brought benefits of £150.3m (c.57% of total cost reductions) to DCC's customers (based on DCC's previous ECGS applications).

Switching Programme

DCC plays a central role in delivering the Switching Programme. The costs and performance of the Switching Programme are dealt with separately from the rest of DCC's business.

We are proposing that DCC's costs associated with the Switching Programme in RY22/23 are economic and efficient. However, in line with our decision in previous years, we propose to disallow DCC's forecast costs for Switching due to a lack of sufficient justification. DCC presents its cost forecasts to the REC code manager shortly before the start of the financial year, and the code manager must then review the DCC budget. Only at the point of REC approval of the budget would we have sufficient certainty and clarity over DCC's Switching costs to be able to approve forecast costs.

In addition, the fifth of the delivery milestones under the Design, Build and Test (DBT) Phase of the Switching Programme occurred in RY22/23. As this milestone was achieved, we propose that DCC should retain all margin associated with this milestone, which corresponds to 30% of the total margin at risk against the Switching Programme.

Next steps

We welcome your views and will consider them when we make our decision. Please send responses to DCCregulation@ofgem.gov.uk by 29 December 2023. We will publish our decision in February 2024.

1. Introduction

What are we consulting on?

1.1. We are consulting on our proposed positions for DCC's costs, revenues, and margin application for the RY22/23 under the Price Control mechanism. As required by the Licence, our assessment of DCC's costs is based on comparing DCC's incurred costs and revised forecast with the previous year's forecast and with DCC's Licence Application Business Plan (LABP).[6] Our guidance document, published in July 2022, 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.[7]

1.2. We have restricted the level of detail we can include in this consultation due to the commercially sensitive nature of the evidence we consider; some stakeholders may find it difficult to provide meaningful input to the Price Control consultation process.

1.3. DCC provides additional transparency on costs directly to its customers through its quarterly finance forums under suitable confidentiality arrangements. Further, alongside this consultation, DCC has published parts of its Price Control submission for RY22/23.[8] This additional information should be helpful to stakeholders in responding to this consultation.

1.4. A stakeholder meeting will also be held in December 2023 to provide DCC's customers and other key stakeholders an opportunity to explore the issues highlighted in this consultation with both Ofgem and DCC.

1.5. The content of each section of this document is summarised below, along with the questions to which we are seeking your response.

[6] DCC (2014), Smart DCC Ltd Licence Application Business Plan. Accessible at: www.smartdcc.co.uk/media/6531/redacted-labp-marked-public-151021.pdf
[7] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[8] DCC (2023), Price Control Submission 2022-23. www.smartdcc.co.uk/about/price-control/

Section 1: Introduction

1.6. This section includes a short summary of the other sections in this document, a summary of DCC's activities during RY22/23, and an overview of DCC's costs during the year. It also sets out the stages in the consultation process, specifies how you should respond, and explains how we will treat your responses.

Section 2: Consultation stages

1.7. This section summarises the key dates of the consultation process and how your data and responses will be treated in accordance with our confidentiality regulations. It sets out guidance on how to submit any feedback in regard to the consultation process and track its progression.

Section 3: External Costs

1.8. This section sets out our assessment of the costs incurred by DCC through its contracts with existing FSPs, SMETS1 and ECOS service providers, as well as the next 4G Comms Hubs & Networks and TAF service providers in RY22/23, as well as the updated forecasts for the remainder of the Licence term. It includes an overview of how costs have changed relative previous year's reporting, DCC's justification for any changes in those costs, and our response to that.

Question 1: What are your views on our proposal to disallow £4.159m in incurred External Costs and £12.406m in forecast External Costs associated with DCC's procurement of an interim solution for the SMETS1 supply chain?

Question 2: What are your views on our proposed cost disallowance of up to £2.675m in relation to SMETS1 service stabilisation in RY22/23?

Question 3: What are you views on our proposal for a disallowance *up to* the amount of External Costs incurred on a directly awarded contract in the 4G CHs & Networks programme?

Question 4: What are your views on our proposal to disallow £44.054m in forecast FSP External Costs?

Question 5: Do you have any other views on External Costs?

Section 4: Internal Costs

1.9. This section examines DCC's Internal Costs, namely the costs that are incurred by DCC for the purposes of the provision of the DCC service (these exclude External Costs and Pass-through costs). It examines Internal Costs incurred in RY22/23 and DCC's updated forecasts for the remainder of the Licence term, focussing on changes in those costs compared with last year's forecast and the LABP. It sets out DCC's justification for any changes in those costs and our response, specifically considering Payroll and External Services. This section also investigates DCC's approach to, and the results of, the benchmarking of permanent staff and contractor remuneration.

Question 6: What are your views on our proposals on disallow a 50% proportion of the RY22/23 resource costs associated to Corporate Management, Design and Assurance, Security cost centres and the Network Evolution programme?

Question 7: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 8: What are your views on our proposal to disallow the continued costs that are linked to the activities that we disallowed in RY21/22 – these include additional costs associated with the Executive training programme, innovation and growth as well as a continuation of the RY21/22 non-competitive procurements?

Question 9: What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not have been resourced in the most economic and efficient way?

Question 10: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

Question 11: What are your views on our proposal to disallow costs associated with the RY22/23 non-competitive procurements for which we have not received satisfactory justification or evidence?

Question 12: What are your views on our proposals on the Shared Service Charge?

Question 13: What are your views on our proposal to disallow forecast resource cost variances in RY23/24 and RY24/25; and disallow all baseline forecast costs for RY24/25 onwards?

Section 5: Performance Incentives

1.10. This section covers DCC's performance under the Operational Performance Regime (OPR), and any relevant Baseline Margin Project Performance Adjustment Schemes. It sets out DCC's submission of its performance under these regimes, and our response.

Question 14: What are your views on our proposed position on DCC's System Performance?

Question 15: What are your views on our proposed position on DCC's Contract Management?

Question 16: What are your views on our proposed position on DCC's Customer Engagement?

Question 17: What are your views on our proposed position on the assessment of the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS)?

Section 6: Baseline Margin Adjustment and External Contract Gain Share

1.11. This section summarises DCC's application for adjustments to its Baseline Margin and ECGS and sets out our response.

Question 18: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

Question 19: What are your views on our assessment of DCC's application to adjust its ECGS?

Section 7: Switching

1.12. This section examines DCC's costs associated with the Switching Programme, and our assessment of the fifth incentivised milestone for the Design, Build and Test phase of the programme.

Question 20: What are your views on our proposed position on DCC's costs associated with Switching?

Question 21: What are your views on our assessment of Delivery Milestone 5 of the Switching Programme?

Section 8: Proposals to amend future Baseline Margin and Shared Services Charges

1.13. This section examines our proposals to amend future Baseline Margin and Shared Services charges.

Question 22: Do you agree with our proposal to apply a margin somewhere in the range of 7-9% when calculating BM adjustments from 01 April 2024 onwards? Do you have a specific figure that you think should be applied?

Question 23: Do you agree with our proposal to adjust the Shared Services Charge (SSC) from 9.5% to 4.5%?

Question 24: Do you agree with our proposal that any services provided to DCC by Capita, whether through a services contract or through the SSC arrangements, should not be eligible to earn any additional BM through the adjustment process from 01 April 2024 onwards?

Related Publications

1.14. DCC's Licence is at: Smart Meter Communication Licence

1.15. The DCC Regulatory Instructions and Guidance 2023 is at: Data Communications Company (DCC): Regulatory Instructions and Guidance 2023

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

1.17. Last year's consultation document is at: DCC Price Control consultation: Regulatory Year 2021/22

1.18. Last year's decision document is at: DCC Price Control Decision Regulatory Year 2021/22

1.19. The Price Control part of DCC's website is at: www.smartdcc.co.uk/about/price-control/

DCC's summary of RY22/23

1.20. In its submission, DCC provided an overview of its key activities during RY22/23 and the factors which drove the overall level of activity and spending across the organisation.

1.21. In RY22/23, DCC continued to make important progress in delivering its core programmes including SMETS2, SMETS1, Network Evolution and the Faster Switching programme. DCC highlighted the following achievements during RY22/23:

- Adding 7.3 million meters (38% growth) to the network with 2.5 million SMETS1 meters.
- Increasing service availability of smart meters to 99.9%
- Reducing planned maintenance/outages by 85%, reducing pre-payment top up failures by 50% and successfully delivering change 95% of the time.
- Processing over 1.4 billion messages per month across the smart meter network in 16 million homes
- Ensuring the CSS (Central Switching Service) successfully went live in July 2022 and has supported over eight million switches.
- Formally adopting a Treasury Green Book business case approach and establishing a centre of excellence to manage this.

DCC identified a number of key themes in its submission that summarise its work through the year:

- **Delivering the service:** DCC saw a significant growth in the scope and scale of the smart metering network with over half of British homes being connected. Progress has been made on the migration of SMETS1 meters with over 10m connected to the network. The SEC Systems Release and REC Releases have also been delivered on time and under budget.

- **Improving performance:** DCC has made progress with standardising its finance processes to improve efficiency and cost transparency. It has developed enhanced management reporting capability through Power BI and has received positive feedback from SEC Panel in its level of engagement.

- **Transforming infrastructure:** DCC recognise the importance of responding to an evolving technology and security landscape. DCC has established its 4G Communications Hubs & Networks (CH&N) programme to provide continuity of service and has remained on track to deliver against its joint industry implementation plan.

- **Delivering value for money:** DCC reported it is within the penalty threshold and has invested in its underlying capability to ensure it is more efficient and flexible. DCC is continuing to improve the ways in which it manages its supply chain, alongside negotiating new contracts and holding Service Providers accountable for their costs.

Summary of DCC costs

DCC RY22/23 Costs

1.22. Overall, DCC's total reported costs for RY22/23 are £611m. Excluding pass-through costs,[9] the figure is £591m.

1.23. This is a 24% increase in total costs incurred in RY22/23 compared to last year's forecasts (or a 27% increase with pass-through costs excluded). Table 1.1 shows how the main cost categories in RY22/23 compared to the forecasts of DCC's RY21/22 submission.

[9] Pass-through costs include the fee paid by the Licensee to the Authority and the payments to SECCo Ltd for purposes associated with the governance and administration of the Smart Energy Code (SEC).

Table 1.1: RY22/23 reported costs compared to RY21/22 forecast in current year prices

	RY21/22 forecast (£m)	RY22/23 (£m)	Variance (£m)	Variance (%)
Total External Costs	376	430	54	14%
Total Internal Costs (excl. SS)	71	129	58	81%
CRS total costs (excl. SS)	12	21	9	69%
Total Shared Services cost (for Internal Costs and CRS)	6	11	5	68%
Total Costs excl. Pass-Through Costs	466	591	125	27%
Pass-Through Costs	26	20	(6)	(23%)
Total Costs	**492**	**611**	**118**	**24%**

1.24. The greatest percentage change in the variance comes from the Total Internal Costs (excl. SSC). Internal Costs increased by 81% between the reported costs in RY22/23 and the RY21/22 forecast. Similar to the previous regulatory year, the CRS Total Costs also had a significant variance percentage change. Total Shared Services increased sizeably by 68% and pass-through costs reported a negative variance percentage change of -23%.

DCC Costs over the Licence Period

1.25. Figure 1.1 reports the trends in DCC's costs over the Licence period as reported in its latest submission. DCC's forecast costs increase, with total costs peaking at £707m in RY21/22, before decreasing in RY22/23 and rising again towards the end of the Licence term.

Figure 1.1: Trends in DCC's costs (£m, 22/23 prices) in current year prices

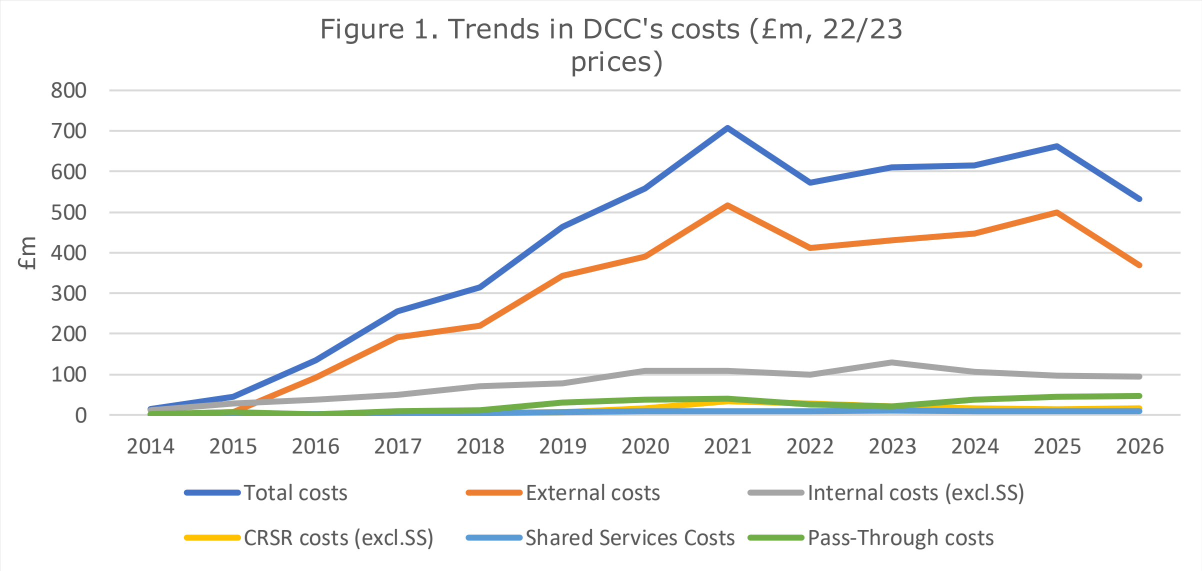


Figure 1.1: Data table[10]

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Total costs	14.5	43.6	133.9	254.4	313.4	464.4	558.9	707.3	571.4	**610.6**	614.8	663.3	533.1
External costs	0.7	7.3	90.9	191.6	220.1	343.4	389.5	516.5	411.0	**429.5**	446.1	499.4	367.9
Internal Costs (excl. SS)	11.4	28.2	38.5	49.4	71.6	77.1	109.1	109.1	97.9	**129.3**	106.6	96.8	95.0
CRSR costs (excl. SS)	-	-	-	-	4.7	6.4	15.5	33.7	27.7	**21.1**	15.1	14.3	15.1
Shared Services costs	0.9	2.1	3.0	3.8	5.3	6.3	8.4	8.5	8.0	**10.6**	9.6	8.7	8.5
Pass-Through costs	1.5	6.0	1.4	9.7	11.6	31.3	36.4	39.6	26.8	**20.0**	37.3	44.0	46.6

[10] Totals may not add up due to rounding

1.26. DCC's latest forecast total costs over the Licence period (RY13/14-RY25/26), as contained in its submission, is £5.48b. Excluding pass-through costs, its forecast for costs over the Licence period is £5.17b.

Table 1.2: RY22/23 forecast, and variation compared to RY21/22 forecast over the Licence period (RY13/14-RY25/26) in current year prices

	RY21/22 forecast (£m)	RY22/23 (£m)	Variance (£m)	Variance (%)
External - Baseline	1,968	2,117	149	8
External – New Scope	1,696	1,796	100	6
Total External Costs	**3,665**	**3,914**	**249**	**7**
Internal – Baseline (excl. SS)	679	956	277	41
Internal – New Scope (excl. SS)	64	64	0	0
Total Internal Costs (excl. SS)	**743**	**1,020**	**277**	**37**
CRS (excl. SS)	110	154	44	40
Total Shared Services cost (for Internal Costs and CRS)	59	84	25	41
Total Costs excl. Pass-Through Costs	**4,577**	**5,171**	**594**	**13**
Pass-Through Costs	272	312	40	15
Total Costs	**4,849**	**5,484**	**635**	**13**

1.27. External Costs over the Licence period have increased by 7% compared to the RY21/22 forecast to £3.91b. This increase is primarily due to the costs associated with the FSPs. Section 2 summarises the External Cost variations, DCC's justifications and our response.

1.28. Total Internal Costs excluding Shared Services have increased by 37% over the Licence period compared to last year's forecast, from £743m to £1,020m. This is largely driven by increases in the Finance and Corporate Management cost centres and Additional Baseline costs. Section 3 summarises the Internal Cost variations, DCC's justifications and our response.

Comparison to the Licence Application Business Plan (LABP)

1.29. As the length of time since the DCC Licence award increases, we will continue to place a greater weight on the previous year's forecasts to inform our cost assessment rather than DCC's Licence Application Business Plan (LABP). However, comparing costs with the LABP remains an important benchmark for DCC costs and allows us to hold DCC to account for its competitive bid position. The LABP comparison also allows us to ensure costs are economic and efficient.

1.30. Figure 1.2 shows how the main cost categories in RY22/23 compared to the forecast at LABP. In aggregate, costs are £3.14b, or 134% higher over the Licence term compared to DCC's forecast as part of the bid.

Figure 1.2: Comparison of RY22/23 costs to LABP in current year prices

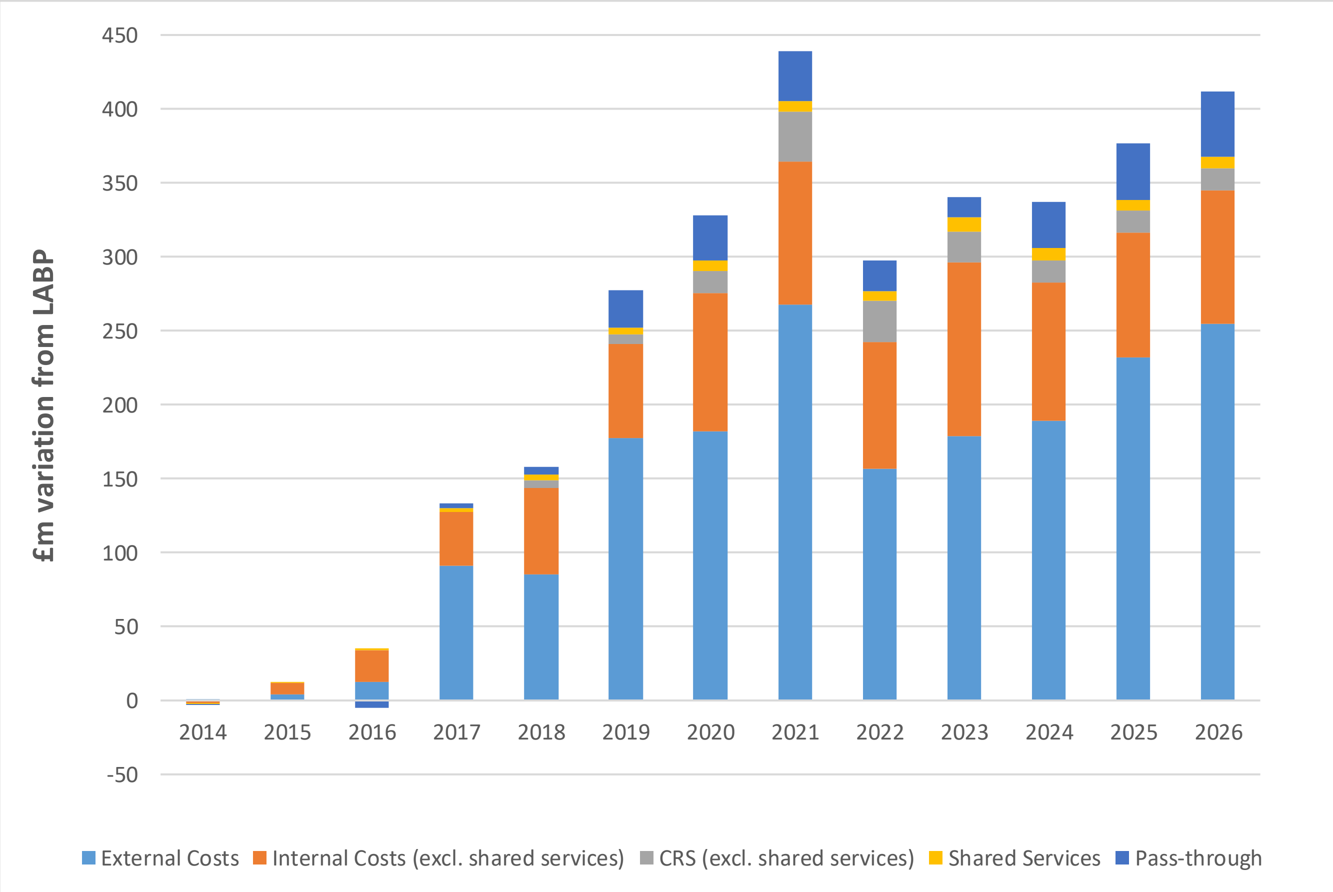


Figure 1.2: Data table

£m	RY13 /14	RY14 /15	RY15 /16	RY16 /17	RY17 /18	RY18 /19	RY19 /20	RY20 /21	RY21 /22	RY22 /23	RY23 /24	RY24 /25	RY25 /26
External costs	0.7	4.1	12.9	91.1	85.2	177.2	181.9	267.9	156.5	178.9	189.1	231.7	254.5
Internal Costs	(1.9)	7.6	21.0	36.2	58.6	63.8	93.3	96.4	85.8	117.2	93.4	84.9	90.1
CRS costs (excl. SSC)	-	-	-	-	4.7	6.4	15.5	33.7	27.7	21.1	15.1	14.3	15.1
Shared Services costs	(0.2)	0.2	1.4	2.5	4.1	5.0	6.9	7.3	6.9	9.4	8.4	7.6	8.0
Pass-Through costs	(0.4)	(0.1)	(4.7)	3.6	5.6	25.2	30.4	33.5	20.8	13.9	31.2	38.0	44.1

Comparison to Last Year's Forecast

1.31. Figure 1.3 shows how the main cost categories in RY22/23 compared to the forecast created as part of DCC's RY21/22 submission.

1.32. Overall, costs are £635m higher over the Licence term compared to the forecasts in DCC's RY21/22 submission.

Figure 1.3: Comparison to RY21/22 forecast in current year prices.

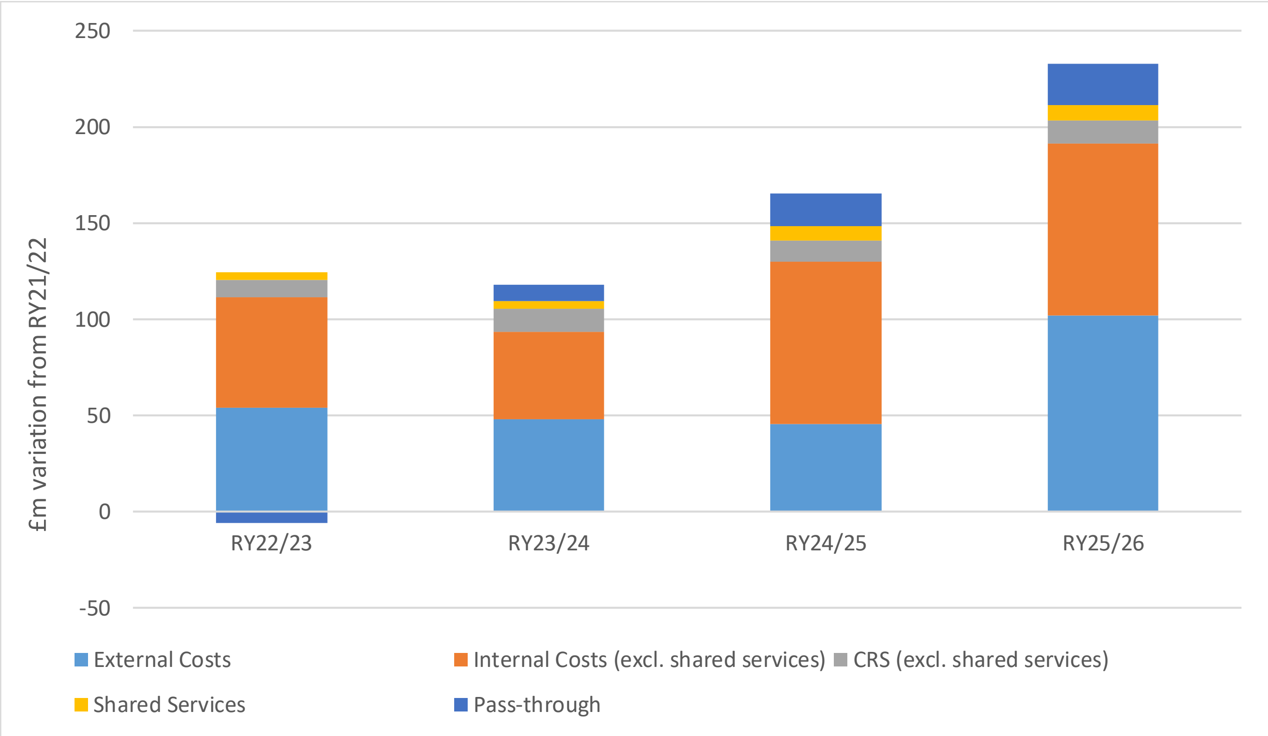


Figure 1.3: Data table

£m	RY22/23	RY23/24	RY24/25	RY25/26
External costs	53.8	48.0	45.8	101.8
Internal Costs	57.9	45.3	84.1	89.6
CRS costs (excl. SS)	8.7	12.0	11.2	12.0
Shared Services costs	4.3	4.3	7.5	8.0
Pass-Through costs	-6.1	8.4	16.8	21.3

2. Consultation stages

2.1. The key dates of the consultation process are set out in Figure 1.4 below.

Figure 1.4: Consultation stages

Consultation open	Consultation closes (awaiting decision). Deadline for responses	Responses reviewed and published	Consultation decision/policy statement
01/11/2023	**29/12/2023**	**February 2024**	**February 2024**

How to respond

2.2. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

2.3. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

2.4. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data, and confidentiality

2.5. You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

2.6. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we will get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

2.7. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

2.8. If you wish to respond confidentially, we will keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

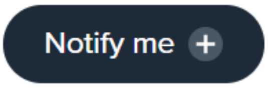
2.9. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We would also like to get your answers to these questions:

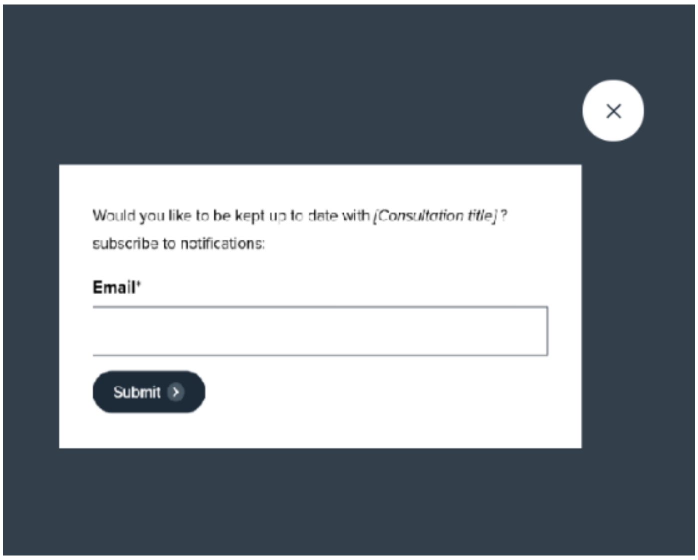
1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6.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

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

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. [Ofgem.gov.uk/consultations.](https://www.ofgem.gov.uk/consultations)





Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

3. External Costs

Section summary

A core part of DCC's role is to manage a large number of contracts with External Service Providers responsible for delivering the smart metering infrastructure. DCC is expected to follow best practice in contract management to derive value from these contracts, effectively manage change, and deliver value for money to its customers and consumers.

External Costs form the largest part of DCC's costs at ~70%. This chapter provides an overview of DCC's External Costs in RY22/23, both incurred and forecasted, and our assessment of DCC's submission and justification. Based on our assessment of evidence provided to us to date, we are consulting on the following cost disallowances. We propose to disallow £4.159m in incurred and £12.406m in forecast External Costs associated with DCC's procurement of an interim solution for a component of the SMETS1 supply chain on the grounds that these costs have not been economically and efficiently incurred. Furthermore, we are minded-to disallow additional costs up to £2.675m in connection with poor performance and issues within the control of DCC's service providers in the SMETS1 programme. We also have significant concerns about a new contract in the 4G Comms Hubs & Networks Programme where DCC did not follow competitive procurement and evidence to date does not provide sufficient justification for the economy and efficiency of the resulting costs. Subject to further evidence, we propose a disallowance *up to* the amount of costs incurred in relation to this contract in RY22/23. Finally, we are minded-to disallow £44.054m in forecast FSP External Costs on the grounds of insufficient evidence and uncertainty.

As per last year, we also identified other issues of concern, including poor quality of regulatory submission, continued reliance on temporary funding mechanisms outside agreed change process and inconsistent forecasting.[11] We expect DCC to make improvements across the board.

[11] For more details on issues identified in our last year's Price Control assessment, please see: Ofgem

Consultation questions

Question 1: What are your views on our proposal to disallow £4.159m in incurred External Costs and £12.406m in forecast External Costs associated with DCC's procurement of an interim solution for the SMETS1 supply chain?

Question 2: What are your views on our proposed cost disallowance of up to £2.675m in relation to SMETS1 service stabilisation in RY22/23?

Question 3: What are you views on our proposal for a disallowance *up to* the amount of External Costs incurred on a directly awarded contract in the 4G CHs & Networks programme?

Question 4: What are your views on our proposal to disallow £44.054m in forecast FSP External Costs?

Question 5: Do you have any other views on External Costs?

What are External Costs?

3.1. External Costs form the majority of DCC's Allowed Revenue (~70% of total costs in RY22/23). These costs are incurred by DCC's FSPs as well as other service providers delivering the SMETS1, Switching, Enduring Change of Supplier (ECoS), and since RY22/23, also the 4G Comms Hubs & Network (CH&N), and Test Automation and Robotics Framework (TAF) programmes. DCC's key role is to effectively manage these service providers under its contracts to derive value for money and quality service for its customers.

3.2. The original FSPs were appointed following a competitive tender process that was run by the government. They include the Data Service Provider (DSP), and the two Communication Service Providers (CSPs). Together, the FSPs are responsible for

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(2022), DCC Price Control consultation: Regulatory Year 2021/22, Chapter 2 (Section Summary), p.30. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122 delivering the data and communications services to support smart metering across Great Britain.

3.3. The SMETS1 service comprises several components provided by a number of providers, which DCC procured over time:

- SMETS1 Service Providers (S1SPs) translating DCC format service requests into a format that SMETS1 meters can understand (in effect acting as upgraded SMSOs[12])
- Dual Control Organisation (DCO) software enhancing security arrangements of the SMETS1 solution; initially provided by two service providers, a third service provider was appointed by DCC in RY22/23
- Communications Service Providers (S1 CSPs) whose network allows DCC to communicate and control the SIMs in each comms hub.
- In addition, the Commissioning Party service enables smart metering systems, which have successfully migrated to DCC, to be set up as 'commissioned'.

3.4. The ECoS Programme is delivered by two service providers, responsible for the following roles:

- Design, build and test of the ECoS Programme arrangements and their integration into the DCC system including communication with the CSS[13]
- Hosting services & service management (*ie* ongoing hosting & maintenance of the ECoS Programme)

3.5. In addition to a new DCO SP, RY22/23 saw the procurement of several new service providers by DCC to deliver two new programmes.

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[12] Smart meter system operators
[13] Centralised Switching Service

3.6. First, five new service providers were appointed by DCC to be responsible for the following roles in the 4G Comms Hubs & Network (CH&N) Programme:

- Component Integration – ensuring an integrated system and service design for the other components of the CH&N solution.
- Device Management – supporting installation, configuration and monitoring of comms hubs, including deployment of firmware upgrades.
- Comms hub provision
- Wide Area Network (WAN) provision to provide a communications service supporting messages to and from 4G comms hubs.
- Integration & Assurance

3.7. Secondly, a new service provider was appointed following a competitive tender process run by DCC to develop, operate, and maintain the TAF programme.

3.8. Table A1.1 in Appendix 1 provides an overview of DCC's main contracts with the FSPs, SMETS1, ECoS, 4G CH&N and TAF service providers, their roles and the years of their contract. New contracts have been highlighted for ease of reference.

How have External Costs changed?

3.9. Over the course of RY22/23, DCC incurred approximately **£445.3m** in External Costs, including Switching External costs.[14] Table 3.1 shows a breakdown for each programme.

[14] Please note that all Switching costs are assessed separately. Throughout this chapter, when we refer to External Costs, we do not include Switching costs. For more information on Switching, see chapter 7 of this document

Table 3.1: Breakdown of External Costs incurred in RY22/23

Programme	Costs incurred in RY22/23 in [£m][15]
SMETS2 – core	302.7
SMETS1	103.1
Switching	16.0
ECoS	6.9
4G CH&N	15.9
TAF	0.7
TOTAL	**445.3**

3.10. Costs incurred by the FSPs, SMETS1, and ECoS service providers (i.e., service providers operating prior to RY22/23) total **£412.75m**. This represents c.0.4% increase on these service providers' total costs compared to last year. However, there are a further **£16.581m** in costs driven by the newly appointed 4G CH&N and TAF programme service providers. Overall, the total incurred External Costs **increased by c.4.5%.** As detailed in table 3.2 below, External Costs have also increased relative to the RY21/22 forecast, as well as the LABP forecast.

3.11. Compared to the forecast accepted under last year's Price Control adjusted for inflation, External Costs are 14% higher in RY22/23 and 7% higher over the Licence term. In comparison to the LABP forecast (i.e., costs forecast at the Licence award), External Costs are 71% higher in RY22/23 and 88% higher over the full Licence term.

Table 3.2: External Costs variance compared to RY21/22 and LABP forecasts (adjusted for inflation)

	Variance in RY22/23		Total variance over the full Licence term	
	£m	%	£m	%
From RY21/22 forecast	53.794	14%	249.365	7%
From LABP forecast	178.923	71%	1,831.851	88%

[15] Please note that these are approximate values and may not add up due to rounding.

3.12. The variance of 7% in total External Costs across the Licence period translates into a growth of over £249m. Figure 3.1. shows the variance in forecast External Costs per RY.

Figure 3.1: External Cost Variance across the whole Licence period

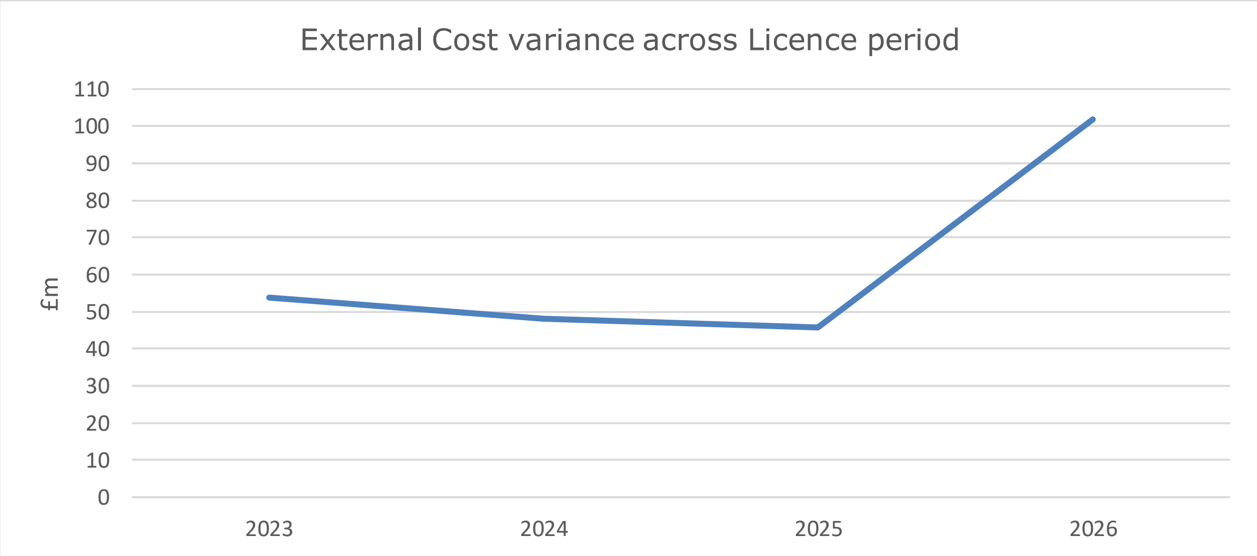

Figure 3.1: Input table

Reg. year	22/23	23/24	24/25	25/26
Variance (£m)	53.851	47.987	45.753	101.833

3.13. As shown in Figure 3.2, the increase in External Costs in RY22/23 compared to last year's forecast is mainly driven by DSP and SMETS1 costs, which account for around 72% of the total positive variance. The remaining 28% of positive variance is explained by ECoS, CH&N and TAF costs; the latter two Programmes being new for RY22/23 with no forecast costs from the year prior (which means all costs represent a 'variance' as there is no forecast from last year).

3.14. However, the overall total increase in variance has been offset by negative variance of -£18.48m in CSP costs. It should be noted that this negative variance has been driven by inflation adjustment of last year's forecast, rather than a decrease in total incurred costs. Without adjusting for inflation, total CSP variance for RY22/23 is £2.385m above last year's forecast.

Figure 3.2: External Cost variance breakdown in RY22/23

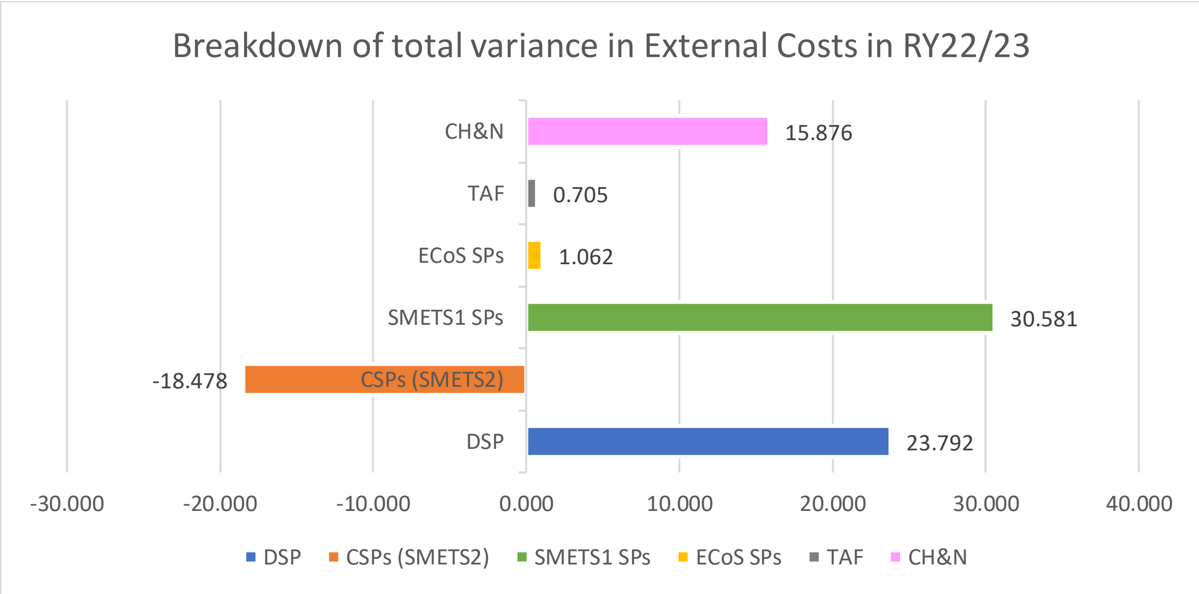

Figure 3.2: Input table

	DSP	CSPs (SMETS2)	SMETS1 SPs	ECoS SPs	4G CH&N	TAF	Total
Variance from RY21/22 in [£m] (inflation adjusted)	23.792	-18.478	30.581	1.062	15.876	0.705	53.794
As % of total variance[16]	33%	N/A	42%	1%	22%	1%	100%

3.15. Table 3.3 provides further details on how costs have changed for DSP, individual CSPs, SMETS1 and ECoS service providers, compared to last year's forecast (adjusted for inflation). In RY22/23, the biggest increase was in DSP costs at c.61% on last year's projection.[17]

[16] Percentage figures have been calculated as a percentage of total positive variance (ie excluding negative CSP variance). However, the total variance figure provided is net variance (ie including negative CSP variance).

[17] Note that while CH&N and TAF variances have been included in figure 3.2 to illustrate total External Cost variance for RY22/23, they have been excluded from table 3.3 as they are new External Cost categories for RY22/23 and thus had no specific forecast in DCC's RY21/22 submission to compare against.

Table 3.3: Cost variation by FSPs, SMETS1 and ECoS SPs compared to RY21/22 forecast (adjusted for inflation)

Service providers	Variance in RY22/23 [%]	Over the Licence term
DSP	61%	12%
CSP-N	-1%	1%
CSP-C	-8%	-4%
CSP-S	-12%	-3%
SMETS1	42%	17%
ECoS SPs	18%	129%

3.16. Examining the variance in forecast costs to the end of the Licence term, we observe a 17% increase in SMETS1 service provider costs (c.£104.57m) and a 6% increase in DSP costs (c.94.07m). Together with 4G CH&N costs (£80.78m), as detailed in figure 3.3 below, these are the principal drivers of cost variances from RY22/23 to the end of the Licence term. While there are also increases in the ECoS programme, given the comparatively lower overall costs of the programme relative to DSP, SMETS1 and 4G CH&N, these increases are less pronounced within the overall variance. These cost increases are partially offset by negative variance in CSP costs across the Licence term, which, when combined, comes to -c.2% (-44.72m) for the Licence term.

Figure 3.3: External Cost variance across the whole Licence period

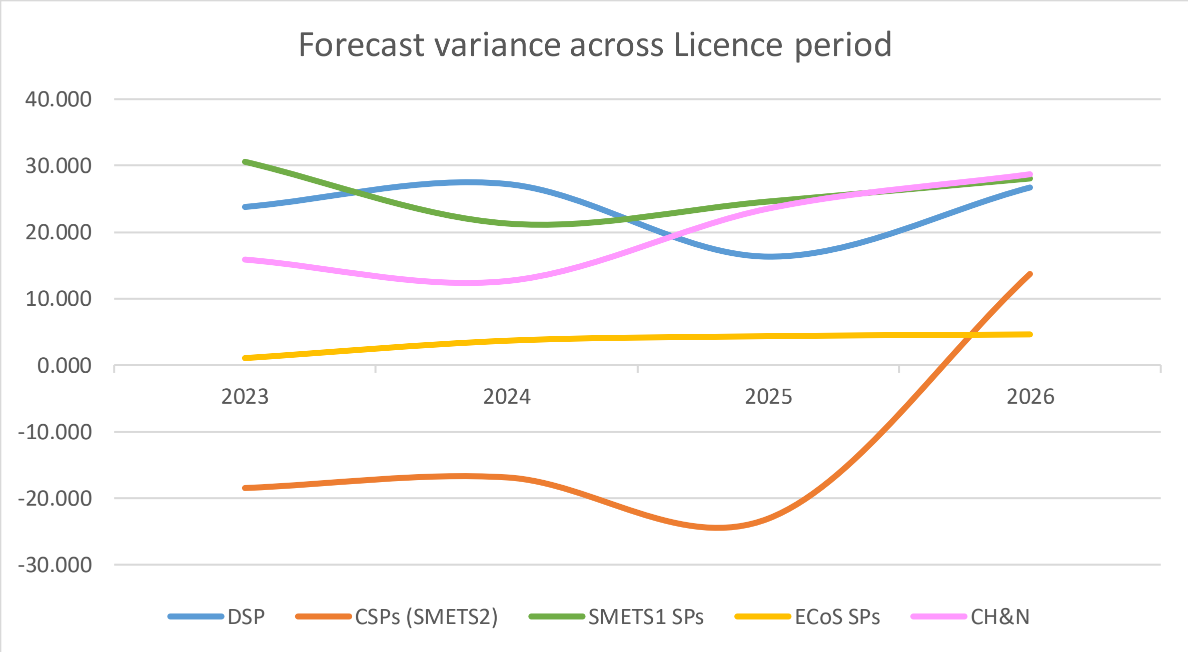

Figure 3.3: Input table

Variance in each reg. year in [£]	22/23	23/24	24/25	25/26	Total variance
DSP	23.792	27.243	16.319	26.717	94.070
CSPs (SMEST2)	-18.478	-16.878	-23.077	13.711	-44.722
SMETS1 SPs	30.581	21.306	24.609	28.075	104.570
ECoS SPs	1.062	3.672	4.351	4.623	13.708
4G CH&N	15.876	12.644	23.550	28.708	80.777
TAF	0.705	-	-	-	0.705
Other	0.256	-	-	-	0.256
Total variance	**53.794**	**47.986**	**45.753**	**101.832**	**249.365**

DSP costs

3.17. DSP costs drive a significant portion of variance in both a year-on-year comparison and for the forecast of the remainder of the Licence. New DSP costs in RY22/23 were driven primarily by:

- System Integration Testing (SIT) and User Integration Testing (UIT).

- Newly justified SMETS2 change requests (CRs) and project requests (PRs).
- Greater demand for user gateway connections than forecasted.
- DSP's role supporting SMETS1 Final Operating Capacity (FOC) and the ECoS Programme.

3.18. In addition to the year-on-year increase, the variance over the full Licence term is driven primarily by:

- User Integration Testing.
- Impact of indexation on Foxed Operational Charges.
- Costs of newly justified SMETS2 PRs/CRs materialising in RY23/24.
- DSP role in the Network Evolution Programme.

CSP costs

3.19. CSP costs, on the other hand, show an overall negative variance for three RYs up to RY24/25. As mentioned above, this is principally on account of inflation adjustment of previous year's forecast. The total nominal costs are not expected to decrease. Variance for RY22/23 on last year's forecast is -£18.48m, while the net variance across the Licence term is -£44.72.

3.20. Examining individual CSPs, CSP-N variance is negative after adjusting for inflation in RY22/23, at -£1.139m. However, it is positive for each subsequent RY across the remainder of the Licence term, leading to a net variance of £7.439m for the period overall. For CSP-C and CSP-S in RY22/23, the net variances are -£7.940m and -£9.399m, respectively. Variances for these two CSPs remain negative overall across the Licence period, totalling -£32.780m and -£19.380m respectively.

3.21. Despite these net negative variances, all CSPs register some cost increases driven mainly by:

- Newly justified SMETS2 PRs/CRs, in particular relating to SEC Release implementation and financing in tranches introduced in RY22/23
- A modest impact of indexation on the fixed operational charges
- For CSP-N in RY22/23 specifically, higher than expected customer requests for test hubs/remote test labs.

3.22. Comms hub charges impact CSP costs both in RY22/23 and in the forecast from RY23/24. Figure 3.4 below shows the total variance in comms hubs costs in each RY. It can be seen that the charges are projected to decrease over RYs 23/24 and 24/25 and increase again from RY24/25. Considering all fluctuations, DCC forecasts a total variance of –£10.81m by the end of the Licence term. DCC reported the following key changes to its forecast assumptions:

- Revised indexation assumptions.
- More volumes of comms hubs expected to be installed in future years.

3.23. These are similar trends seen in previous years. The impact of this revised comms hubs forecast is more pronounced for CSP-C and CSP-S than CSP-N, contributing to their overall negative variance over the Licence term. Comms hubs costs for CSP-C&S were affected by DCC's agreement to provide a temporary relief to the supply chain in the form or a price support arrangement. We discuss our assessment of this arrangement in paragraphs 3.88-3.90 below.

Figure 3.4: Total variance in comms hub charges per RY

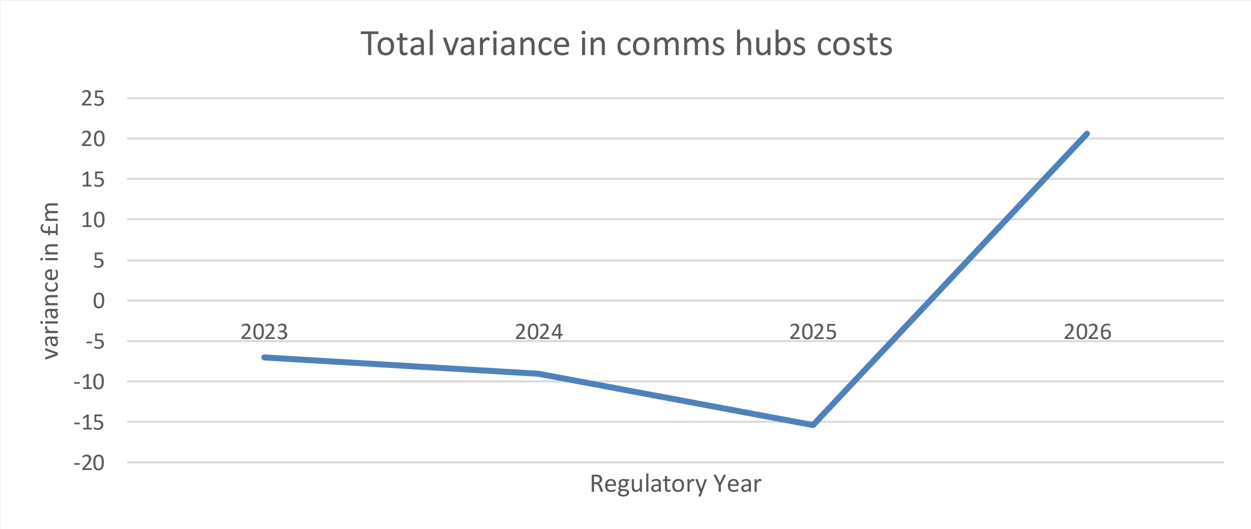

Figure 3.4: Input table

Reg. year	22/23	23/24	24/25	25/26	Total
Variance (£m)	-7.008	-9.024	-15.388	20.615	-10.805

Costs of SMETS1 service providers

3.24. Total SMETS1 service provider costs increased by c.23% (£19.17m) compared to last year. They have also increased relative to RY21/22 forecast for the current RY as well as the Licence term by 42% and 17%, respectively. Table 3.4 below shows the variance for each service provider. It can be observed that in RY22/23 five service providers (highlighted) registered increases in incurred costs above previously accepted forecasts. These were driven primarily by:

- Extension of service for migration of meters in the Initial Operating Capability (IOC) cohort.
- Delivery of the Final Operating Capability (FOC) post go-live date comprising resolution of outstanding technical issues, device swap out functionality, and efforts to maximise migrations.
- Development of a Central Logging System for S1SP_3b.

- Reintroduction of previously disallowed costs for the extension of contracts for the Application Network Security Organisation (ANSO) & Commissioning Party service with S1_DCOa, and S1SP_3b (FOC SP).

- DCC's intervention in the SMETS1 supply chain and build of a temporary emergency solution for a newly appointed service provider[18].

3.25. As in previous years, some of this variance has been offset by a decrease in operational costs reported by the SMETS1 Communications Service Providers, as well as the service provider for MOC. The reduction in operational costs for these three providers is principally due to delays in the SMETS1 programme leading to slower meter migration. As such, costs are deferred until future years as the enrolment process completes.

3.26. The SMETS1 forecast over the Licence period has increased by £104.63m, or roughly 17%, largely driven by the abovementioned contract extensions with two SPs, as well as newly forecasted operational costs of the incoming S1_DCOc provider, and the deferred charges for MOC meter migration.

Table 3.4: Cost variances for SMETS1 service providers compared to RY21/22 forecast (adjusted for inflation)

	Variance in RY22/23 [%]	Variance over the Licence-term
S1SP_1	73%	10%
S1_CSP_1	-27%	-37%
S1SP_2	-11%	20%
S1_CSP_2	-44%	-35%
S1SP_3a	29%	5%
S1SP_3b	155%	86%
S1_DCOa	255%	32%

[18] see paragraphs 3.52-3.63 for more details

	Variance in RY22/23 [%]	Variance over the Licence-term
S1_DCOb	42%	13%
S1_DCOc	N/A	N/A
Total variance in [%]	**42%**	**17%**
Total variance in [£m]	**30.581**	**104.627**

ECoS costs

3.27. In RY22/23 External Costs related to the ECoS programme totalled £6.919m. This is an increase compared to RY21/22 with a variance of £1.06m compared to last year's forecast for RY22/23. Across the Licence term, forecast ECoS costs total £24.33m, representing a variance of 129% (£13.71m) over last year's forecast for the Licence term.

3.28. There is no material variance in costs (>£1m) associated with the Application Build/IT Solution component of the ECoS Programme in RY22/23. Across the Licence term, there are no forecast costs, as the ECoS programme has since gone live and thus the work associated with this element of the Programme is complete.

3.29. As a result, the vast majority of variance across the Licence term is driven by the costs associated Hosting Services & Service Management component of the ECoS programme which has seen significantly revised forecast costs for the remainder of the Licence term. This has been driven primarily by the addition of the forecast operating costs of the contract which were not included in last year's submission, as well as costs associated with the revision of the ECoS Programme's 'go-live' date.

Table 3.5: Cost variances for ECoS Programme service providers compared to RY21/22 forecast (adjusted for inflation)

Contract description	Variance in RY22/23 [%]	Variance over the Licence-term [%]
Application Build/IT Solution	59%	19%
Hosting Services & Service Management	6%	158%
Total variance in [%]	**18%**	**129%**
Total variance in [£m]	**1.062**	**13.708**

4G CH&N costs

3.30. The CH&N programme is new for RY22/23. There were no forecasts in RY21/22 to compare against. As such, all of the incurred and forecasted costs contribute directly to the overall cost variance. The reported aggregate costs for all new contracts in this programme are set out in table 3.6 below.

Table 3.6: Newly reported aggregate costs of 4G CH&N programme

Reg. year	22/23	23/24	24/25	25/26	Total
Total costs	15.876	12.644	23.550	28.708	**80.777**

TAF costs

3.31. The Test Automation Framework (TAF) is likewise a new activity in RY22/23. As such, there are no variances from RY21/22 to report this year. The programme's costs for this year are explained in the next section.

General cost justification

3.32. DCC has to justify its External Costs as 'economic and efficient'. DCC typically does this by reporting and justifying material contractual variations agreed with its service providers – change requests (CRs) and project requests (PRs). This year DCC justified 22 material programme- or project-related CRs/PRs. Material CRs/PRs are understood as those with a 'life value' that exceeds £1m. In line with the established process, DCC justified individual material CRs/PRs through a narrative submission linked to its quantitative reporting for each programme and provided supporting evidence of the scope, drivers and approach to commercial negotiations to ensure value for money.

3.33. Additionally, DCC sought to justify procurement of 6 new contracts and an extension of two existing contracts. To that end, DCC provided details of the procurement process followed, such as the bidding parties involved, the stages of negotiations and shortlisting of bids, the rationale behind the choice of successful bids, as well as details of any savings and value for money achieved through negotiations. For contracts procured under the 4G CH&N programme, DCC also supplied a full business case, copies of internal documentation such as award recommendation reports, and upon further request, resource models and value for money provisions from its contracts.

For contract extensions, DCC provided a financial model and assurance around the continued terms of the contract.

SMETS2

3.34. DCC reported 5 new material CRs and 8 PRs across six areas: Enterprise Change, SEC Release, FOC Uplift, Testing, Security, and System Integration (SI) Release Management. As set out in table 3.7 below, the combined reported value of these CRs/PRs is £37.65m, of which 9 were raised with DSP, accounting for £18.59m. The remaining 6 were raised with CSPs and had the total reported value of £19.06m.

3.35. The largest proportion of the new SMETS2 costs (56%) relates to the SEC Release delivery in particular:

- Second phase of implementation of SECMP0007 (Firmware updates to IHDs and PPMIDs), which comprised the single largest change request as a continuation of work commenced in previous RY.
- Implementation of GBCS 4.1

3.36. Enterprise change consisted of three ECoS-related PRs/CRs for System and User Integration testing and Gamma Connectivity.

3.37. SI Release Management comprised 3 DSP PRs with a combined value of £4.53m. These PRs covered system integration service for the ECoS and CH&N programmes, as well as a 12-month release management to October 2023.

3.38. Further individual PRs/CRs were raised with FSPs to:

- Provide dispensation for meter radio frequency interface at 900Hz to expand the range of meters that can be installed.
- Transition to a new threat-based security solution for DSP
- Extend production support testing service.

Table 3.7: Costs incurred on newly justified CRs/PRs within the SMETS2 Programme

SMETS2 Programme Area	# of new CRs/PRs over £1m[19]	Cost (£m)	% of new costs	Σ (£m)
SEC Release	5 (4)	21.30	56%	37.65
Enterprise Change	3	5.15	14%	
SI Release Management	3	4.53	12%	
Other (security, testing etc)	4 (3)	6.68	18%	
Split between DSP & CSPs				
DSP	9	18.59	49%	36.65
CSPs	6	19.06	51%	

SMETS1

3.39. DCC's submission identified three principal drivers for new SMETS1 costs in RY22/23: delivery of the FOC cohort post go-live date, maximising migrations, and device swap-out functionality. DCC has continued to work with its service providers to deliver periodical maintenance releases, technology refresh and enduring solution for the final meter cohort and to resolve outstanding technical issues. Nonetheless, further unforeseen challenges have resulted in meter migrations progressing more slowly than envisaged. DCC also encountered design defects and operational incidents. We provide our assessment of the costs associated with the delivery of the SMET1 programme below in paragraphs 3.64-3.72.

3.40. DCC also reported 8 new material PRs/CRs with a combined value of £14.02m. Two CRs related to the extension of migration service and B stream environments for IOC. Three CR/PRs were raised with an FOC SP requiring an uplift to its central logging platform to enable meter migration at larger volumes. One CR covered an extension of the Commissioning Party service. Finally, two material PRs related to DCC's procurement of a new service provider appointed to take over a functionality

[19] Where the same PR/CR was raised with multiple service providers, it is counted twice due to separate reporting in DCC's submission.

previously provided by a subcontractor who existed the market. We discuss this issue in more details in paragraphs 3.52-3.63 below (section ’Our assessment’).

3.41. DCC also re-justified its extension of contracts with the ANSO and FOC service providers to ensure continued service provision of the SMETS1 service. DCC reported that those contracts were extended on existing or improved terms.

ECoS

3.42. DCC justified two new CRs associated with the Hosting Services & Service Management element of the ECoS Programme, with total costs of £1.817m.

3.43. One CR was associated with developing an enduring Pre-Integration Testing (PIT) environment to replace the existing short-term solution. The enduring solution gives DCC and the service provider an environment to test changes and fixes to the ECoS solution that are intended to be promoted to System Integration Testing (SIT) and User Integration Testing (UIT) environments.

3.44. The second CR covered a 4.5-month delay to the ECoS Programme’s go-live date (from mid-February 2023 to 30 June 2023). DCC consulted on this revised timeline with both ECoS service providers, the SEC Panel and SEC Parties, before receiving approval for a change to the Joint Industry Plan (JIP).

TAF costs

3.45. DCC justified £0.705m in incurred costs in RY22/23 on the new Test Automation and Robotics Framework (TAF) programme. These comprise initial setup costs prior to the commencement of the programme which is expected to begin in RY23/24. DCC did not report any forecast costs due to lack of certainty.

Our assessment

3.46. We apply consistent methodology and principles in our cost assessment. These are set out in our Price Control Guidance, which is updated periodically and published on Ofgem's website.[20]

3.47. Overall, as in previous years, we consider DCC's submission acceptable to provide justification for most of its External Costs. We accept DCC's justifications of the drivers behind most of the newly justified change requests and projects and how DCC sought to manage those costs to ensure value for money. DCC was generally able to demonstrate how it achieved savings during negotiations with its service providers, for example by challenging resource requirements and controlling scope. We also welcome DCC's supporting evidence aiding our qualitative and quantitative assessment, including copies of relevant impact assessments and cost breakdowns provided through 'supplementary schedules' to the RIGs.

3.48. However, this year's submission did not meet the expected standard in a number of areas:

- DCC failed to include in its initial submission any justification for the new contracts associated with the 4G CHs & Networks programme and Test Automation Framework, despite reporting £16.837m in newly incurred costs through these contracts. Similarly, DCC reinstated previously disallowed costs associated with contract extensions of two SMETS1 service providers without accompanying explanation. DCC supplied additional evidence and justifications upon request, but we expect this information to meet the deadline of 31st July set out in LC 32.4.

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

- The submission contained a number of errors necessitating several rounds of resubmissions of the regulatory reporting. This was pronounced in particular in the reporting of DSP costs.

- Some of the information provided to us in accompanying narrative on CRs/PRs was incomplete. For example, despite reporting additional costs incurred in delivery of SECMP0007,[21] DCC did not initially provide details of these costs or how value for money was secured in this year's submission, and reconciliation of the reporting had to be sought through further engagement.

3.49. Altogether, we found it necessary to ask over 100 formal clarification questions. While DCC did comply with our requests for further information, we noted a further drop in the quality of DCC's reporting this year and expect DCC to make improvements. We would be happy to engage with DCC to discuss improvements to its regulatory submission in future years.

3.50. We would reiterate that, in line with LC 37 Part A, DCC must provide an explanation for all material variances in its incurred and forecast costs. To manage the regulatory burden on both Ofgem and DCC, DCC is asked to apply a materiality threshold to its cost justifications. As in previous years, DCC has selected a threshold of £1m. However, in areas of concern, we may request more granular information to assist our cost assessment, which may extend to costs below the materiality threshold. Further, as set out in our Guidance, DCC must demonstrate that any cost changes, including costs of new contracts, are justified as economic and efficient and deliver value for money.[22] If no or insufficient justification is provided in support of newly incurred costs, such costs may be considered to be Unacceptable. We cannot assume costs are economic and efficient; the burden of evidence lies with DCC.[23]

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[21] For details, see Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 2.68-2.74. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122
[22] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, paragraphs, 2.68-2.71. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[23] Ibid, paragraph 2.60.

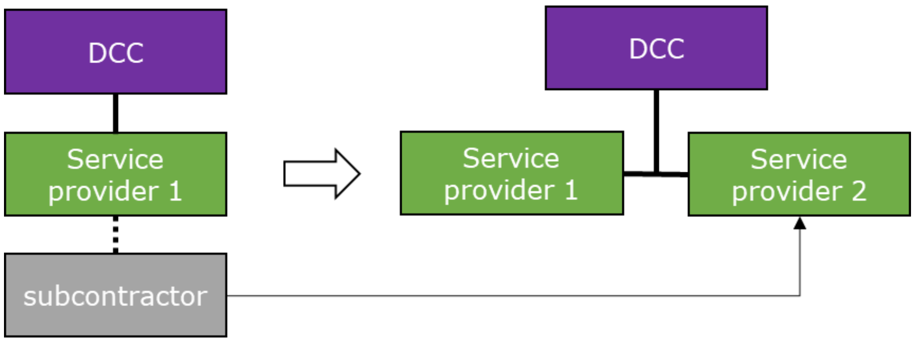
3.51. Below we set out our key findings and areas of concern. Please note that due to confidentiality reasons, some details have been omitted from this section. DCC will be provided with further details alongside this consultation document, should it wish to submit additional evidence in response to our proposal.

SMETS1: Supply chain

Background

3.52. In 2021, a subcontractor of one of DCC's SMETS1 service providers experienced financial difficulties. To ensure continuity of service provided by this party, DCC stepped in and, in cooperation with the service provider responsible for this subcontractor, worked to transfer this service to a new provider under an interim emergency solution. The overall service is now delivered by two service providers, as visualised in the schema below.

Figure 3.5: Visualisation of the original and new solution



3.53. The process did not follow a competitive procurement route and attracted new costs associated both with the set-up of the new solution ('build costs') and enduring charges ('run costs').

DCC's justification

3.54. DCC sought to justify this procurement and resulting costs on two main grounds.

3.55. First, DCC provided extensive narrative around the timeline of events and the decision-making around its intervention. DCC explained that it opted for a direct award to a service provider who was able to accommodate a 'lift and shift' solution on a tight timeline. This proved technically successful, and the service continued without disruption.

3.56. Secondly, DCC sought to justify the build and run costs as follows:

- Build costs were paid to the original service provider to cover on-demand support, procurement of third-party licences for a private cloud provided by the new SP, support the incoming SP in their build of a second data centre, as well as service transition and infrastructure decommissioning, among others.

- Build costs were paid to the incoming service provider to cover set-up, labour, test and run costs associated with an existing and a new data centre.

- Run costs are being paid to the new SP on a monthly basis. These costs are c.30% higher than under the original subcontracted solution due to the need for four additional services built into the ecosystem, replacing automated processes which had previously existed between the original SP and its subcontractor.

3.57. DCC also provided information on a contractual amendment removing the charges associated with the defunct service and their replacement by a service uplift charge for the management of the new supplier by the exiting SP.

Our view

3.58. We recognise that the situation required an emergency intervention by DCC to ensure business continuity and prevent significant disruption to the smart metering service. As such, we acknowledge that DCC was constrained in its options to move away from the original provider and are minded-to accept the overall interim emergency measure until its end date in April 2024. However, we have concerns about the associated costs in some areas.

3.59. First, DCC's evidence shows that the new SP started providing services under the emergency measure no later than autumn 2022, prior to the default of the original subcontractor. However, charges for the defunct service were not removed from the existing contract until July 2023, resulting in a period of at least 9 months where DCC appears to have paid for the same service twice. **We do not consider such charges, totalling £2.574m** (split between reporting for RY22/23 and RY23/24), **to be economic and efficient and are minded to exclude them from DCC's Allowed Revenue.**

3.60. Secondly, we are minded to accept DCC's explanation that the interim emergency measure may attract higher run costs which were not foreseeable at the time. However, given these elevated enduring costs, as well as significant expenditure on build costs by the new provider, we at present do not consider the ongoing service uplift and management charges paid to the to the original SP to be justified. **We therefore consider these charges, totalling £0.731m in RY23/24 and £0.937m in subsequent years, Unacceptable Costs and thus propose to exclude them from DCC's Allowed Revenue.**

3.61. Thirdly, we are concerned about the magnitude of the set-up (build) costs, particularly those paid to the SP responsible for the failed subcontractor. We did not receive any evidence showing that DCC sought to, or indeed did, share any of the resulting costs with this SP despite its contractual obligation for service delivery. **We are minded-to reject and disallow a portion of these build costs totalling £2.443m** which we consider to not be economic and efficient on the grounds that they should have been included in the build costs of the incoming service provider, and/or borne by the responsible SP at its own cost.

3.62. Finally, although we accept DCC's decision to enter into this emergency contract on an interim basis, we expect DCC to run a complete competitive procurement for an enduring solution at the earliest possible opportunity. As such, **we are minded to-exclude from DCC's Allowed Revenue all of forecast enduring (run) costs following the contract end date in April 2024.**

3.63. Table 3.8 below provides an overview of our proposed disallowances across these four areas. We will consider any new evidence prior to making our final determination.

Table 3.8: Proposed disallowances per RY, in [£m]

	RY22/23	RY23/24	RY24/25	RY25/26
Charges paid to original SP	1.716	0.858	-	-
Service uplift & management	-	0.731	0.937	0.937
Build costs	2.443	-	-	-
Run costs of new solution	-	-	4.471	4.471
TOTAL	**4.159**	**1.589**	**5.408**	**5.408**

SMETS1: Service stabilisation

Background

3.64. While the enrolment and adoption service for all three SMETS1 cohorts (IOC, MOC, FOC) has gone live, the programme continued to experience technical issues and slower migrations in RY22/23. This led to additional costs expended by DCC to stabilise the service.

3.65. DCC's Annual Service Report further showed that throughout RY22/23 performance of relevant service providers co-delivering the programme at times fell below the expected standard, including a high number of incidents, and key performance measures and targets not being met.[24]

DCC's justification

3.66. DCC attributed the new costs for service stabilisation to five main areas:

- Operational Maintenance Releases carried out throughout the year, including work on resolving solution defects requiring additional testing, outstanding technical changes not delivered prior to the go-live date, and delivery of further change requests.

[24] DCC (2023), Annual Service Report 2022/23. Available at: www.smartdcc.co.uk/search-results/?search=annual+service+report

- Two unforeseen operational incidents in areas of incorrect implementation of the solution design.
- A design change to account for higher-than-expected failures of the DCO service.
- Technology refresh and end of life service to ensure continued operational support.
- Improvements to operational capacity to meet industry demand.

3.67. Upon further request, DCC provided a more detailed breakdown of these costs alongside its assessment of where costs arose as a result of unforeseen issues, incidents, or defects. DCC sought to show that it had successfully avoided paying for a number of activities, such as defect fixes, where it considered them to be the responsibility of its external service providers.

3.68. DCC further explained that it has worked with SPs to bring performance to satisfactory levels, noting improvement on last year for at least one SP.

Our view

3.69. First, we acknowledge that the SMETS1 programme has proved technically complex and recognise the effort of both DCC and industry to mitigate issues and deliver a successful solution. However, as set out in our RY21/22 decision,[25] we do not consider that DCC customers, and by extension consumers, should bear the costs associated with under-delivery or poor performance of DCC's service providers.

3.70. The evidence we have received through the submission suggests that although DCC successfully resolved a number of issues at the cost of SPs (where the relevant SP was found to be the responsible party), there remains a portion of costs expended on the

[25] Ofgem (2023), DCC Price Control Decision Regulatory Year 2021/22, paragraphs 2.16-2.18. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202122

SMETS1 service stabilisation and borne by DCC, which can be ascribed to a service provider failure or poor delivery. These comprise the following:

- A portion of costs incurred through maintenance releases where responsibility lies with a service provider.
- An operational incident caused by a functional error in the supply chain.
- Design change resulting from failures within one contracted component of the SMETS1 infrastructure.

3.71. Based on the evidence received to date we at present **do not view these costs, totalling £1.429m, as economic and efficient and, in line with our previous decision on a similar issue, are minded-to exclude them from DCC's Allowed Revenue.** One of DCC's key roles is to effectively manage its service providers and derive value for money from its contracts on behalf of customers and energy consumers. This includes having an appropriate risk sharing framework in place and effectively utilising contractual levers in case of poor performance so that any resulting costs are apportioned fairly to the responsible party. We would encourage DCC to continue to focus on bringing up performance of its service providers to consistently satisfactory levels. Despite stated improvements, as observed by the independent auditor in their report on DCC's contract management under the Operational Performance Regime (OPR), DCC failed to fully uplift the performance of service providers who had been found to be underperforming in RY21/22.[26] We recommend that DCC study the findings of the auditor to drive improvements in programme delivery going forward.

3.72. Secondly, the evidence received to date provides justification for only a portion of the costs reported for service stabilisation – this includes both those costs we are minded-to accept and those discussed above under a proposed disallowance. Of the remaining costs lacking justification, over 90% were incurred by two service providers whose

[26] See paragraph 5.66 in this document

poor performance demonstrably contributed to the identifiable Unacceptable Costs discussed above and which was observed by the independent auditor in their report. As such, **in the absence of any further evidence, we are minded-to consider *up to* £1.246m of these costs to not have been incurred economically and efficiently and exclude them from DCC's Allowed Revenue for RY22/23**. Should we receive further information in support of these costs, we may revise our proposed disallowance to better reflect the proportion of Unacceptable Costs. The Licensee will be provided with a detailed breakdown of this proposed disallowance, and we encourage DCC to supply additional evidence in response to this consultation.

4G Comms Hubs & Networks: Procurement of new Fundamental Service Capability

Background

3.73. In RY22/23, DCC procured several new External Service Provider Contracts to deliver the 4G Comms Hubs & Networks programme, as detailed in paragraph 3.6 above. The programme is expected to go live in 2025 and last for 8 years during which 2G and 3G CHs and related infrastructure will be gradually replaced by new 4G equivalents. These contracts will be in place for a number of years and their collective value for the duration, as currently negotiated by DCC, is over £800m. It is therefore crucial that DCC demonstrate that these new contracts deliver value for money.

3.74. We are concerned about the costs associated with one of these contracts that was not procured on a competitive basis (which is the baseline requirement of the Licence provisions dealing with FSC)[27] but awarded directly to a selected service provider.

DCC's justification

3.75. DCC sought to justify both its approach towards this non-competitive procurement as well as the value for money and costs of the final contract.

3.76. First, DCC explained that it had originally planned to provide the capability covered by this contract in house. However, upon realisation that doing so may be in

[27] LC 16.5

contravention of provisions regarding procurement of FSC (and the restriction on obtaining FSC from its own resources),[28] a decision was taken to instead procure the service externally. DCC argued that due to the critical nature of the service, at that point in time, a full competitive procurement would have led to a programme delay at a significant cost to the industry. As such, DCC proceeded to negotiate directly with a preferred provider who in DCC's view had displayed sufficient expertise to undertake this capability on account of their provision of other services to DCC.

3.77. Secondly, upon request, DCC provided supporting evidence which sought to demonstrate that its negotiations secured value for money, including contractual 'value for money' provisions and a financial model setting out the resource profile.

Our view

3.78. Upon our assessment of the evidence submitted by DCC, we remain concerned about certain aspects of the process and the outcome of this procurement.

3.79. First, whilst we acknowledge the time constraints for running a full competitive procurement, in DCC's admission, no competitive procurement had been envisaged for this contract as DCC had intended to provide the service in house despite the Licence provisions on procurement of FSC from external service providers and restrictions placed on the provision of non-FSC from own resources.[29] We are engaging with DCC to understand to what extent it was within its control to undertake a timely competitive procurement.

3.80. Secondly, as set out in our commentary on procurement in RY21/22 Price Control Consultation,[30] DCC has an obligation under the Licence to drive fair, transparent and effective competition, and should ensure that incumbent providers do not receive any undue advantage in bidding for future contracts. In this instance DCC selected one of its incumbent providers with a proven record of delivery but also knowledge of DCC's

[28] LC 16.6
[29] LC 16.4-16.6
[30] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraph 2.76. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

systems and processes. We are concerned that this constrained DCC's ability to exercise competitive pressure during negotiations.

3.81. Thirdly, submitted evidence currently does not provide sufficient justification for the cost and value for money of the contract which have not been tested in the open market.

3.82. As set out in our Guidance, "if any part of the FSP contract is reprocured, this needs to be evidenced as the best solution to secure an economic and efficient outcome".[31] Overall, following our assessment of the information made available to us to date, we are not satisfied that all of the resulting costs were incurred economically and efficiently. We are requesting further evidence from DCC on this matter. **In the absence of further information, we are considering *up to* the total costs associated with this contract to be Unacceptable and are minded-to exclude them from DCC's Allowed Revenue for RY22/23**. Facilitating effective competition is one of the DCC's main objectives under the Licence.[32] As part of this, under LC16, DCC is expected to drive a fair and effective procurement process, and consequently this should be treated as the primary expected vehicle to deliver value for money. In assessing the economy and efficiency of DCC's spend, we consider various factors, including how Licence conditions requiring competitive procurement apply to any particular circumstance, as well as any evidence DCC can provide us which speaks to the efficiency and economy of its actions.

3.83. Finally, we would note that we make case by case assessments of the efficiency and economy of the DCC's spend under the Licence and Guidance, and nothing in these decisions determines the outcome of future decisions, including any future scrutiny of compliance with the Licence obligations.

[31] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, paragraph 2.71. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[32] Under LC 5.10 (a), the Second Enduring General Objective of the Licensee is to carry on the Mandatory Business in the manner that is most likely to facilitate effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy under the Principal Energy Legislation.

CSP-C&S price support

Background

3.84. In RY21/22 DCC agreed to a contractual amendment to pay additional cost per comms hub to CSP-C&S for a limited period of 12 months from March 2022 to March 2023 (subject to possible early termination) in order to protect the supply of comms hubs at a time of global pressures on supply chains.[33]

3.85. In our RY21/22 Price Control Decision, we said that we accepted in principle the need for DCC to enter into the temporary price support agreement. However, we lacked assurance that sufficient controls were in place for the 12-month duration of the price support to ensure that no costs were incurred beyond a point when the conditions necessitating its continuation no longer applied. We therefore determined that those costs would be excluded from forecasts and directed DCC to resubmit its justification after the end point of the arrangement with focus on total incurred costs, the decision taken on the eventual end date, controls and reviews in place, and actions to minimise further expenditure beyond contracted terms.

DCC's justification

3.86. DCC reported that the price support ran its course to March 2023. The number of CHs provided in this period was below the negotiated cap and the relief to the supply chain translated into £4.3m of incurred costs when factoring in a negotiated indexation deferral. Controls in place throughout the duration of the price support included: weekly supply chain reviews with the CSP, updates from the CSP on the component prices, DCC's assessment of market conditions with independent assurance, or customer engagement via forums such as SEC Ops group, among others.

[33] For more details, see Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 2.52-2.56. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

3.87. DCC provided assurance that the price support has now ceased to be in effect and costs have returned to the contractual level. It was confirmed that no price support is currently in place.

Our view

3.88. Upon review of the additional *ex-post* justification provided by DCC in its submission, we are minded to accept the incurred costs of the price support. The reported costs are in line with the expected magnitude; DCC was able to negotiate savings, such as deferral of the indexation which reduced the level of actual incurred costs. We are also satisfied that DCC put in place sufficient controls to ensure that the duration of the arrangement did not exceed period of necessity.

3.89. Nevertheless, going forward, we expect DCC to stick to its contractual terms and protect customers, and consumers, from further price hikes. We would expect the long-term nature of the contracts with FSPs to accommodate and smooth out price fluctuations.

3.90. We also maintain our ECGS position from our decision in RY21/22 and are minded-to reject the proportion of ECGS associated with the temporary price increase. For more details on the ECGS application, please see chapter 6.

Early Engagement Instructions

3.91. In previous years, we expressed concerns about DCC's potential over-reliance on instruments providing a temporary cover for ongoing work while negotiations with relevant service provider are underway. These temporary funding mechanisms in the absence of a Final Impact Assessment/Statement of Work were intended to be limited to exceptional circumstances, for example where work is required to commence on a tight timeline. In practice, we found that DCC often funded a significant number of PRs/CRs through this interim mechanism, particularly in programmes that faced delays. DCC in the past committed to phasing out this practice as programmes move to BAU operations.

3.92. DCC initially employed Letters of Instructions (LoIs), which were superseded by Urgent Work Orders (UWOs) in RY20/21. UWOs were designed to provide stronger controls over spend and governance compared to LoIs. In RY22/23, UWOs were in turn replaced by a new policy of Early Engagement Instructions (EEIs). Evidence from DCC shows their continued use across different programmes over the past RY. As noted by the independent auditor in their report on DCC's compliance with the NAO framework for contract management, and corroborating our earlier observations, repeated use of the EEIs increases commercial risk to both DCC and its service providers due to deviation from regular Contract Change Policy.[34] We also remain concerned that the continued use of EEIs may be symptomatic of broader issues with timing in change governance and management.

3.93. Going forward, we expect DCC to minimise the use of EEIs, or a similar policy, to instances of genuine necessity. We will continue to actively monitor their use, including through the independent contract management audit. While on this occasion we are not proposing a cost disallowance, we are proposing to reduce DCC's margin at risk against the contract management incentive, in part on account of partial non-compliance with the NAO framework in the area of change control. (For more details, please see table 4.3 in this document.)

Forecast costs (FSPs)

Background

3.94. DCC's forecast External Costs (*ie* over 3 years from RY23/24 to the end of the Licence term) have increased by £195.57m.[35] Our guidance sets out the principles for updating forecasts.[36] In general, forecast costs should only contain economic and efficient costs and be significantly more likely than not to occur. If DCC fails to justify any forecast costs as being economic and efficient we may remove them from the forecasts as part of the determination.

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[34] See paragraph 5.64 of this document.
[35] When compared to last year's forecast adjusted for inflation.
[36] 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

3.95. There are several instances where DCC's submission did not provide justification for forecast costs, both in terms of their economy and efficiency and meeting the certainty threshold. We asked DCC for additional evidence as part of our cost assessment.

3.96. Additionally, we queried DCC's reporting of costs relating to SECMP0007 (Firmware updates to IHDs and PPMIDs). Last year we scrutinised the costs associated with implementation of this SEC mod and accepted them to the value of £26.6m, noting that we expect DCC to improve the quality of its impact assessments and reporting of costs to the SEC parties.[37] This year's quantitative submission includes forecast costs which exceed this level without clear explanation.

3.97. Table 3.9 below details the costs, split into relevant areas and RYs, which presently lack sufficient justification.

DCC's justification

3.98. DCC provided the following justifications for the queried forecast costs (all of these relate to DSP):

- With respect to two CRs associated with User Integration testing, DCC explained that one covered an extension to a testing environment for releases prior to live production, while another provided cover for an initial set-up of a new service provider in SIT and UIT environments and the provision of test data

- One SMETS2 PR was justified by DCC in its written submission on a time and materials basis.

- For one SMETS2 CR, DCC reported that financial terms were being finalised; similarly, DCC confirmed that terms of one ECoS CR had only been agreed in July 2023.

[37] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 2.68-2.74. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

- Finally, DCC explained that its forecasts for a number of smaller items reported under Network Evolution originated in its Annual Business Plan forecast which had been assessed by the internal Finance and Commercial teams.

3.99. On request, DCC submitted a high-level cost analysis of SECMP0007, including its current cost forecast of £29.1m. DCC also sought to provide assurance that this expenditure receives full scrutiny by industry both before and after the release go-live date.

Our view

3.100. In relation to the two User Integration Testing CRs, and one ECoS CR, we note that these are new CRs which meet the materiality threshold of £1m. We would therefore expect to see a more comprehensive justification detailing the driver, value for money and other relevant information typically provided for material PRs/CRs. Pending such information, we are minded-to remove these costs from DCC's forecasts on the grounds of insufficient justification.

3.101. We note that the queried SMETS2 PR was explained in DCC's written submission. Nevertheless, the forecast costs exceed the justified amount. In the absence of further evidence, we are minded-to remove these costs from the forecasts.

3.102. We invite DCC to provide confirmation and evidence in its consultation response of the final commercial terms for the SMETS2 CR in negotiation. However, without this information, we propose to remove the interim values from the forecasts due to these costs not meeting the required certainty threshold.

3.103. Finally, we have not received evidence corroborating DCC's forecasts for Network Evolution DPS and DSMS costs. We encourage DCC to submit its reviewed Annual Business Plan forecast in its consultation response to provide assurance around the projected costs. In the absence of this evidence, we are minded-to disallow these forecasts due to lack of justification.

3.104. With respect to SECMP0007 costs, we are unable to reconcile DCC's regulatory reporting with its commentary and cost analysis. We have also not received any evidence of scrutiny by the industry of the SEC Panel as DCC appears to have omitted this from its supplementary note. As such, we are minded-to remove all forecast costs of SECMP0007 for two service providers pending receipt of clear reconciliation of incurred and forecast costs and evidence of stakeholder engagement on the cost increase above £26.6m. We would encourage DCC to provide this evidence as part of its consultation response.

3.105. **Taken together, subject to further sufficient information being received, we propose to disallow and remove from DCC's forecasts £44.054m in FSP costs.** We note that throughout our assessment, in response to our clarification questions, DCC repeatedly resubmitted its regulatory reporting due to identified errors, many of which occurred in forecast costs. We would remind DCC of the importance of providing accurate and complete information in its submission and expect an improvement in the quality assurance of the regulatory reporting. Forecast costs should provide a reasonable baseline against which to compare costs at the next Price Control – as such, their reporting should be accompanied by appropriate justification.

3.106. Overall, we are disappointed that DCC's forecasting continues to be inconsistent. While we acknowledge that parts of DCC's business, such as live programmes, can at times be challenging to accurately project, large parts of DCC's Allowed Revenue have moved to live operations and their costs should be expected to be sufficiently stable and predictable. This is especially important as we commence the process of moving towards an *ex-ante* price control regime with the aim to bring in improvements to the existing arrangements from April 2025 for the duration of any Licence extension.[38]

[38] See: Ofgem (2023): DCC Review: Phase 1 Decision, chapter 5. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision

Table 3.9: Proposed forecast FSP External Cost disallowances

Area/ General description	Proposed disallowance in [£m] per RY		
	RY23/24	RY24/25	RY25/26
User Integration Testing: *SP onboarding*	1.236	-	-
User Integration Testing	1.111	1.126	1.145
SMETS2 PRs: *Production Support Testing*	1.783	-	-
SMETS2 CRs	0.560	0.022	-
ECoS CRs	1.682	-	-
Network Evolution – DSP: *aggregate items*	1.409	3.678	10.586
Network Evolution – DSMS: *aggregate items*	7.507	0.567	0.500
SECMP0007	5.363	5.768	0.011
TOTAL	**20.651**	**11.161**	**12.242**
GRAND TOTAL			**44.054**

4. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY22/23 and its updated forecasts. DCC has provided sufficient justification for the majority of these costs.

We are proposing to disallow **£9.605m** of non-resource costs[39] incurred in RY22/23. This is largely due to a combination of inefficiencies in the planning and resourcing of activities, the procurement of various External Services, additional spend on the Business Accuracy Programme, Shared Service Charges, contractor benchmarking, as well as continued activity relating to innovation, noting this is not part of DCC's Authorised Business.

We are also proposing to disallow **£1.914m** of resource costs due to a lack of justification for the extra resource, particularly in the Security, Design and Assurance and Corporate Management cost centres, and the Network Evolution programme.

We are minded-to disallow **£44.625m** of DCC's forecast costs over RY23/24 and RY24/25 which comprises of both resource and non-resource costs. This is due to insufficient justification for the additional resource and increasing costs. Furthermore, we are proposing to disallow costs around activities which are not part of DCC's mandatory duties.

Finally, we are also proposing to disallow **£89.613m** of baseline forecast costs for RY25/26 (end of the Licence term) due to a lack of justification provided by DCC.

[39] The Unacceptable Costs shown in the section summary are not inclusive of any associated Shared Service Charge (SSC). Please see Appendix 3 for the detailed breakdown on the proposed Unacceptable Costs.

Consultation questions

Question 6: What are your views on our proposals on disallow a 50% proportion of the RY22/23 resource costs associated to Corporate Management, Design and Assurance, Security cost centres and the Network Evolution programme?

Question 7: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 8: What are your views on our proposal to disallow the continued costs that are linked to the activities that we disallowed in RY21/22 – these include additional costs associated with the Executive training programme, innovation and growth as well as a continuation of the RY21/22 non-competitive procurements?

Question 9: What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not have been resourced in the most economic and efficient way?

Question 10: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

Question 11: What are your views on our proposal to disallow costs associated with the RY22/23 non-competitive procurements for which we have not received satisfactory justification or evidence?

Question 12: What are your views on our proposals on the Shared Service Charge?

Question 13: What are your views on our proposal to disallow forecast cost

What are Internal Costs?

4.1. Internal Costs comprise the costs that are economically and efficiently incurred by DCC for the purposes of the provision of the DCC service (excluding External Costs and Pass-Through Costs). These are defined by ten general ledger (GL) categories: Payroll Costs, Non-Payroll Costs, Recruitment, Accommodation, External Services, Internal Services, Service Management, Transition, IT services, and Office Sundry. Internal Costs are reported by 'cost centres' which cover the main activities where DCC incurs costs. Please see Appendix 2 for more detail.

How have Internal Costs changed?

4.2. Figure 4.1 shows the distribution of costs by general ledger (GL) code over the Licence period, based on DCC's RY22/23 submission. Internal Costs have peaked in RY22/23 at £139.916m[40], this is £62m more than was forecasted in RY21/22. The GL codes are dominated by payroll costs – this reflects the fact that DCC is a relatively asset-light company with a primary focus on contract management and programme delivery. Total Internal Costs are therefore driven primarily by salaries and headcount, and non-resource costs.

[40] This figure includes Shared Service cost.

Figure 4.1: Internal Costs by cost type or GL code in current year prices

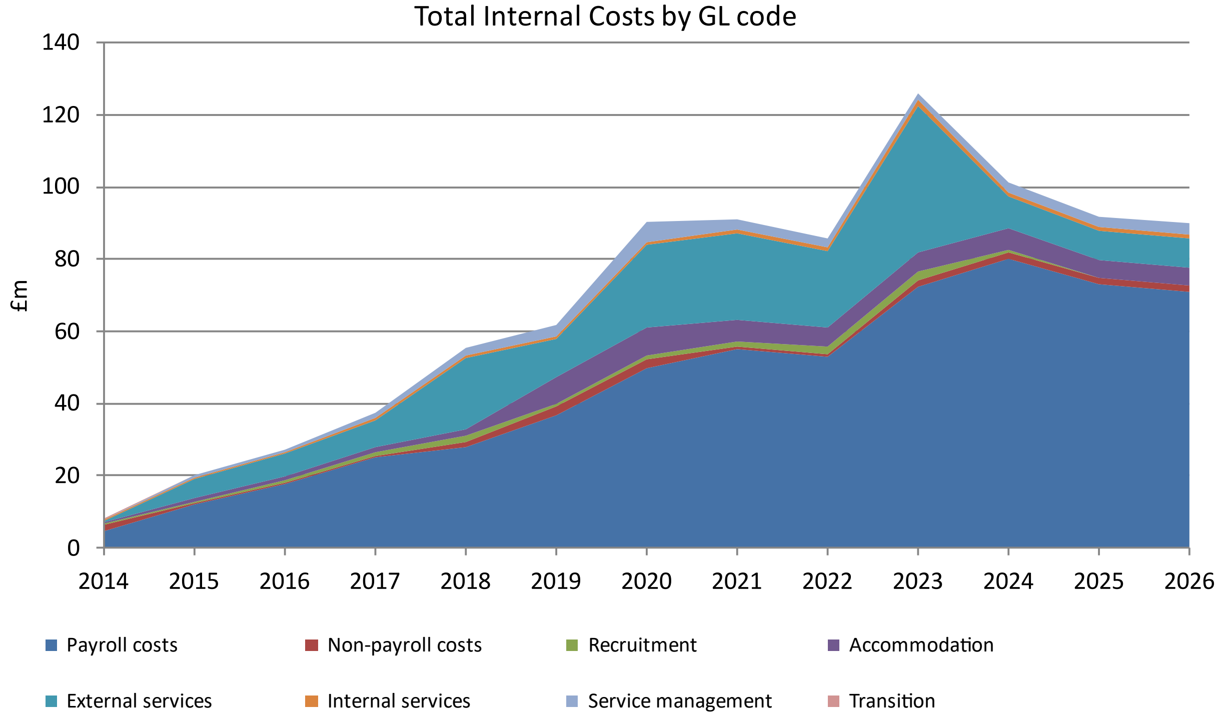

Figure 4.1: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Payroll costs	5.8	14.8	21.5	30.5	33.0	42.5	56.6	62.2	57.6	72.3	80.2	73.0	71.1
Non-payroll costs	2.2	0.6	0.7	0.4	1.7	2.7	2.7	0.8	0.8	1.8	1.8	1.8	1.8
Recruitment	0.5	0.4	0.5	1.0	1.7	1.1	1.3	1.5	2.2	2.4	0.6	0.0	-
Accommodation	0.4	1.5	1.5	1.8	2.3	8.4	8.7	6.6	5.7	5.4	5.9	4.9	4.9
External Services	0.3	6.2	7.8	9.3	23.2	12.5	26.4	27.4	23.0	40.6	9.1	8.1	8.2
Internal Services	0.6	0.6	0.6	0.7	0.8	0.5	0.7	0.9	1.4	1.5	1.0	0.9	0.8
Service management	-	0.8	0.9	1.7	2.5	3.6	6.2	3.3	2.6	2.1	2.8	3.1	3.4
Transition	0.6	0.0	-	-	-	-	-	-	-	-	-	-	-
IT services	1.0	3.3	4.9	4.0	6.2	5.8	6.2	6.2	4.3	3.1	5.1	4.7	4.7
Office sundry	0.0	0.1	0.1	-	0.1	0.0	0.2	0.3	0.3	-	0.1	0.1	0.1

4.3. Figure 4.2 shows the distribution of Internal Costs. Additional Baseline, Corporate Management and Operations cost centres continue to be the three largest cost drivers in RY22/23.

Figure 4.2: Internal Costs by cost centre in current year prices

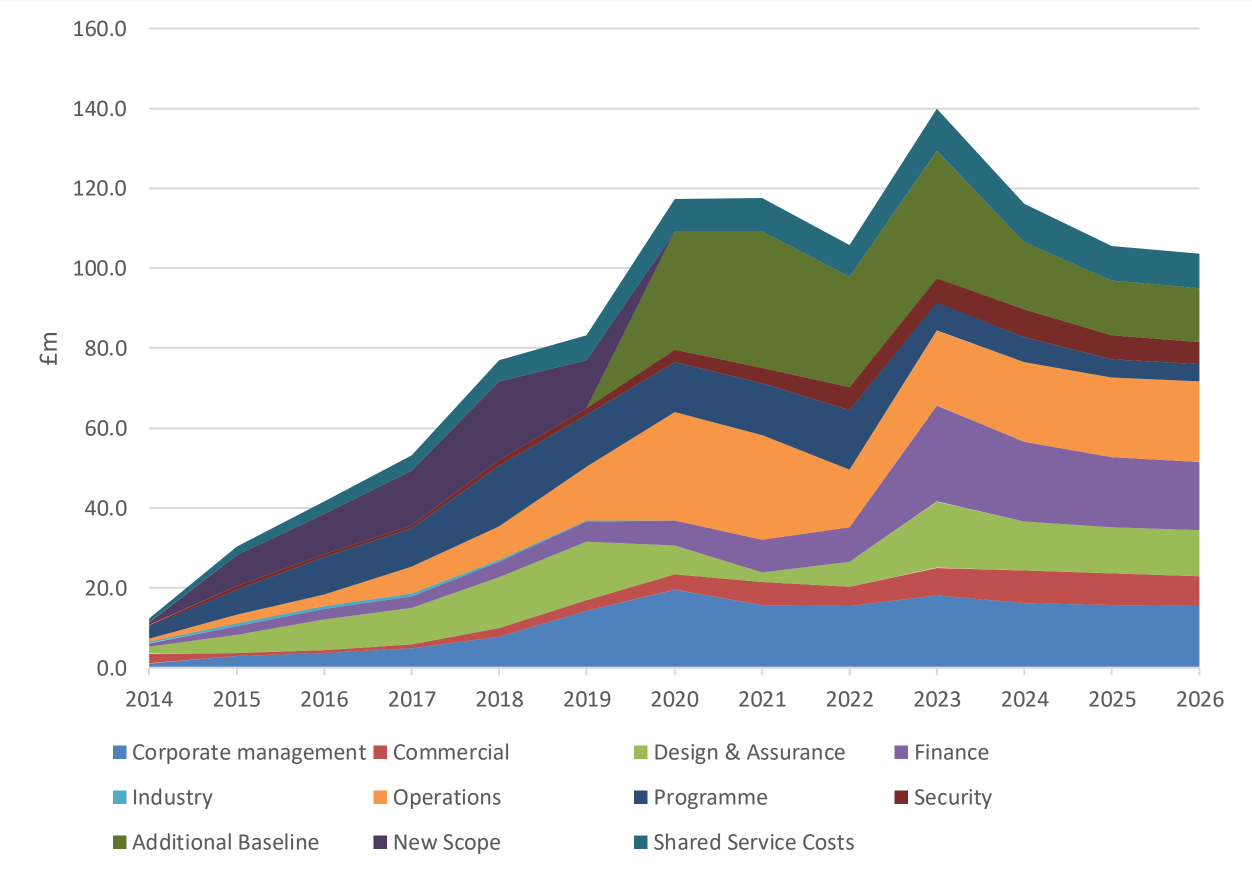

Figure 4.3 data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	1.1	3.0	3.6	4.8	7.8	14.3	19.5	15.7	15.3	18.1	16.3	15.7	15.5
Commercial	2.4	0.7	0.8	0.9	2.1	2.7	3.8	5.7	4.8	6.8	8.2	7.9	7.3
Design & Assurance	1.8	4.5	7.6	9.2	12.9	14.6	7.2	2.5	6.4	16.6	12.2	11.6	11.6
Finance	0.9	2.1	2.7	2.9	3.7	5.0	6.3	8.2	8.5	24.1	19.9	17.5	17.1
Industry	0.4	0.6	0.7	0.8	0.5	0.1	-0.0	-	-	-	-	-	-
Operations	0.7	2.3	2.8	6.6	8.5	13.6	27.3	26.1	14.5	18.7	19.7	20.0	20.2
Programme	3.1	6.2	9.4	9.6	15.2	13.0	12.4	13.2	15.0	7.2	6.4	4.5	4.4
Security	0.4	0.9	0.8	0.8	1.2	1.7	3.2	3.8	5.7	6.0	6.9	6.1	5.4
Additional Baseline	-	-	-	-	-	-	29.4	34.0	27.7	31.8	17.0	13.6	13.6
New Scope	0.7	7.8	10.1	13.7	19.8	12.0	-	-	-	-	-	-	-
Shared Service Costs	0.9	2.1	3.0	3.8	5.3	6.3	8.4	8.5	7.8	10.6	9.6	8.7	8.5

Variance on last year's forecast

4.4. In RY22/23 Internal Costs, excluding Shared Services, were £129.32m. This is £58m (81%) higher than forecast in RY21/22 and £117.2m higher than the LABP forecast. Over the remainder of the Licence period, Internal Costs are forecast to increase by a further £276.9m relative to the RY21/22 forecast, and by £846.5m compared to the LABP.

4.5. Figure 4.3 shows the variance in costs by GL code compared to the RY21/22 forecast. Payroll costs account for the greatest proportion of the variation in Internal Costs over all forecast years. External Services accounted for the largest proportion of the variation since RY20/21. In RY22/23, the proportion of the External Services variation was circa 54% followed by payroll costs approximately at 42%. The majority of the variance in External Services is attributed to the SMETS1 programme, the Network Evolution programme, and the Finance cost centre, which accounts for over 60% of the External Services variance.

Figure 4.4 Internal Cost variance by GL code relative to RY21/22 forecast (excluding Shared Services) in current year prices

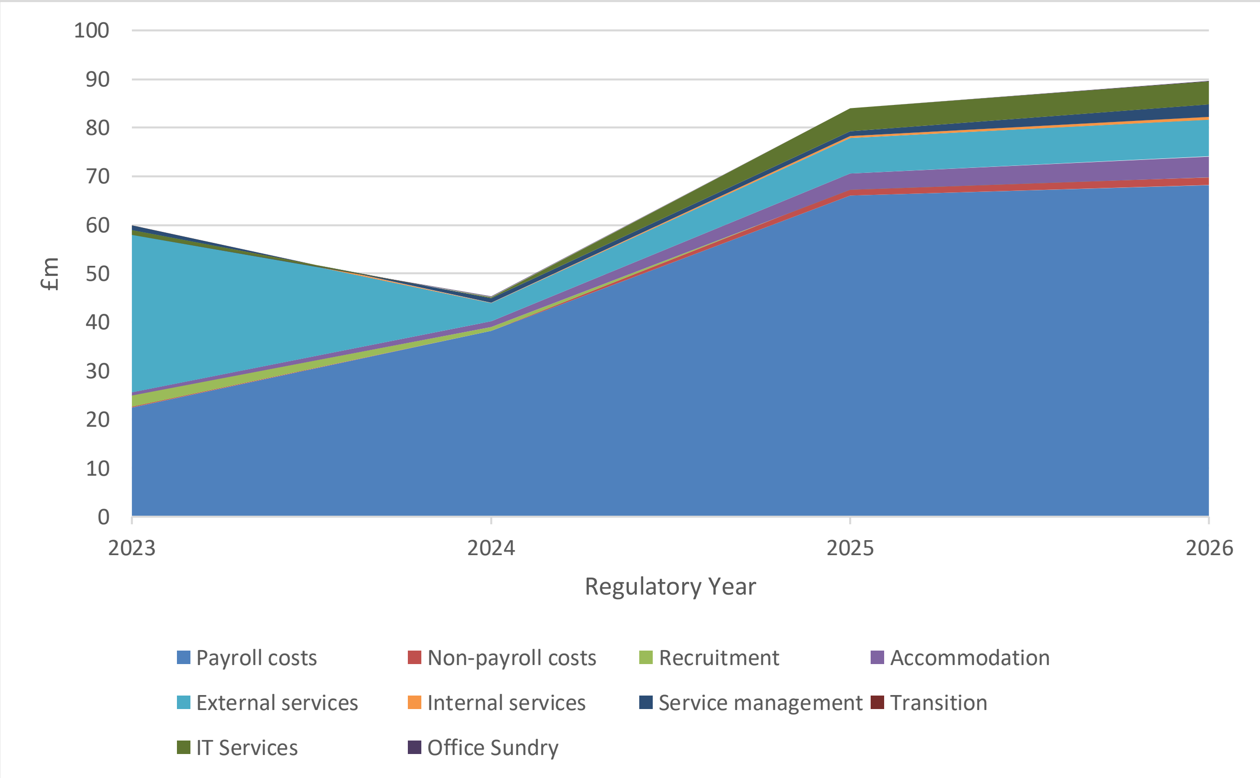

Figure 4.4: data table

£m	RY22/23	RY23/24	RY24/25	RY25/26
Payroll costs	22.45	38.17	66.02	68.16
Non-payroll costs	0.16	0.14	1.32	1.59
Recruitment	2.31	0.60	-0.06	-0.03
Accommodation	0.64	1.24	3.27	4.31
External Services	33.69	3.75	7.29	7.63
Internal Services	0.58	0.09	0.39	0.59
Service management	-0.84	0.93	1.05	2.54
Transition	0.00	0.00	0.00	0.00
IT services	-1.09	0.28	4.74	4.73
Office sundry	0.00	0.13	0.02	0.09

Payroll

4.6. DCC has applied for the payroll costs shown in Table 4.5. Payroll costs incurred in RY22/23 are more than forecasted in RY21/22 and continue to increase over the forecast in future years.

Table 4.5: Payroll costs compared to last year's forecast, in current year prices

Payroll (£m)	RY22/23	RY23/24	RY24/25	RY25/26
RY21/22 accepted forecast	49.89	42.07	7.02	2.92
Variation proposed in RY22/23	22.45	38.17	66.02	68.16
Total	72.33	80.24	73.04	71.08

Headcount

4.7. Figure 4.6 shows that DCC's staff headcount has increased from 643 full time equivalents (FTEs) in RY21/22 to 704 FTEs in RY22/23. This is an increase of about 5% compared to last year's forecasts for RY22/23. The number of permanent staff has increased from 510 FTEs to 591 FTEs. This is slightly under last year's forecast of 601 FTEs for RY22/23.

4.8. Headcount is expected to increase for permanent staff to 692 FTEs and for contractors to 114 in RY23/24. DCC did not provide forecasts for its headcount beyond RY23/24.

Figure 4.6: DCC headcount (FTEs, excluding service desk staff)

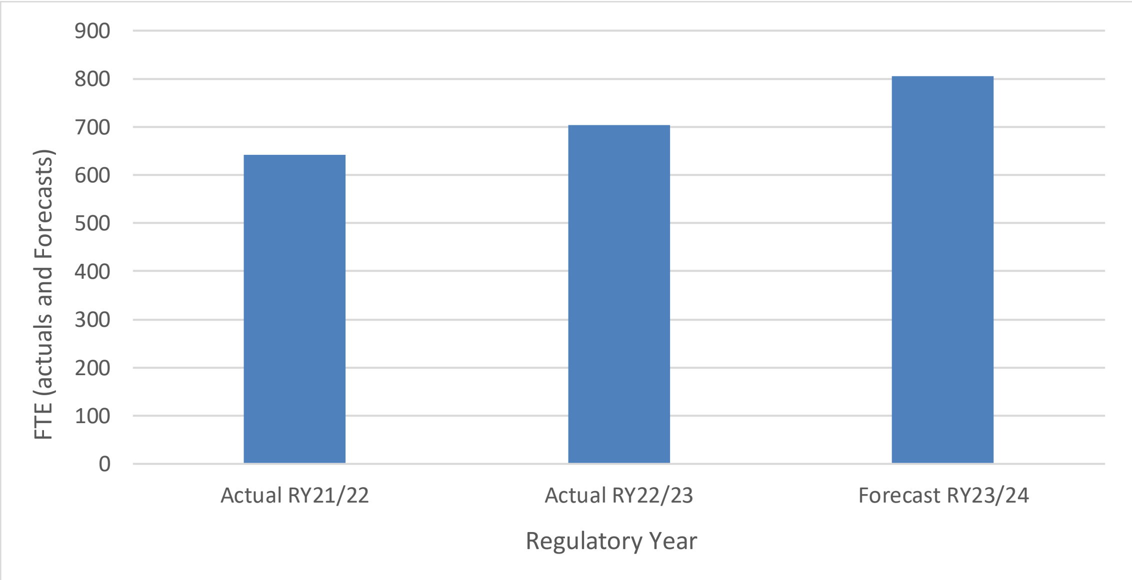

Figure 4.6: data table

	Actual RY21/22	Actual RY22/23	Forecast RY23/24
FTEs	642.95	703.77	806.18

Permanent-contractor staff ratio

4.9. In RY16/17 the ratio was around 40% contractor to 60% permanent staff. In RY17/18 there was a significant reduction in DCC's dependence on contractors and the ratio reduced to 22% contractor to 78% permanent staff. In RY20/21, the ratio remained consistent at this level with 21% contractor to 79% permanent staff. In RY21/22 the ratio remained identical to last year. According to the regulatory reporting the ratio for RY22/23 has further decreased to 14.5% contractor to 85.5% permanent staff.

Benchmarking

Context

4.10. We expect DCC to recruit staff at economic and efficient remuneration levels. Similar to previous Price Controls, DCC provided evidence of this for permanent staff through a benchmarking exercise that compared base salaries to equivalent roles in the wider employment market, using Korn Ferry's (formerly Hay) "PayNet" Benchmarking salary database for permanent staff. For contractors, DCC uses data from three different providers.

4.11. When recruiting permanent candidates, DCC's default strategy is to offer remuneration packages that are in-line with market rates. For benchmarking purposes, using the Hays database, the "market salary rate" would be defined as the median salary, i.e., 50th percentile (50P) of a distribution of salaries for comparable roles.

4.12. DCC excludes non-base salary benefits from its main permanent staff benchmarking methodology, which we identified as an area of concern in RY18/19 and RY19/20. In response to our feedback, in RY20/21 and RY21/22 DCC carried out analysis of the wider benefits package against that of comparable sectors and organisations. The analysis revealed that the majority of DCC's wider benefits packages were below the average, while its bonuses were slightly above. No further analysis on non-base salary benefits has been submitted this year.

4.13. Following our feedback from previous years, in RY20/21 DCC changed its approach for contractors so that it would be more aligned with the approach for permanent staff. It also expanded the benchmarking dataset with data from two additional recruitment specialists, and only used comparable market salaries drawn from a minimum of 20 data points. In RY22/23 DCC has maintained this approach.

DCC's justification

Benchmarking process

4.14. For both permanent and contractor candidates, DCC stated that it benchmarks at three distinct stages during the recruitment process:

- Before the role is launched
- Before DCC chooses to interview a candidate
- Prior to agreeing a remuneration package with a candidate

4.15. In response to our feedback from previous years, last year DCC stated that it improved the governance in this area. For example, DCC explained that any proposal to offer above the salary range must be referred to the chief product officer CPO, chief financial officer CFO and chief strategy and regulatory officer CSRO with an accompanying business case, on an "as needs" basis. In addition to this, whilst approval would be virtual (e.g., by email, telephone, or video call), and no formal panel meeting would be required, the outcomes must be recorded for Price Control purposes. DCC has reiterated this in this year's submission.

4.16. DCC also explained that in addition to using benchmarks in the recruitment process, it also uses them to inform its own internal policy on pay and promotions.

4.17. Finally, as in previous years, in its submission DCC argued that although benchmarks are important, the assessment of whether its recruitment decisions have been economic and efficient should not be the only consideration because:

- The cost of unfilled vacancies can be higher in some cases than the cost of a salary over benchmark.
- The cost of replacing an individual who does not pass probation because they do not have the right skills or competencies can be significant.

Permanent staff

4.18. Korn Ferry's PayNet Benchmarking database includes a comprehensive range of job families, roles, and levels across different industries in the different regions of the UK. The database produces benchmarks based on percentiles from a distribution of salaries of comparable roles. To reach the benchmark for a specific role the database draws data from dozens of companies and hundreds of individuals within these companies. In addition, DCC explained that its use of PayNet has been externally assured by consultants from Korn Ferry (owners of the Hay model) to ensure that DCC's mapping of roles to the model is appropriate.

4.19. As was noted in previous years, DCC explained that its aim is generally to offer remuneration rates that equate to the market average for permanent members of staff up to the 50th percentile (50P). However, DCC states it may offer higher than the 50P of the benchmark to attract the right candidates. This can be due to the role requiring niche or technical skills, or merely the lack of supply in the market. Thus, recruiting managers have the discretion to offer up to 10% above the benchmark with approval required by the HR Business Partner. If the salary is in excess of this, a business case is required for approval.

4.20. As part of its submission, DCC presented a comparison of the remuneration of permanent members of staff against Korn Ferry's Benchmark, showing how it differs (in aggregate and against each cost centre) from both the 50P and 50P + 10% margin (50P10). The information is presented in a way that sets out both the net outcome[41] of the results as well as the marginal overspend against the 50P10 benchmark.[42]

4.21. This year DCC reported recruiting approximately 12 roles in RY22/23 with a salary materially above the 50P10 benchmark, representing approximately 8% of the total benchmarked roles recruited in RY22/23. DCC calculated that this resulted in an overall marginal cost of £0.069m. Note, this figure assumes that all staff were hired at the beginning of RY22/23, whereas staff might have only commenced employment midway through the regulatory year. This would result in an over-estimate of the incurred cost by DCC.

4.22. This year, DCC included all permanent staff which incurred costs in RY22/23 (and not only new staff) in their benchmarking analysis. It argued that this puts more roles in scope for analysis and ensures existing employees remain compliant, for example after in-flight pay increases. This analysis showed that 78 roles had a positive variance above the 50P10 benchmark (out of 704 roles were in scope for this year's benchmarking), representing approximately 11% of the total of benchmarked roles. DCC argued that this reflects DCC's success over the course of RY22/23 in adhering to

[41] Sum of all positive and negative cost variances against the benchmark.
[42] Sum of adverse cost variance to the relevant benchmark only (*ie* only variances above the 50P10 benchmark are counted) for each role.

clear governance designed to ensure salaries are kept in line with established market salaries as determined by our benchmarking exercises.

4.23. DCC provided some justification for the roles hired above the benchmark, however, did not provide any business case or similar showing that it has followed its own internal processes.

Permanent staff – wider benefits

4.24. DCC did not present any new evidence on this area. It explained that it does not intend to repeat the analysis that was submitted in RY21/22 every year, as benefits do not change frequently, unlike pay, but said it would continue to monitor comparators to ensure it offer value for money whilst remaining an attractive place to work.

Contractors

4.25. A total of 255 contractors were in scope of the RY22/23 benchmarking analysis, with a total cost of £22.2m. For comparison, in RY21/22 these figures were 186 contractors with an associated cost of £11.7m. However, last year DCC excluded some consultant resource contracted from Capita from the benchmarking process, therefore the comparison with last year's figures would not be a like-for-like one. Approximately 80% of contractors and their associated expenditure fell within the Programme and Operations cost centres.

4.26. As part of its submission, DCC presented a calculation of the net and marginal costs associated with all contractors benchmarked in RY22/23 against the 50P10 benchmark. This resulted in a net negative variance[43] of £5.52m and a total marginal cost[44] of £0.421m, based on 213 roles hired under and 42 roles hired over the relevant benchmark. This shows that 83% of contractors were paid below the 50P10

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[43] The net variance is calculated as the sum of the cost variances against the relevant benchmark (*ie* 50P10 benchmark) for each role. The net variance could be defined as the sum of the differences between the cost of each role and the benchmark value. In this case, the net variance is negative because the total cost below the benchmark is greater than the total cost above it.
[44] The total marginal cost is calculated as the sum of the adverse cost variance against the relevant benchmark only (*ie* only variances above the 50P10 benchmark are counted) for each role.

benchmark, which is a deterioration from the 93% figure in RY21/22, but an improvement compared to 76% in RY20/21, and 66% in RY19/20. In its submission DCC reiterated the argument raised in previous years that the salaries paid below the 50P10 benchmark should be considered as "savings" which offset the salaries paid above that benchmark, as shown by the net negative variance.

4.27. DCC provided some justification for contractors hired above benchmark where the variance between the incurred cost and the relevant benchmark was deemed to be significant. In general, DCC argued that it was sometimes necessary to exceed the benchmark on the basis of the complexity and specialised nature of these roles as well as the strategic importance of certain roles for the timely delivery of key programmes.

Our view

Permanent-contractor staff ratio

4.28. We welcome DCC's continuous improvement in the permanent-contractor staff ratio. We recognise that there is a case for some roles to be efficiently filled by contractors rather than permanent staff.

Permanent staff

4.29. This year DCC's permanent staff FTE increased from 510 FTEs in RY21/22 to 591 FTEs in RY22/23. As such, and as we noted in last year's consultation document, it is increasingly important that DCC applies its hiring policies robustly to drive payroll efficiencies.

4.30. We welcome that in RY22/23 DCC has continued applying its internal process to hire staff at salaries below the 50th percentile +10% (50P10) benchmark. However, both the total value of marginal cost, and the % of all roles hired above the benchmark, have increased compared to last year. In particular, the total marginal cost was £0.069m in RY22/23 compared to £0.021m in RY21/22. Similarly, the % of roles hired above the benchmark relative to the number of new roles was 8% in RY22/23 compared to 3.7% in RY21/22. However, after considering the justification presented by DCC for hiring roles above the benchmark, we consider the figure for the total value of marginal cost to be £0.047m, and the % of roles hired above the benchmark 6%.

4.31. We are concerned about the regression in the benchmarking numbers, however, given the relative immateriality of the costs above the benchmark**, we are not proposing a disallowance in this area at this time**. Nonetheless, we would encourage DCC to keep working to ensure its permanent staff costs are economic and efficient.

4.32. We welcome that DCC has increased the scope of its benchmarking analysis to include all roles that incurred costs in RY22/23. We agree that is important to ensure internal promotions are economical too.

Permanent staff – wider benefits

4.33. We understand DCC's position that it is not necessary to benchmark non-salary benefits every year, as the results are unlikely to change in the short to medium term. However, we would like to reiterate our position from previous years that we are not convinced the bonus policy is economic and efficient, as the data presented by DCC showed DCC's bonus appears to sit above the average and median quartile, albeit below the upper quartile, across all staff categories. That said, we recognise that more work might be required to properly assess the efficiency of the bonus package.

4.34. In light of the above**, we do not propose any disallowance of permanent staff benefits costs in RY22/23.** However, we would encourage DCC to review its bonus package to ensure it is economic and efficient going forward. This will remain an area of scrutiny.

Contractors

4.35. We welcome that DCC has continued using its reviewed approach to benchmark contractors based on the 50P10 benchmark.

4.36. We are disappointed that both the number of contractors hired above the benchmark and total marginal costs have increased significantly from last year. However, we acknowledge that this will be in great part explained by the inclusion of Capita consultant resource that was excluded from last year's analysis. The figures we are seeing this year are very similar to those submitted in RY20/21. This would suggest that DCC's performance in this area has been consistent over the last 3 years.

4.37. In line with previous Price Control decisions, our position is that hiring up to the median of the benchmark is the economic and efficient approach, and that a 10% margin above that should give DCC enough flexibility in most cases.

4.38. As we have said in previous years, we do recognise that in certain situations DCC might require to depart from this approach and hire contractors above the 50P10 benchmark. However, we are not satisfied with most of the justification presented to us as part of DCC's submission. In particular, we would expect DCC to be able to fully justify these cases beyond generic references to skill, seniority, or a simple job description, such as the provision of an approved business case, which we note is DCC's policy for hiring above the 50P10 benchmark.

4.39. Accordingly, we requested DCC to submit to us the business case for a sample of contractors hired above the 50P10 benchmark. DCC did not submit any business cases for the requested roles, although it did provide further justification for some of them. It is, however, disappointing that DCC has not submitted any business cases or similar documents showing it has followed its own hiring policy. This is particularly the case given that, since last year, DCC has claimed to have improved the governance in this area, with the declared intention to be able to provide better justification for the Price Control submission.

4.40. As a result of the above, we are minded-to disallow some costs where they materially fall above reasonable market rates and were not properly justified. To calculate this inefficiency, we have followed the same methodology we have applied since RY20/21: using the 50P10 benchmark based on the expanded dataset, and for all contractors employed during RY22/23. Including all contractors employed during the regulatory year is consistent with our approach since RY18/19.

4.41. In light of the above, **we are therefore minded-to disallow £0.402m of contractor costs in RY22/23.**

4.42. As in previous years, we remain open to receiving additional evidence from DCC to justify its remuneration of contractors.

4.43. We expect to see DCC consistently applying its approach to recruiting contractors, and to be able to provide evidence of its decision making. Finally, we expect DCC to ensure all its recruiting costs are economic and efficient. This includes contractors and Capita consultants. It is worth noting that whilst DCC has confirmed consultants were included in the benchmarking process, we were not able to independently verify that all consultants were included. We expect DCC to improve its reporting to us so that this can be verified for future submissions.

Payroll Costs

4.44. We are proposing payroll disallowances in across four cost centres, totalling £1.714m. See table 4.7 for details.

Table 4.7: Proposed forecast disallowances per cost centre in RY22/23

Cost Centre	RY22/23 Disallowance (£m)
Corporate Management	0.09
Design and Assurance	0.105
Security	0.178
Network Evolution	1.341
Total	**1.714**

Corporate Management

Context

4.45. The Corporate Management cost centre includes some of the businesses key enabling functions, including Strategy and Regulation, Corporate Affairs and Customer Engagement.

4.46. The cost centre is broken down into eleven payroll sub-teams. Total payroll variance in 22/23 was reported as £1.971m, with five of the sub-teams showing a material variance of greater than £150k.

DCC's justification

4.47. DCC reported the main drivers of costs over 22/23 as follows:

- Delivery of new in-house capability to create quality business cases aligned to the Treasury Green Book approach.
- Implementation of the restructured Customer Experience function.
- Optimisation of resource demands through the creation of a Transformation team.
- Consolidation of the Strategy and Regulation function.
- Support for the delivery of the annual Price Control submission.

Our view

4.48. We consider that DCC has appropriately justified the vast majority of the variance through its submission.

4.49. However, we are proposing to disallow £90k of incurred costs under the Customer Experience sub-team. These costs, reported within the sub-team as relating to "Partnerships", are associated with DCC's support of innovation activity.

4.50. As we noted in our 22/23 Price Control decision in March 2023, "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 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. 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".

4.51. In line with our 22/23 position therefore, **we propose to disallow these costs of £90k relating to innovation activity**.

Design and Assurance

Context

4.52. The Design and Assurance cost centre, overseen by the Chief Technology Officer (CTO), is responsible for DCC's technology architecture and design decisions. This includes activities such as designing the Enterprise Architecture for the DSP procurement and Network Evolution communication hubs, working with customers, reviewing internal practices to improve ways of working, and designing technical solutions to address SEC modifications other customer-led changes.

4.53. The cost centre is broken down into six payroll sub-teams. Total 22/23 payroll costs were £12.667m against a baseline of £9.313m, representing a variance of £3.354m. Four of the six sub-teams reported a material variance of greater than £150k.

DCC's justification

4.54. Design and Assurance payroll costs are typically dominated by the Testing Services and Assurance sub-team. This has been further heightened in 22/23 as testing resource previously reported under Service Delivery has transitioned across into the Design and Assurance function. In total, the Testing Services and Assurance sub-team was responsible for £2.328m of the variance.

4.55. The 22/23 variance was driven by an increase in activity in the 4G CH&P programme and in DSP procurement activity.

Our view

4.56. Again, we consider that DCC has appropriately justified the vast majority of the variance through its submission.

4.57. **We are however proposing to disallow £105k of incurred costs in the Technology Innovation sub-team, again as they relate to innovation work**. This is based on our assumption, in line with previous Price Control years, that 50% of this sub-team are responsible for innovation specific activities.

Security

Context

4.58. The Security function is responsible for securing the DCC Total System, including providing assurance and best practice direction around security, and for operating the secure Smart Meter System cyber security defence platform.

4.59. The cost centre is broken down into four payroll sub-teams. Total 22/23 payroll costs were £3.856m against a baseline of £2.566m, representing a variance of £1.290m. Three of the sub-teams showed a material variance of greater than £150k.

DCC's justification

4.60. DCC justified the variance in the three sub-teams as follows:

- Chief Information Security Office (CISO) Office - DCC appointed a new CISO in September 2022, generating additional cost for a handover period with the previous outgoing temporary CISO.
- Security Architecture and Assurance sub-team - increase in demand from DCC programmes to provide security assurance support.
- Security Governance Risk and Compliance sub-team - increase in data protection support for the new Faster Switching Programme.

Our view

4.61. Whilst accepting DCC's justification for two of the three sub-teams, **we propose to disallow the £0.178m variance in the CISO office**. We do not consider that DCC's justification of a handover period between two CISO's justifies a variance of that value.

Network Evolution

Context

4.62. The Network Evolution Programme is the umbrella term for a series of core technology programmes that contribute to DCC's continued delivery of a secure and stable service and to the continual improvement of the customer experience, all whilst achieving greater value for money. The programmes include the 4G Communication Hubs and Networks (CH&N), Data Services Provider (DSP), Digital Service Management Systems (DSMS), Test Automation Framework and Public Key Infrastructure Enduring (PKI-E).

4.63. Last year we disallowed all forecast variance for Network Evolution, as we did with SMETS1 and ECoS. This was partially due to the degree of uncertainty linked to these programmes as well as a lack of satisfactory justification from DCC of these forecast costs. All RY22/23 costs were therefore reported as variance.

4.64. DCC committed a significant increase in resources towards Network Evolution in RY22/23. Comparing back to those disallowed RY22/23 forecasts in the RY21/22 submission, we see a significant variance in the Service Delivery sub-team (formerly termed the Regulatory Affairs sub-team) of £2.682m. This RY22/23 incurred cost figure is also £2.305m above the incurred costs reported in RY21/22 for Service Delivery. We note that all other sub-teams were broadly within the threshold, or in some cases under spent relative to last year's forecasts.

4.65. The Service Delivery sub-team is responsible for ensuring that the programme is delivering in line with the regulatory framework, and that changes are understood and supported by all stakeholders including DESNZ, Ofgem and DCC's customers. The team includes a Programme Director, Programme Managers, Project Managers, PMO and Business Analysts (BAs) required to deliver the programme.

DCC's justification

4.66. DCC listed the key activities of the Service Delivery sub-team in RY22/23. This included delivery of the Strategic Outline Case (SOC) for DSP, delivery of the TSP Tactical Programme for PKI-E, the completion of the Full Business Case (FBC) and provision of continued project and programme management support for CH&N, support with the RFI and subsequent contract management development for DSMS, and the publication of a Customer Engagement Strategy.

Our view

4.67. The forecasted RY22/23 activities for the Network Evolution programme in the RY21/22 submission largely mirrors what was reported by DCC to have been delivered in the RY22/23 submission - it is therefore not clear why the programme, specifically the Service Delivery sub-team, has incurred over £2.5m in additional costs. We have requested DCC provide additional information and evidence to justify these costs, however we have not received any satisfactory explanation of how the increased costs relate to an increase in activity relative to RY21/22.

4.68. In the absence of any further satisfactory evidence, we propose to disallow 50% of the difference between the RY22/23 incurred costs and the RY22/23 forecasted costs in the RY21/22 submission for the Service Delivery sub-team, due to lack of justification.

Based on the difference being £2.682m, **we propose a disallowance of £1.341m for the Network Evolution Programme**. Should we however receive further satisfactory evidence through the consultation response, we may reduce the proposed disallowance accordingly. We welcome views and evidence from stakeholders on this issue.

Non-Resource Costs

4.69. DCC uses External, Internal and IT Services to provide support such as short-term technical expertise in meeting regulatory requirements.

4.70. Costs associated with External Services include costs of third-party suppliers such as consulting fees, legal fees, and bank charges. Separately, DCC also sources IT and other professional services directly from the Licensee's parent group; these services are referred to as Internal Services and are exclusive of the Shared services, and the costs for these services are charged directly to DCC.

4.71. More specifically, the use of External Services has steadily increased in recent years. Total internal costs for RY22/23 show a large variance of **£64m** against last year's baseline. This is significantly higher than the incurred variance (**£26m**) in RY21/22. More than half of this year's variance, **£34m**, was driven by non-resource activities, more specifically Internal, External and IT services. Circa **£15m-£16m** (i.e., **44%-47%**) of the Internal, External and IT Services contracts this year, with a material value of £150k[45] or greater, were sourced non-competitively; around 22%-23% of the Internal, External and IT services contracts, with a material value of £150k or greater, were awarded to a single service provider.

4.72. Figure 4.8 below shows the evolution of External, Internal and IT Services costs by RY, in £m, nominal prices.

[45] For the ease of regulatory reporting, Ofgem requires DCC to justify all procurements with a minimum variance £150k.

Figure 4.8: External, Internal and IT Services costs by RY

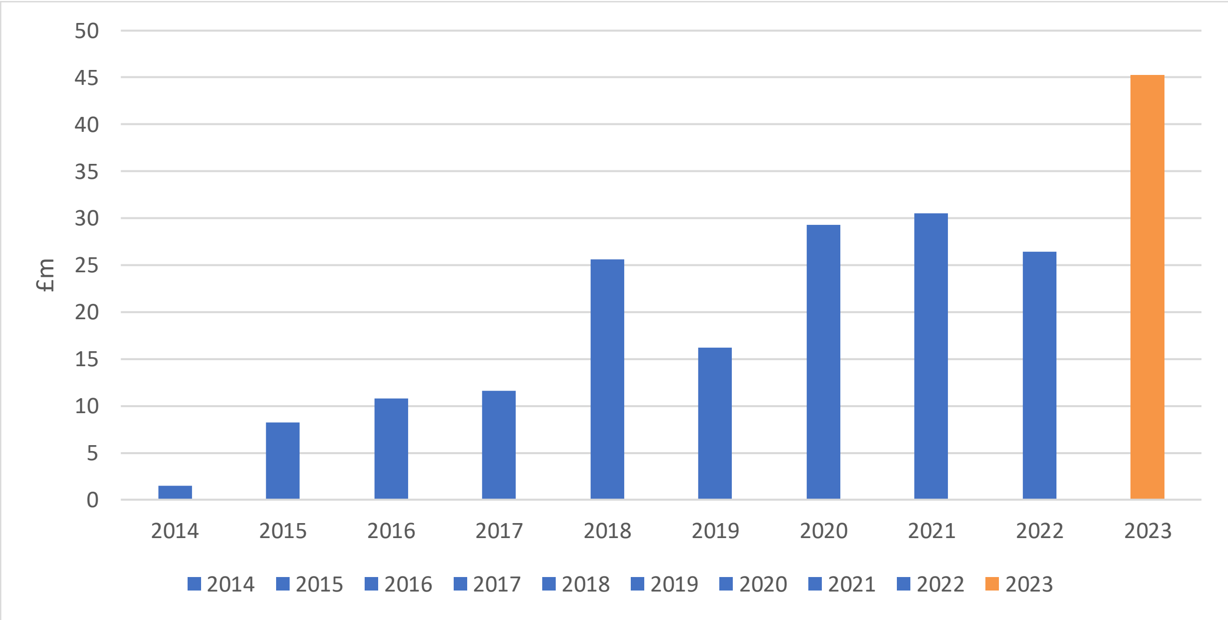

Figure 4.8: data table

RY	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23
Inc. Cost (£m)	1.533	8.205	10.829	11.606	25.600	16.237	29.318	30.567	26.415	45.269

4.73. The following sections highlight the areas where we have identified a number of concerns, including where we are proposing a disallowance of costs.

4.74. As part of this year's cost assessment, we have also observed a range of costs that are directly related to projects that we disallowed either last year, or that were disallowed in previous years. More specifically, these costs relate to innovation and growth specific non-resource activities; the executive leadership programme which we disallowed in RY21/22; as well as a number of non-competitive procurements that we disallowed in RY21/22, but that appear to have carried forward further costs into RY22/23.

4.75. In respect of the innovation and growth specific activities, we remain of the view that DCC's priority and business strategy must be the delivery of its core business. We recognise that some of these activities could become part of DCC's business in the future, however at this stage, we are firm that it does not form a mandated requirement. **We are proposing for that reason to also disallow these additional costs, £0.148m in RY22/23.**

4.76. As to the Executive Leadership Programme, we note that DCC has incurred an additional spend of **£0.132m** in RY22/23. DCC procured this service in RY21/22 for the provision of additional learning and development resources for its senior leadership team. We disallowed the costs associated with this project last year on the grounds that DCC did not provide sufficient evidence that this service was delivering value for money compared to this service previously being offered by Capita. **We are proposing to disallow the additional costs for RY22/23 on the same grounds as those in RY21/22.**

4.77. Finally, we have also observed a number of non-competitive procurements that we disallowed in RY22/23 but that are continuing to incur costs in RY22/23. These procurements were disallowed on the grounds that DCC was unable to demonstrate to us how it had arrived at the decision that a direct award for these particular projects was the most economic and efficient solution. **We are proposing to disallow a cost of £0.49m that is directly related to these contracts.** Further below, we discuss in more detail the concerns that we have in respect of a of a number of non-competitive procurements that were undertaken in RY22/23.

Planning, Scoping and Resourcing of projects

Context

4.78. As per last year, we remain concerned about DCC's approach to ensure that it carefully manages the timelines and risks of projects through sufficient up-front planning and engagement.

4.79. Similar to RY21/22 we have again observed multiple procurements that appear to have been either extended several times, or are very similar in scope and nature, without having a clear understanding of how these different procurements are efficiently coordinated.

4.80. We are concerned that this potentially leads to a 'piecemeal' approach to planning that results in possible duplications of work with limited assurance that value for money is achieved. To obtain further clarity, we requested as part of the cost visit that DCC sets out its approach on how it ensures that **a).** the drivers and scope of a particular project are clearly understood and well defined; **b).** the outputs of these project(s) are efficiently monitored and **c).** any incremental changes or additions to the original scope of a project are carefully assessed and governed.

4.81. In RY21/22, we disallowed on similar grounds the Customer Engagement Portal (CEP) and the Order Management System (OMS); both projects were paused in RY21/22 as a result of rising costs, project difficulties and customer feedback, yet customers were continuing to incur costs. DCC reported in RY22/23 an additional cost of £0.049m and £0.303m respectively for the OMS and CEP projects. We specifically asked DCC to provide additional evidence or explanation of what it had done to avoid these additional costs.

4.82. As part of the process of planning projects effectively, we also expect DCC to consider whether it is more economic and efficient for specific works or projects to be taken on by either existing staff or by hiring additional permanent staff or contractors, or a combination of both. Given the magnitude of the variance of non-resource spend in RY22/23, we are concerned that DCC is becoming increasingly reliant on the use of External and/or Internal Services. We are particularly concerned where this is the case for activities that are of a recurring nature, and can therefore be easily planned and forecasted, as well as for activities that we consider to be part of DCC's BAU operations.

4.83. With that in mind, we asked DCC to explain what internal checks and processes it has in place to ensure that activities are resourced in the most economic and efficient way. To add further context, we have also asked DCC to demonstrate how it has applied that internal process for a sample of projects, including various works on areas such as business case writing, customer engagement, legal advice for the CH&N programmes, advice on resourcing and strategic leadership, as well as core regulatory support.

4.84. Where relevant, we also asked DCC to justify why it had decided to outsource a particular activity where the recruitment of additional staff had previously been forecasted by DCC and approved by Ofgem through Price Control.

DCC's justification

4.85. During the clarification questions process, DCC explained that it had introduced a new "Front Door" process at the start of 2023. This process provides the necessary structure and controls around the initiation of new projects. According to DCC, a key element of this process is for the business owner to articulate the description, scope, strategic alignment and intended outcomes for their initiative. These are then discussed and presented to representatives from all of the DCC functions. DCC further explained that it is through this process that the scope is refined and any potential overlaps or gaps with other initiatives are identified. An early impact assessment is also carried out by the different functions to flag any concerns around resourcing, contention or other delivery risks that will need to be accounted for in the next stage of the initiative and developing the detailed delivery plan. Outputs of major projects are reported through ongoing reporting to Exco and Opco.

4.86. In regard to the increased use of consultancies in recent years, DCC responded that this is directly linked to the unique nature of the organisation; DCC has evolved at a very fast pace, transitioning from a single to a multi-programme organisation, meaning that certain skillsets are not necessarily always available in-house.

4.87. In terms of the internal checks and processes being followed to determine how activities are best resourced, DCC explained that decisions are taken on a case-by-case basis, as well as there being further checkpoints (and signoffs) as to what is required on a quarterly basis and at the annual business planning stage. For the requested sample of procurements however, DCC did not provide any evidence of how it had assessed different options to arrive at its conclusion that these activities were resourced in the most economic and efficient way in each case.

4.88. DCC confirmed as part of the clarification question process that the costs associated with the CEP and OMS projects were a continuation of last year's costs. In response to the question of whether DCC had tried to avoid these costs, DCC noted that part of the ongoing charges (£0.141m) for the CEP were to retain a number of licences to allow customers to continue to access the CEP.

Our view

4.89. Whilst we agree that the business has evolved rapidly since the start of the programme in 2013, we expect DCC's operations to have reached a more mature phase and to be more stable than previously. Notwithstanding that the system will continue to be subject to changes and upgrades, we note that the network (and the associated programmes) is much more stable and predictable than ever before.

4.90. We expect DCC for these reasons to carefully manage all of its projects through robust planning, scoping, and engagement. This will help maximise value for money throughout, as it is able to ensure that the outputs of all these different projects are monitored and effectively built on.

4.91. We fully recognise that DCC is required to outsource certain projects where it does not hold particular skills in-house or where the nature of the activity is short-term. Notwithstanding that, we expect DCC, going forward, to adopt an approach that carefully considers alternative options before defaulting to the outsourcing of an activity. We will continue to closely monitor this area in future Price Control assessments.

4.92. In regard to the sample of procurements for which we requested additional evidence around the decision on how to resource them, we are proposing to disallow a proportion of the costs where no satisfactory evidence was received. We are proposing to disallow the difference in costs against:

- DCC's corresponding contractor benchmarks where we have been able to compare the costs of the individual consultancy profiles (making up the procured service); or
- Variance resource costs previously forecasted and approved as part of Price Control, to carry out that particular type of activity.

4.93. **In summary, we are proposing to disallow £3.335m and £0.312m in respectively RY22/23 and RY23/24, that is linked to activities that we do consider not to have been resourced in the most economic and efficient way.**

4.94. As per last year, we did not receive a satisfactory explanation of what was done to prevent the OMS and CEP projects from continuing to incur costs. Given that these projects have continued to incur costs whilst failing to deliver the planned benefits to customers, we remain of the view that they are not economic and efficient. We are minded-to disallow the additional costs that both projects have incurred in RY22/23 with the exception of the ongoing CEP charges that were necessary to retain a number of licences to allow customers to continue to access the CEP.

4.95. **We are proposing to disallow £0.049m and £0.162m for respectively the OMS and CEP projects in RY22/23.**

4.96. We welcome views and evidence from stakeholders on our proposals in this area.

Business Accuracy Programme

Context

4.97. In RY21/22, DCC initiated the Business Accuracy Programme (BAP). The BAP is an internal business transformation programme that seeks to deliver robust process, system, and data improvements across key functions including Finance, Commercial, Portfolio and Risk.

4.98. According to DCC, the efficiency gains are circa **£11.8m** over the period post implementation to RY25/26. Circa £1.8m of direct savings were expected to be realised because of automation and the subsequent reduction of resource costs; circa £10m of indirect efficiencies would be achieved through improved benchmarking of suppliers' costs, performance, and processes.

4.99. In RY21/22, we rejected all incurred costs, **£2.56m**, associated with the BAP on the grounds that there was insufficient evidence of how the projected benefits would be tracked and realised. At the same time, we also expressed concerns about the transparency in customer engagement around the BAP as well as the potential overlap in scope with other activities, projects and services already provided for under the Shared Service Charge (SSC).

4.100. During last year's Price Control consultation, we consulted with DCC separately to consider whether to accept an Undertaking.[46] After carefully reviewing the proposed Undertaking, we concluded that it did not meet the requirements set out under LC37.9; 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.

4.101. In RY22/23 the BAP incurred an additional cost of **£3.845m** through various competitive as well as non-competitive procurements. According to DCC, this covered the following deliverables:

- BAP architecture
- BAP project management
- MVP (first tranche of performance) reporting
- DCC Lock development (business planning)
- Board Reporting
- Board strategy and business planning
- Build of DCC's financial planning tool
- Build of One Data Hub

4.102. DCC expects the BAP to incur a further cost in **RY23/24** of **£0.243m**.

DCC's justification

4.103. As part of the RY22/23 submission, DCC explained that as the business is shifting towards a more controlled, governed, and rigorous culture, the BAP forms part of that

[46] In accordance with Conditions 37 and 38 of the Licence.

journey; it is to make sure that DCC's internal capabilities are upgraded so that it can cope with the increased scope and complexity of its activities in the future.

4.104. In response to our request for further evidence on the realisation of benefits, DCC shared with us the BAP project closure report. The report relisted the direct benefits of the BAP as part of a wider transformation towards an accountable, resilient, and efficient DCC. According to DCC these include:

- Transparency of performance for key stakeholders, based on clear and accurate data. DCC confirmed that this would be measured through improved engagement with its customers.
- Predictability and accuracy of delivery and costs, and risk management. DCC confirmed that this would be measured by improved staff productivity and reduced slippage in plans and budget.
- Process efficiency and focus on benchmarking to deliver cost efficiencies and reduce customer cash contingency balance. DCC confirmed that this would be measured in reduced costs for DCC and our customers.
- Improvement in staff engagement, and efficiency, through easier ways of working and collaboration. DCC confirmed that this would be measured through improved staff satisfaction and productivity.
- Quicker and more agile ways of working across the business. DCC confirmed that this too would be measured through improved staff satisfaction and productivity.

4.105. In summary, DCC noted that majority of the benefits of BAP are in relation to the building of a platform which is more reliable (reducing errors), more flexible and transparent (creating better insight in decision making), and more accurate (allowing better assessment of risk). DCC also clarified that it had built an integrated planning and performance framework that can track performance and highlight emerging trends and issues in an efficient and comprehensive manner. This would enable DCC to quickly identify areas for improvement along all core processes as well as identify cost efficiency improvements. According to DCC, these savings cannot be directly attributed to BAP; notwithstanding that DCC notes that companies that adopt a decision intelligence approach are likely to see operational costs reduce by up to 20%.

4.106. DCC confirmed that these benefits will continue to be tracked and managed by the DCC Finance team to ensure they are realised into RY23/24 and for the two years thereafter.

4.107. As part of the clarification process as well as the cost visit, we also requested that DCC shares any further evidence of customer engagement during RY22/23 in respect of how the benefits had been tracked and the programme was governed. DCC did not provide any further evidence of customer engagement during RY22/23 around the monitoring and tracking of the programme's benefits; it solely referred to the evidence of customer engagement previously shared with us in RY21/22.

Our view

4.108. As explained in our RY21/22 price control decision, we welcome all efforts from DCC to realise cost efficiencies and provide greater predictability and accuracy around the forecast costs of its different programmes and activities.

4.109. We have reviewed the additional information that has been shared with us as part of this year's Price Control. Whilst we welcome DCC's extra efforts to explain how it intends to measure some of the benefits, there remains insufficient evidence of a robust cost benefit analysis in place that precisely sets out when and how such savings will be realised, including a methodology for monitoring, and tracking them.

4.110. We also continue to have concerns about the transparency in customer engagement around the BAP. We regret that DCC has not been able to share any further evidence with us of how it has engaged with industry on the programme, and especially around the realisation of benefits.

4.111. As per last year, we also remain concerned about the potential overlap in scope between the programme and several other workstreams including activities on cost benchmarking and the integrated activity planning. It is particularly important that as and when such investments are initiated, the scope of such works are unambiguously scoped and defined to guarantee full transparency in respect of its customers.

4.112. **We are proposing to disallow all costs that are directly associated to the BAP. The total disallowance cost amounts to £3.845m and £0.243m respectively for RY22/23 and RY22/24.**

4.113. We welcome views and evidence from stakeholders on this issue.

Non-Competitive Procurements

Context

4.114. We first expressed concerns about DCC's use of non-competitive procurements as part of our RY20/21 Price Control consultation. In the RY21/22 DCC Price Control we witnessed and raised growing concerns about DCC's failure to meet its Licence obligations in respect of the procurement of all Relevant Service Capability (RSC). More specifically, last year, we decided for that reason to disallow a cost of £2.085m associated with non-competitive procurements for which DCC was unable to share any satisfactory justification or evidence.

4.115. We have subsequently raised further concerns with DCC in regard to its proposed approach for the (re-)procurement of the Data Service Provider (DSP), the Order Management System (OMS), the DCC Service Management System (DSMS) and the logistics services. The Licence provides that RSC must be procured from External Service Providers on a competitive basis unless certain limited circumstances apply. We expect DCC to evidence why a particular approach has been taken. We have to assess what an economic and efficient level of spend would have been and, in doing so we'll consider various factors including procurement requirements under the licence and any other relevant information which the DCC can provide about a particular circumstance.

4.116. DCC is required to manage its costs appropriately and ensure that the best possible outcomes for consumers are achieved. The burden of proof for evidencing whether an approach is economical and efficient 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.

4.117. This year, we identified again that a significant proportion of the External and Internal services in RY22/23, with a material value of £150k[47] or greater, were sourced non-competitively; more specifically, this relates to a total contract value of around **£15m-£16m**, or a proportion of around **44%-47%** of the aggregate External and Internal Services contract value.

4.118. As per last year, we requested, for a sub-selection of these contracts, that DCC demonstrates and provides evidence (including key procurement documentation) of how it has adhered to the relevant conditions in the Licence, as well as the Procurement Strategy and DCC's own internal procurement procedure. The Licence, in particular (but not limited to) LC16.34 and LC 16.35 require DCC to retain such key documentation and make available to Ofgem.

4.119. Given the increased use of direct awards for both Internal Costs as well as External Costs (FSC), we have also asked DCC to advise us at the cost visit what improvements it had internally made (or is planning to make) to:

- Limit the use of non-competitive procurements in accordance with the requirements set out in the Licence, the procurement strategy, and DCC's internal procurement policy; and
- Ensure that it is able to retain and share with us on request all key documentation in relation to any procurement.

DCC's justification

4.120. In response to the question of what changes DCC has introduced in this area over the past year, DCC recognised that whilst this work is still ongoing, improvements had already been introduced around record-keeping and the retention of key procurement documentation. To that effect, we effectively observed a slight improvement in that

[47] For the ease of regulatory reporting, Ofgem requires DCC to justify all procurements with a minimum variance £150k.

DCC was able to share with us the Award Recommendation Reports (ARR) for most procurements we requested evidence for.

4.121. As part of the procurement evidence that DCC shared with us, we noted however that DCC considers a sourcing strategy not to be required in the event of a non-competitive procurement.

4.122. In reviewing the evidence that DCC has shared with us on particular procurements, we also noted that, similar to last year, DCC often put forward "*urgency*" and a service provider's "*understanding of DCC's processes and systems*" as justifications for the use of direct awards.

Our view

4.123. Whilst we welcome DCC's recent improvements in record-keeping, we require DCC to further step up its efforts in this space. We particularly ask that DCC better aligns its internal processes, and actively manages any risks of non-compliance to: what is required in the Licence; the latest approved version of the Procurement Strategy and its own internal procurement policy and procedures document.

4.124. We do not agree, for example, with DCC's claim that no sourcing strategy is required in the event of a direct award. The procurement strategy explicitly states that "w*here an NCP has been justified, this determination will be evidenced as within the sourcing strategy and such evidence will be made available to the Authority as and when required".* The Procurement Strategy for RSC further requires that an approved sourcing strategy *"…should outline the requirement, procurement process, evaluation methodology and suppliers to be invited…".*

4.125. In summary, DCC's Procurement Policy and Procedures document encourages for single source procurements to be treated as if a competitive procurement had been undertaken. The justification for this essentially lies with providing transparency on what is being delivered and enable DCC to hold the service provider to account with the view of maximising value for money to customers.

4.126. We accept that there may be circumstances where it is not practical to carry out a competitive procurement. This may, for example, be applicable where a particular activity can only be provided by a single service provider, or where it is not practical for reasons that indisputably sit outside DCC's control. As per previous years, we have taken this into account during this year's review and are not proposing any disallowances where this is the case.

4.127. In response to DCC's argument that a particular procurement required a direct award for reasons of urgency, we urge DCC to try and avoid such future scenarios where it is within their control and ensure that activities are planned adequately to allow sufficient time to run a competitive exercise.

4.128. It is regrettable that we continue to observe an overall large number of non-competitive procurements on external and internal services; it is also particularly concerning that we are now witnessing the use of direct awards for the provision of several External Service Providers contracts. We would like to remind DCC again of the need to, and the benefits and importance of, running a competitive procurement. This will lead DCC to arrive at an outcome which is both clear and transparent to all suppliers, as well as demonstrably economic and efficient.

4.129. Providing a smart metering communication service is a licensable activity prohibited by law unless the party is licensed to do so under the Electricity Act 1989 and the Gas Act 1986. The smart meter communication licence sets out the conditions which the holder of the Licence is obliged to comply with in providing this service. The licence, therefore, is an instrument that allows DCC to undertake that designated activity, and we expect all licensees to comply with the conditions of their licence.

4.130. We are minded-to disallow costs that are associated with those procurements for which we have not received any satisfactory justification or evidence from DCC to arrive at the decision that a direct award was the most economic and efficient option. **The total disallowance cost amounts to £1.240m for RY22/23.** For reference, this is in contrast to the total value of approximately £15m-£16m associated with contracts that were procured non-competitively over the course of RY22/23.

4.131. Should we however receive additional evidence and justification that demonstrates that an NCP approach for these respective procurements was the most economic and efficient option, we may reduce the proposed disallowance accordingly.

4.132. We welcome further views and evidence from all stakeholders on this issue.

Shared Service Charge

Context

4.133. DCC pays a Shared Service Charge (SSC) to its parent company, Capita, to cover support services such as HR tools, property services, payroll, IT, and senior management support. The inclusion of the SSC was part of the competitive bid during the Licence tender. It is calculated as a percentage of the Internal Costs, as originally set out in the LABP.

4.134. In the RY16/17 Price Control decision, we decided that in future years we would not require further justification for the SSC associated with Baseline Activity for Price Control purposes.[48] For New Scope Activities, DCC must provide full justification to demonstrate that any SSC relating to these activities is economic and efficient.[49]

4.135. DCC does not apply SSC on External Services (ES) procured for Additional Baseline activities.[50] DCC has previously also opted not to apply SSC on some other components such as the costs associated with Brabazon House.

4.136. In RY21/22 DCC applied for an SSC on Internal Service (IS), IT Service (IT) and Office Sundry (OS) services for Network Evolution Programme (NEP) which is an Additional

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[48] Ofgem (2018), DCC Price Control Decision: Regulatory Year 2016/17. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201617

[49] New Scope Activities are activities associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence Award. The Switching Programme is considered New Scope

[50] Additional Baseline activities are associated with requirements that the Licensee was expected to deliver at the time of the Licence Award, but which had not been fully costed in the LABP. For example, SMETS1 enrolment and adoption costs are considered Additional Baseline.

Baseline activity. In our RY21/22 Decision[51] we disallowed the SSC on those costs and made clear that applying for an SCC on non-resource costs for additional baseline activities was inconsistent with DCC's approach in previous years, and therefore, should be properly justified.

4.137. As per our positions in previous years, we would like to re-iterate the importance for DCC to ensure that there is no cross-subsidisation across affiliates or related undertakings.[52] Given the growing concerns in this area, we expect DCC, going forward, to provide greater assurance that the SSC paid to Capita provides value for money. In its response to the RY17/18 consultation DCC proposed to that effect that it would "undertake an in-depth review of Capita Shared Services" and "ensure also that there is no 'double counting' between services provided by DCC and those same equivalent services that should be provided under the SSC"[53]

DCC's justification

4.138. This year, DCC applied the SSC at a rate of 9.5% on Baseline costs, which amounted to £10.598m in RY22/23 and £26.853m in forecast costs to the end of the Licence term.

4.139. As per previous years, DCC did not apply for SSC for New Scope Activities, such as the Switching Programme. DCC did also not apply for SSC on ES costs for Additional Baseline activities such as: Smart Metering Key Infrastructure (SMKI), Parsing and Correlation Service, SMETS1, NEP and Enduring Change of Supplier (ECoS). Finally, DCC also excluded test lab related costs from SSC.

4.140. DCC did apply for SSC on other non-resource costs for Additional Baseline activities. Notably, it applied on incurred costs such as Financial security & stability – IS, SMETS1 – accommodation (AC), and SMETS1 – IS. DCC also applied for SSC on Recruitment

[51] Ofgem (2023), DCC Price Control Decision: Regulatory Year 2021/22. www.ofgem.gov.uk/sites/default/files/2023-02/RY2122%20Price%20Control%20Decision.pdf
[52] This is a requirement under Licence Condition 11 of the Smart Meter Communication Licence.
[53] Ofgem (2019), DCC Price Control Decision: Regulatory Year 2017/18. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201718

(RC) and Non-Payroll (NP) Additional Baseline forecasted costs. DCC did not provide any justification for applying SSC on any of these non-resource Additional Baseline activities.

Our view

4.141. As in previous years, we accept the 9.5% SSC associated with the baseline costs of DCC's core smart metering service.

4.142. We also reiterate our position that, as New Scope and Additional Baseline activities 'were not part of the LABP and therefore not subject to competition, DCC will need to provide full justification that any SSC related to these activities are economic and efficient.

4.143. More generally, we expect DCC to actively ensure, and where possible, evidence, that it is achieving value for money from the SSC applied to both baseline and Additional Baseline activities.

4.144. DCC's decision to apply for an SSC on IS, RC, AC and NP costs for Additional Baseline activities, without any justification, is inconsistent with DCC's approach in previous years where it chose to exclude SSC on on-resource costs for additional baseline activities such as SMETS1. It also goes against our RY21/22 Decision to disallow SSC on non-resource costs for additional activities when these SSCs are not justified. **We are therefore minded-to disallow the SSC on these costs, which amount to £0.124m for RY22/23, and £0.141m for forecasted costs for RY23/24 and RY24/25.**

4.145. As we indicated last year, we intend to keep following the same approach going forward and expect DCC to exclude these costs from SSC for Additional Baseline activities in future years.

4.146. We also propose to disallow the Shared Service Charge associated with the proposed Unacceptable Internal Costs. Taking this into account, **the total proposed disallowance amounts to £0.838m in RY22/23 and £12.245m in forecast costs to the end of the Licence term.**

Forecast Resource Costs

Context

4.147. When updating the forecast for a Price Control submission, DCC must ensure its forecast costs meet the threshold of being significantly more likely than not to occur (the "certainty threshold"). We expect DCC to provide ample evidence that forecast variances meet this certainty threshold. When updating the forecast variance for any Price Control submission, we expect DCC to further explain and provide sufficient evidence that it has made the most economic and efficient decisions. In line with our Price Control Processes and Procedures Guidance, if DCC fails to justify any forecast costs as being economic and efficient we may remove them from the forecasts as part of our determination.

4.148. In its Price Control submissions, 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 the forecast baseline costs until the end of the licence term due to a lack of justification.

4.149. However, this year there are also a number of forecast costs over RY23/24 and RY24/25 where we have concerns over DCC's justifications. This has been discussed in the relevant sections in this chapter.

DCC's justification

Corporate Management cost centre

4.150. DCC provided justification for the Document Writing Unit which is the team responsible for assembling HMT Green Book compliant business cases while the new Centre of Excellence was being established. DCC explained the Unit was formed of three full time members of DCC staff who had formerly been in the Regulatory Design and Delivery team. DCC stated the Unit played an integral role in supporting the progression of the CH&N business cases required under LC16.6 (A-C).

4.151. DCC further explained the Customer Experience function headed by the Chief Customer Officer lead on engaging DCC's customers on its strategy and programme portfolio.

DCC forecast £1.268m in RY23/24 and £1.916m in RY24/25, both of which was above the baseline. DCC attributed the forecast variance in RY24/25 due to a zero baseline.

Finance cost centre

4.152. DCC's People Team created a new set of Values and Behaviours which they believed would increase the focus on leadership capability and would showcase an investment in employee engagement towards the organisation. DCC justified the team by discussing the emphasis placed on benchmarking activities to attract and retain the talent DCC needs. DCC forecasted a variance of £2.173m in RY23/24 and £1.811m in RY24/25.

4.153. The Portfolio and PMO team were responsible for enterprise-wide activity planning and process improvement. DCC forecasted a variance of £1.426m and £2.529m in RY23/24 and RY24/25 respectively. DCC state this particular team will be transferred back into Service Delivery in RY23/24.

Commercial cost centre

4.154. DCC have expanded their Commercial Operations and Planning team as it believes the team plays a crucial role in driving value within the Commercial function. DCC state to have adjusted its activities to align with the National Audit Office (NAO) framework to meet the new contract management aspect of the Operational Performance Regime (OPR). DCC forecasted a variance of £1.017m in RY23/24 and £2.336m in RY24/25 with the latter being compared to a zero baseline.

4.155. DCC recruited five new roles within the Vendor Management team as a continuation of its drive to enhance the capability and maturity of the Contract Management function. As a result of these incoming roles, DCC forecasted a variance of £1.147m in RY23/24 and £2.850m in RY24/25.

Design and Assurance cost centre

4.156. Within the technology innovation team, DCC recruited an additional three Full Time Employees (FTE) to support the Smart Energy Code (SEC) modifications. DCC declared there would be additional FTEs to support the Retail Energy Code (REC) as there is potential for the team to grow in the future, but the demand is not yet fully known.

4.157. DCC forecast that demand for resource on the Network Evolution programmes will increase significantly and admitted it would be largely reliant on the use of a consultancy partner which will continue into the next financial years. Consequently, DCC reported a forecast variance of £1.965m in RY23/24 and £4.370m in RY24/25.

Programme (Service Delivery) cost centre

4.158. DCC forecasted 20 contractor roles for a pilot Managed Service Provider Service with North Highland in RY23/24. DCC also clarified the Programme Office team will transfer back into Service Delivery, resulting in an increased headcount and costs for the Professional Services Practice. DCC forecast a variance of £3.403m in RY23/24 and £2.523m in RY24/25. DCC state the variance in RY24/25 remains high because the costs are being compared to a zero-baseline due to previous forecast disallowances.

Security cost centre

4.159. DCC highlight the importance of the Governance, Risk and Compliance (GRC) team who ensure DCC manages business risk and industry appetite. DCC have hired a new Director within this team and hence forecasted a variance of £0.721m in RY23/24 and £1.312m in RY24/25.

Operations cost centre

4.160. DCC explained the Customer Relationship Management team will focus on improving customer communication and the general health of the network. As a result, the FTE is likely to increase the total headcount position by four. DCC forecast a variance of £0.743m and £1.765m in RY23/24 and RY24/25 respectively for these roles.

SMETS1 programme

4.161. DCC affirmed a new service will be taking place in RY22/23 for Trilliant for which testing will be required. DCC recruited one Testing Manager and one Device Model Combination Testing (DMCT) Test Assurance Lead which are forecast to continue into RY23/24 and RY24/25. DCC also hired one Lead E2E Architect to support the SMETS1 migration. DCC forecast a variance of £2.116m in RY23/24 and £0.312m in RY24/25 for the addition of these roles.

Network Evolution programme

4.162. DCC stated Service Delivery resources will be required in the upcoming regulatory years to support with external engagement activities. This includes activities linked to DSP, PKI-E, CH&N and DSMS. For the deliverance of Test Automation, DCC indicated the contract was awarded to the successful bidder. Consequently, DCC forecast a variance of £4.438m in RY23/24 and £2.774m in RY24/25.

Forecast Baseline costs

4.163. As with previous Price Control submissions, and in line with our Price Control Processes and Procedures Guidance, DCC's criteria for inclusion of costs is whether activities and costs are significantly more likely to occur than not. DCC therefore only attempted to justify forecast costs for RY23/24 and RY24/25 as the certainty criteria had not been met for RY25/26 onwards.

Our view

4.164. We deem that forecast costs have not been sufficiently justified and as a result we are minded-to disallow the forecast variances stated above. The total forecast variance associated with the above roles and services totals £18.228m for RY23/24 and £24.416m for RY24/25. Table 3.2 provides a breakdown of these disallowances.

4.165. We are also minded-to disallow all variation in DCC's baseline forecasts from RY25/26 onwards as zero evidence was provided in justifying these costs. **This amounts to £89.613m disallowance** (excludes associated SSC which are reported in the section above).

4.166. We encourage DCC to work on its customer engagement strategy however we are unclear on the rationale behind the Document Writing Unit given the Business Case Centre of Excellence has now been established. It is still unclear how this team provides value to consumers with minimal justification to argue for the continuation of this Unit. We have disallowed the Partnerships Director role based on previous years' grounds and involvement in innovation specific activities.

4.167. We have previously raised concerns on the number of roles within the People team and the rationale for expansion. It is unclear why the team continues to recruit more and more people. DCC must better forecast the costs associated with the team to avoid such high variances.

4.168. In line with previous years, we assume 50% of the technology innovation team within Design and Assurance carries innovation specific activities. As a result, we are minded-to disallow the forecast costs in this team due to a lack of justification for the extra resource. Similarly, the roles within the Commercial team and the CISO Office within Security have not been sufficiently justified.

4.169. Although DCC forecasted the 20 contractor roles in RY23/24 for Service Delivery, DCC did not provide justification on whether the hired contractors would exactly replace the initial roles or if the same number of North Highland contractors were required.

4.170. For the Operations cost centre we are minded-to disallow the forecast costs associated with customer engagement. These costs were also disallowed last year, and the business need continues to be vague given the wider customer engagement strategy which DCC already has in place. Furthermore, there is limited justification for further increases regarding its headcount.

4.171. Last year we disallowed all forecast variances for Network Evolution, SMETS1 and ECoS, due to a large degree of uncertainty in these programmes. We are again unsatisfied with the justification provided by DCC for the forecast costs on these programmes, and still consider there to be a large degree of uncertainty. We also do not have assurance that these forecast costs are economic and efficient and therefore propose to disallow all forecasts associated with Network Evolution and SMETS1.

4.172. We are open to receiving more evidence in light of the above. In future reporting, DCC should ensure that all forecast costs are evidenced and accompanied by a thorough justification in the Price Control submission.

Table 4.9: Proposed forecast disallowances per cost centre in RY23/24 and RY24/25

Cost Centre	RY23/24Disallowance (£m)	RY24/25 Disallowance (£m)	Total
Corporate Management	1.000	1.050	2.050
Finance	3.599	4.340	7.939
Commercial	-	5.186	5.186
Design and Assurance	2.208	4.733	6.941
Programme (Service Delivery)	3.403	-	3.403
Security	0.721	1.312	2.033
Operations	0.743	1.765	2.508
SMETS1	0.291	0.312	0.603
Network Evolution	7.689	5.718	13.407
Total	**19.654**	**24.416**	**44.070**

5. 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. This section also covers the assessment of the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS).

Under the OPR, we are proposing for DCC to retain the full margin associated with system performance for RY22/23. In respect of the contract management incentive, under which an auditor assesses DCC's performance against the National Audit Office (NAO) framework, we are proposing to adjust the auditor's score from 1.95 to 1.71 out of 3. This results in a proposed margin reduction of **£0.489m**.

For the customer engagement incentive, we received submissions from both DCC and SEC Panel on DCC's performance during RY22/23. After assessing both submissions we are minded-to award a score of 2, corresponding to a reduction of DCC's BM by **£0.381m**.

In relation to the SMETS1 BMPPAS incentive regime, following its completion on 30 June 2022, DCC submitted results for the two Project Activities (PA 1 and 2) which comprise the incentive. As a result, for RY22/23 we are proposing a reduction of DCC's BM of £6.995m.

Consultation questions

Question 14: What are your views on our proposed position on DCC's System Performance?

Question 15: What are your views on our proposed position on DCC's Contract Management?

Question 16: What are your views on our proposed position on DCC's Customer Engagement?

Question 17: What are your views on our proposed position on the assessment of the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS)?

Background

5.1. All of DCC's Baseline Margin (BM) (including adjustments) is at risk against one of DCC's performance regimes.

5.2. This is the fifth year in which DCC's performance is being assessed by the Operational Performance Regime (OPR), the first year it is assessed by the revised system performance measures, and the first year it is being assessed by the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS).

5.3. Separately to the BM, DCC receives margin on the Switching Programme. The margin linked to Switching is put at risk under a separate performance regime. We discuss this in the Switching section of this document (Section 7).

Operational Performance

Background

5.4. 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.

5.5. Following consultation, in October 2020 we published our decision[54] to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management. As part of our decision, we also implemented

[54] DCC Operational Performance Regime Review: October 2020 Decision: www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision

a Licence change to enable Ofgem to publish guidance, regarding the process, procedures, and criteria of the OPR.[55]

5.6. In March 2021, we published the OPR Guidance to enable implementation, and published a revised OPR Guidance document in March 2022.[56] 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 proposed a trial run in RY20/21 for both customer engagement and contract management, without margin attached, for these incentives to come into effect with margin attached in RY21/22. While we were unable to conduct a trial for contract management, we set out in our RY20/21 Price Control decision[57] that the incentive would come into effect with margin attached in RY21/22 as originally intended. We decided to implement a 12-month grace period ("Transition Year") for system performance measures in RY21/22, for the new regime to come into effect in RY22/23.

5.7. In March 2023, following a period of public consultation[58], we published an updated OPR Guidance document[59] introducing changes to the contract management scoring framework. These changes were set out in the OPR Guidance 2023 Decision document.[60]

5.8. The total BM at risk for RY22/23 is £7.612m. 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.

[55] The relevant changes were made to Licence Condition 38.9
[56] The original and revised OPR Guidance documents can be found at: Decision on OPR Guidance March 2021: www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021
[57] DCC Price control Decision Regulatory Year 20/21: www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021
[58] Revised OPR Guidance consultation January 2023: www.ofgem.gov.uk/publications/revised-opr-guidance-consultation-january-2023
[59] OPR Guidance March 2023: www.ofgem.gov.uk/sites/default/files/2023-03/OPR%20Guidance%20%28March%202023%29.pdf
[60] OPR Guidance 2023 Decision document: www.ofgem.gov.uk/sites/default/files/2023-03/Decision%20on%20OPR%20Guidance%202023.pdf

System Performance

Context

5.9. The original OPR was initially consulted on in March 2016 and the final decision and direction was published in September 2017.[61] In the RY21/22 Transition Year, DCC was assessed on its system performance against a version of the original OPR set out in the original OPR Guidance (March 2021). The revised OPR has come into effect for system performance for the first time in RY22/23[62].

5.10. Under the revised OPR system performance regime DCC is incentivised under five system performance measures: Service Availability, Firmware Management, Install and Commission, Prepayment (Interim Response Times), and Change of Supplier. Where applicable, DCC's performance against these measures is assessed across meter generations (SMETS1 and SMETS2) and – for SMETS2 – also across the smart network regions: North, Central, and South.

5.11. As of RY22/23, three out of five measures currently carry an equal weighting whilst two measures have no weighting attached. Table 5.1 below sets out the current weighting against the margin at risk for the system performance incentive for each measure.

Table 5.1: Operational Performance Measures

Term	Performance Measure (m)	Weighting
SUM1	Service Availability	33.33%
SUM2	Firmware Management	0%
SDM1	Install & Commission	33.33%
SDM2	Prepayment (Interim Response Times)	33.33%
SDM3	Change of Supplier	0%

[61] For more detail on the original OPR please refer to the decision document and consultation documents: www.ofgem.gov.uk/publications-and-updates/decision-dcc-s-operational-performance-regime

[62] Ofgem (2022), Decision letter on Revised OPR Guidance. www.ofgem.gov.uk/sites/default/files/2022-03/Decision%20letter%20on%20Revised%20OPR%20Guidance%20%28March%202022%29.pdf

5.12. These OPR performance measures are composed of a selection of the performance measures reported to the SEC.

Interim system performance measures and the SRV8.11 question – background

5.13. As explained above, in March 2021, following a period of public consultation in January 2021, we published our Decision on OPR Guidance.[63]

5.14. However, in response to our January 2021 OPR Guidance Consultation, DCC raised that it was not technically possible to report on some of the newly introduced System Performance measures from April 2021. Therefore, in our March 2021 OPR Guidance Decision we gave DCC a 12-month grace period for DCC to work closely with its customers and SEC parties and find a technical solution, or if this was not possible, alternative measures supported by industry.[64] This led to setting up of an ad-hoc industry group (OPR Working Group) by DCC, significant engagement between DCC and the Smart Energy Code (SEC) Operations Group (OPSG) and a public consultation issued by DCC in December 2021.[65] DCC submitted recommendations to us on System Performance measures for OPR in February 2022. The SEC Panel submitted to us their views on DCC's recommendations.

5.15. Following DCC's recommendations and SEC Panel's views, as well as the feedback to DCC's December Consultation, we consulted with DCC on a set of proposed changes to the Guidance and conditions in March 2022. After careful consideration of all the feedback received, in March 2022 we took the decision to modify the OPR Guidance in relation to system performance as follows:[66]

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[63] OPR Guidance Consultation was issued in January 2021: www.ofgem.gov.uk/publications/opr-guidance-consultation-january-2021
[64] OPR Guidance Decision was published in March 2021: www.ofgem.gov.uk/sites/default/files/docs/2021/03/decision_on_dcc_operational_performance_regime_guidance.pdf
[65] DCC's consultation on Operation Performance Regime (OPR) potential measures (December 2021): www.smartdcc.co.uk/consultations/consultation-on-operational-performance-regime-opr-potential-measures/
[66] Decision to modify DCC Operational Performance Regime Guidance (March 2022):

- **Install and Commission** measures: accept DCC's recommended alternative measures as interim measures. However, keep the existing Service Reference Variant (SRV) 8.11 (Update HAN Device Log) as an Install and Commission measure.

- **Prepayment** measures: accept DCC's recommended alternative time-based measures as interim measures.

- **Firmware Management** measure PM2 (dormant): reject DCC's recommendation to remove this measure from the OPR (however it would remain dormant).

5.16. Given the complexity of finding and implementing an enduring solution, we did not set a strict timeline for these interim measures. However, we encouraged DCC to keep engaging with its customers and SEC parties to ensure that an enduring solution could be implemented as soon as possible.

SRV8.11

5.17. SRV8.11 is a message type that is primarily sent at the beginning of a smart meter installation to add a device to the Home Area Network (HAN). Because SRV8.11 is included as part of the OPR Install and Commission measure, DCC is incentivised to ensure SRV8.11 messages are delivered within the Target Response Time (TRT) of 30 seconds.

5.18. Whilst we did not agree with all of the arguments raised by DCC to exclude this metric, we acknowledged that some had merit. Notably, that the performance of this SRV was adversely impacted by customer actions, and therefore outside of DCC's full control. However, at that time, DCC was not able to provide concrete evidence for us to consider further. For that reason, we said that we would take wider evidence into account when deciding whether DCC should lose margin under the OPR associated to

https://www.ofgem.gov.uk/sites/default/files/2022-03/Decision%20letter%20on%20Revised%20OPR%20Guidance%20%28March%202022%29.pdf

SRV8.11 as part of the Price Control exercise. For example, we said we would consider whether the targets were not met due to circumstances outside of DCC's control.

DCC's submission – SRV8.11

5.19. As part of this year's Price Control submission, DCC put forward further arguments and some quantitative evidence to support its view that SRV8.11 is not an appropriate measure for the purposes of the OPR, and therefore, it should not lose margin for not meeting the targets for this measure.

5.20. DCC put forward the following reasons to contest the inclusion of SRV8.11:

- The performance of SRV8.11 is adversely impacted by elements outside of DCC control and as such DCC cannot be held solely accountable for the performance. This point is further discussed below.
- There is no provision made in the DCC Communication Service Provider contracts with regards the specific disaggregated performance of SRV8.11 and as such DCC has no formal commercial leverage to manage this performance.
- The current TRTs were set based on an aggregate performance; the systems were not required or designed to meet these targets at a disaggregated level.
- Some SRV sizes have increased materially since the targets were initially set and the systems have never been uplifted to reflect this. Whilst this is not necessarily an issue for meeting the SEC requirements at an aggregate level, because a percentage of SRVs remain similar to the original forecasted size, for some SRVs it makes a material difference.
- SRV8.11 is not a valid measure in the SEC, it is only included as part of a combination of SRVs within the Install and Commission process; therefore, there is no defined or agreed Service Level for SRV8.11 in the SEC, and as such it is not valid for inclusion in the OPR.

SRV8.11 performance is not in DCC's full control

5.21. As noted above, SRV8.11 is primarily used during the Install and Commission process to update the Communications Hub Function's (CHF's) Device Log to either add or remove another device (typically the Electricity Meter, Gas Meter, and In-Home Display) to the Home Area Network (HAN). The CHF's Device Log contains the whitelist of other devices that are part of its HAN.

5.22. Because SRV8.11 is targeted at the CHF only, and as such the message is not transmitted over the HAN (and therefore, stays within DCC System boundaries), it was proposed by customers as an appropriate SRV to measure the time-based performance of the DCC solution during the Install and Commission process.

5.23. However, DCC argued that while it is true that this SRV stays within DCC system boundaries (which is a key criterion to being within DCC control), its performance is still affected by the orchestration process of suppliers. For example, if the CHF is busy with other messages, or if another message is sent whilst the SRV is being processed, then it will be slowed down by other traffic. In particular, DCC provided evidence of the following:[67]

- The impact of parallel service requests during install and commission: it showed that performance was adversely impacted by customers sending parallel SRVs during the process, reducing performance by between 10%-15%. It was noted that customers have full control of the orchestration of service request that are sent which is completely outside of DCC's control.
- That there are other factors adversely impacting performance related to the supplier orchestration process. For example, the timing when sending multiple SRV8.11 during the installation process (each HAN install will require a SRV8.11 for each device added). However, DCC argued that it was not possible to be more precise about this impact without witnessing the orchestration followed by each supplier for each install.

[67] Please note that all the data submitted by DCC to us was based on performance in the North Region. DCC argued that although the same challenges occur in the South and Central regions, the technology is such that the impact of customer behaviour is less material in those regions.

- That when customers follow DCC best practice the performance of SRV8.11 improves significantly (however still below the targets set out in the SEC). In relation to this DCC noted that:

   i. Business processes are not mandated, and there is not appetite from customers to do so; and

   ii. whilst following DCC guidance would improve the reported performance it may not positively impact the time to complete an installation, and in fact it may have an adverse impact. In other words, maximising SRV8.11 performance could negatively impact the overall installation process times for customers.

5.24. In relation to customer engagement, DCC noted that over the past 12 months it has been committed to helping its customer improve their SRV8.11 performance where there has been a customer appetite and willingness to support the analysis required and any associated changes to customer systems and processes.

5.25. DCC said that through this engagement it has become clear that Success Rates for SRVs (and in particular for SRV8.11) are, in many cases, considered far more important than the existing Target Response Times (TRT). It is worth noting that a SEC modification proposal (MP242 'Change to Operational Metrics to Measure on Success'[68]) has been raised by a SEC party, with the intention to allow DCC to measure the 'success' of a Service Request (SR), SRV, or Alert. If this MP is successful, it could facilitate finding an enduring solution for system performance, including the Install and Commission process.

SEC Operations Group (OPSG) views

5.26. Ofgem requested OPSG to provide its views in relation to DCC's claim that SRV8.11 was not fully under its control, as well as the evidence supporting it. The OPSG provided its views to Ofgem in a letter in May 2023. In that letter, the OPSG agreed

[68] Modification Proposal (MP) 242: https://smartenergycodecompany.co.uk/modifications/change-to-operational-metrics-to-measure-on-success/

that the performance (Target Response Time – TRT) achieved for SRV8.11 was not entirely within the control of the DCC, even though TRT is measured only across the DCC infrastructure, due to factors such as User orchestration.

5.27. The OPGS also emphasised the important of finding a suitable metric for the DCC component of the Install and Commission process, given that it was a key business process. However, it recognised that no suitable alternative to the SRV8.11 had yet been tabled. In this regard, the OPSG noted possible approaches for investigation:

- Adjusting the value of the SRV8.11 TRT minimum and target times so that they take account of the diversity of orchestrations employed by users. However, it recognised that while this would require careful investigation, the question of DCC control over the SRV8.11 performance would remain.
- Filtering the instances of the SRV8.11 included in the measurement of the TRT, so that only those not materially influenced by the User choice of orchestration are included. However, it noted that it may be that only a small minority of instances may satisfy the filtering process, and that work to assess the implementation of an enduring process of this type had not been undertaken.
- Consideration of a measure based on a definition of 'Success' rather than TRT.

5.28. Finally, the OPSG noted that discussions with Users had highlighted the limitations of the measurement of the Target Response Times (TRT) methodology, and that there was strong support for considering a measure of "success" as an alternative. Noting that this would require a SEC Modification.

DCC's response to OPSG and proposed options

5.29. In relation to the proposal of adjusting the value of the SRV8.11 TRTs, DCC argued that it would not resolve any of the issues but would reduce the granularity of the reporting.

5.30. In relation to the proposal of filtering the instances of the SRV8.11, DCC argued that it considered this option but concluded that the number of SRV8.11s that would likely qualify for inclusion would be a small minority and therefore not a robust reflection of systems performance. It also raised that it was likely that only one or two users would meet the qualifying criteria and, as such, it would be a OPR measure relevant to a very small minority of users. Finally, it echoed OPSG's point that the work required to identify and agree the exceptions, and produce the reporting capability has not been assessed, and concluded that this option was not viable.

5.31. In relation to the consideration of a measure based on a definition of 'Success' rather than TRT, and of the SEC Modification that would be required, DCC said it was supportive of such modification being progressed and said it was the logical way forward. DCC recommended that any control challenges should be discussed and resolved during the modification process. As noted above, such a SEC modification proposal was raised in May 2023, and it is currently at the Refinement Process stage.[69]

5.32. Finally, DCC proposed three options in relation to the inclusion of SRV8.11 in the OPR as it stands now, which are summarised in table 5.2 below.

Table 5.2: DCC's proposed options to address the challenges with SRV8.11

Option	Positives	Negatives
1) Replace SRV8.11 with an alternative metric	• Ensures the number of Install and Commission metric remains consistent	• Impractical to retrospectively add a metric to the Interim OPR for RY22/23 or RY23/24. • Extensive engagement with customers over the past two years has indicated there are no alternative replacement measures available at this point (as also noted in the letter from the OPSG Chair to Ofgem dated 12 May). • Distraction from agreeing enduring OPR measures.
2) Remove SRV8.11 from the interim OPR.	• Ensures all metrics in the OPR meet appropriate criteria for inclusion.	• Potentially reduces the focus on a metric that is important to customers.

[69] Modification Proposal (MP) 242: https://smartenergycodecompany.co.uk/modifications/change-to-operational-metrics-to-measure-on-success/

Option	Positives	Negatives
		• Impractical to retrospectively remove a metric for RY22/23 or RY23/24.
3) Zero-weight the SRV8.11 metric in the interim OPR.	• Retains reporting of performance (in the PMR) and so encourages continued focus. • Simple to 'reactivate' if criteria met through changes made via the modification process. • Avoids distraction from, and loss of focus on, agreeing measures for the enduring OPR. • Practical (in terms of timescales and process) for both RY22/23 and RY23/24.	• Reduced number of measures for Install and Commission (albeit focus will continue as it will still be a reported measure and overall margin at risk for Install and Commission remains unchanged).

5.33. DCC's recommendation is to follow option 3.

Our view – SRV8.11

5.34. Our view in relation to the arguments put forward by DCC to contest the inclusion of SRV8.11 in the OPR is discussed in the following paragraphs.

5.35. After consideration of the evidence submitted by DCC and in light of the OPSG views, we are minded-to accept DCC's argument that the performance of SRV8.11 is adversely impacted by elements outside of its control (argument 1). Furthermore, given that this impact is not quantifiable by reasonable means, we recognise that it would not be fair to held DCC solely accountable for the performance of this SRV.

5.36. In relation to the options put forward by DCC to address the issues around SRV8.11 for RY22/23, we agree with DCC that: option 1) 'Replace SRV8.11 with an alternative metric', and option 2) 'Remove SRV8.11 from the interim OPR', are not workable given the arguments included in table 5.2. Notably, that there are not alternative replacement measures available at the moment, and the impracticability of retrospectively removing a measure from the OPR for RY22/23. However, we disagree with DCC that it would be impractical to remove the measure for RY23/24 in principle.

5.37. **In light of the above, we are proposing to apply option 3) 'Zero-weight the SRV8.11 metric in the interim OPR' for RY22/23**. This means that no margin would be put at risk against the performance of SRV8.11 in RY22/23. We will issue a separate consultation to consider the way forward from RY23/24 onwards.

5.38. While we are disappointed no alternative measure or methodology could be followed to assess DCC's performance on SRV8.11 in a fair manner, we note the progress around MP242 which was identified as a way forward by both DCC and the OPSG.

5.39. For completeness, we discuss the other arguments put forward by DCC (arguments 2 to 5) to contest the inclusion of SRV8.11 in the OPR below.

5.40. In relation to argument 2, 'no provision made in the DCC Communication Service Provider contracts', we will reiterate what has been our position since our March 2021 Decision on OPR Guidance:[70] that OPR does not need to be reflective of Service Provider Contracts. This is because we expect DCC to work with its service providers to meet the performance levels set by the OPR Guidance. We consider contractual change to be one of several levers that DCC can use to improve its performance and consider there may be other options that customers may consider better value for money.

5.41. In relation to arguments 3 to 5: 'TRTs were set based on an aggregate performance' (argument 3), 'Some SRV sizes have increased materially since the targets were initially set and the systems have never been uplifted to reflect this' (argument 4), and 'SRV8.11 is not a valid measure in the SEC' (argument 5) – our view is that while the facts raised by DCC might be true, we do not consider them to be valid arguments against the inclusion of SRV8.11 in the OPR. This is because:

[70] Paragraph 2.9 of Decision on OPR Guidance March 2021: https://www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021

- the OPR is not a SEC mechanism. It is set out as part of the Licence Conditions and not in the SEC legal text.

- There is no requirement for the OPR measures to be based on the SEC Performance Measures. It was Ofgem decision to use the SEC Performance Measures as a guidance as it was thought to be a good indication of the measures that were useful to customers. However, considerations such as the technicality raised in argument 5 are not relevant in relation to the OPR.

- The OPR measures were publicly consulted upon by Ofgem as part of the OPR Guidance Consultation (January 2021)[71] and they received wide support from Industry, as noted in our Decision on OPR (March 2021).[72] Furthermore, these concerns (arguments 3 to 5) were not raised by DCC during that consultation process.

DCC's submission – system performance

5.42. The total BM at risk against system performance in RY22/23 is £5.328m. DCC reported that it did not meet the performance targets for the SDM1 measure (Install and Commission) due to the underperformance of the metric SRV8.11 in the North region. However, as discussed in the section above, it argued that the performance of this metric was not under its full control and as such, no margin should be put at risk against it.

5.43. DCC met the targets for all the other measures that are not dormant. Table 5.3 below shows the overall performance DCC reported under OPR system performance for RY22/23, it includes both the active and the dormant measures.

[71] Ofgem (January 2021) OPR Guidance Consultation: www.ofgem.gov.uk/publications/opr-guidance-consultation-january-2021
[72] Ofgem (2021), Decision on OPR Guidance: www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021

Table 5.3 DCC's submitted OPR system performance values

OPR measures	BM at risk (£m)	BM reduction (£m)	Targets [minimum – target] (%)	DCC's performance
SUM1	1.776	0	99.50-98.00	Penalty Mechanism A: 99.99%
SUM2 (Dormant)	0	0	99.00-96.00	Penalty Mechanism A: Not reported Penalty Mechanism B: - North: 97.65% - Central: 98.68% - South: 98.74%
SDM1	1.776	0	99.00-96.00	Penalty Mechanism B: - North: 99.96% - Central: 99.98% - South: 99.99%
SDM2	1.776	0	99.00-96.00	Penalty Mechanism A: 99.88% Penalty Mechanism B: - North: 100% - Central: 99.75% - South: 99.76%
SDM3 (Dormant)	0	0	99.00-96.00	Penalty Mechanism A: 47.68% Penalty Mechanism B: - North: 20.29% - Central: 61.65% - South: 61.80%
Total	**5.328**	**0**	**-**	**-**

Our view

5.44. The question of whether DCC should be incentivised for SRV8.11 as part of the OPR, and therefore, whether DCC's margin should be put against its performance, is extensively discussed in the section above 'Interim system performance measures and the SRV8.11 question'. Our minded to position in relation to it is set out in paragraph 5.38.

5.45. In summary, we accept DCC's argument that SRV8.11 is not fully under its control, that there is not a practical way to assess and determine how much is under its control, and that therefore it would not be fair for DCC to lose margin because of SRV8.11 underperformance.

5.46. **Our minded to position is, therefore, for DCC to retain the full margin associated with system performance for RY22/23**.

5.47. We acknowledge that this might disappoint some users who might have experienced performance issues over the RY22/23 period. We understand that a way forward to facilitate an enduring OPR solution for system performance has been identified by both SEC parties and DCC, and that it is progressing in the form of a SEC Modification Proposal (MP242). We encourage DCC to keep working with its customers to ensure that an enduring solution, which adequately reflects user experience of the DCC network, is found and can be implemented as soon as possible.

5.48. While the work to find an enduring solution is being progressed, we will be shortly consulting on potential changes to the OPR, notably on the weighting of its different elements (system performance, customer engagement and contract management). We think that changes to the weight of the different elements of the OPR might help incentivise DCC in a more effective and balanced way, particularly while we are applying an interim system performance regime.

Contract Management

Context

5.49. RY21/22 was the first year in which DCC's contract management performance was financially incentivised under the revised OPR. DCC's performance is assessed by an independent auditor using the National Audit Office (NAO) Framework, in line with scope and terms of reference set out in the OPR Guidance.[73] RY22/23 marks the second year of the audit.

5.50. The scope of the audit covers DCC's contract management of its Communication Service Providers (Arqiva and VM02), Data Service providers (CGI) and the three SMETS1 Service Providers who have incurred the highest costs over RY22/23. The

[73] Ofgem (March 2021) Decision on OPR Guidance: www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021

audit also assesses DCC's procurement and re-procurement activities in RY22/23 under DCC's Network Evolution programme, including procurement of 4G Comms Hubs and Networks, re-procurement of Data Service Provider (DSP) and Smart Metering Key Infrastructure (SMKI). The scope of the audit also assesses adherence to the SEC Modifications (SEC Mods).

5.51. The final audit report was provided to Ofgem on completion in July 2023.

Audit report

5.52. The audit report, referred to as 'report', sets out the auditors finding of DCC's performance against each supporting question under the NAO framework. Under the incentive, a score is awarded of 0,1,2 or 3 to each of the individual questions (as set out in Table 5.4). An overall score of **1.95 out of 3** was awarded to DCC by the auditor. Based on further analysis of the information available to us we are minded to reduce the score to **1.71 out of 3** due to DCC's procurement approach and failure to improve the performance of its 2nd Tier Suppliers.

Table 5.4: Summary of scores awarded against each supporting question in the NAO Framework domain

Domain	Key question	Supporting questions	Score
1. Commercial strategy	Is there an overarching commercial strategy, with a clear rationale for the approach being taken?	1.1. Is there a clear and consistently held view of what the contract is producing, the type of commercial relationship desired, the basic contract structure and how it will be managed?	**3**
		1.2 Has there been an assessment of strategic drivers, including policy drivers, and the internal and external environment?	**2**
		1.3 Has the commercial strategy been based upon the assessment of strategic drivers and the internal and external environment?	**1**
	Does DCC have the capability	2.1 Does DCC have the necessary capability, skills and systems?	**1**

Domain	Key question	Supporting questions	Score
2. Capability & governance	needed to manage the contract and is it developing capability for the future?	2.2 Does DCC understand its future needs and is it working towards meeting them?	**2**
		2.3 Has DCC deployed its capability in a balanced way across the lifecycle and is commercial capability effectively integrated with the business?	**2**
3. Market management & sourcing	Has sourcing supported the commercial strategy and followed recognised good practice to optimise VFM?[74]	3.1 Has market management driven long term value for money?	**1**
		3.2 Was there a defensible process that resulted in the selection of a capable supplier?	**1**
		3.3 Was there optimum use of competitive pressure?	**1**
4. Contract Approach	Does the balance of risk and reward encourage service improvement, minimise perverse incentives and promote good relationships?	4.1. Is there an appropriate allocation of risk between DCC and the supplier?	**2**
		4.2. Are there incentives to encourage the supplier to act in the interest of DCC?	**3**
		4.3. Are suitable mechanisms established to drive the desired relationship?	**2**
5. Contract management	Is the service being managed well, with costs and benefits being realised as expected?	5.1 Do DCC and the supplier have comprehensive knowledge of service performance?	**3**
		5.2. Are the suppliers delivering in accordance with the contracts, and are they actively managed by DCC to meet or exceed requirements (including delivering accurate, timely Impact Assessments)?	**1**

[74] VFM = Value for Money

Domain	Key question	Supporting questions	Score
		5.3 Is DCC meeting its obligations?	**1**
6. Contract lifecycle	Will the service continue to demonstrate VfM through its lifecycle?	6.1. Does the contract continue to support DCC's strategic intent?	**2**
		6.2. Are VFM mechanisms used to ensure the contract continues to deliver VFM over its life?	**0**
		6.3. Is change controlled and well managed and does the contract remain current?	**1**
7. Transition & termination	Is DCC ready for the end of the contract?	7.1 Has market management been undertaken to support new contracts?	**3**
		7.2 Has the end of the contract been managed effectively to allow re-bid or handover?	**2**
		7.3 Are insights from the operation of the contract brought to bear in developing the new contract?	**2**
		Total Weighted Score	**1.71**

5.53. The report in general notes the quality of DCC documentation for contract management and procurement as being consistent with good industry practice.

5.54. However, the auditor found a number of direct award recommendations and decisions taken by DCC which could have otherwise been sought through competition had DCC carried out the necessary market engagements.

5.55. The auditors also found that DCC consistently underperforms on timelines for its SEC Mods.

5.56. The auditor has provided some recommendations which we have briefly set out below.

Summary of key recommendations

5.57. The auditor has provided the following recommendations:

5.58. A deep dive review into implementing appropriate remedial actions response to the deficiencies found in the year 1 and year 2 of the audits. This should include but not be limited to:

- DCC's procurement process, including its approach to market segmentation, category planning, market engagement and ensuring VFM through competitive tendering.

- Improved leadership of procurement, programme, and contract management activities by the DCC executive leadership team

- The requirements of the future licensee i.e., any additional expectations, ways of working, obligations that you may reasonably require in response to the findings and wish to see deployed across the DCC and into its BAU ways of working.

5.59. A maturity and competency assessment of the procurement and programme functions within DCC should be made, so as to ensure that DCC's procurement capability, capacity and strategy are aligned to (and capable of delivering) its licence obligations. This is specifically to the procurement and re-procurement audit pillar findings, was key area for the Year 2 audit.

5.60. An end-to-end review of the terms of engagement/reference and ways of working between parties to the various approval and review stages.

- Approval and review of formal Business Cases and Commercial Strategies

- SEC Mods, including the adherence to and appropriateness of the impact assessment timescales.

- The adoption of 2nd Tier Providers within the modification process

- Adherence with the HMT Greenbook standards

- Generally, the mandate and remit of parties when participating in (either as an approver or review) any procurement or re-procurement matters with DCC.

Findings and recommendations - Procurement and re-procurement

5.61. The auditor has observed that DCC has carried out a number of direct awards in circumstances where appropriate levels of market engagement would have allowed competition to be sought.

5.62. The auditor also observed that there is little evidence to suggest DCC are taking measures to implement its proposals for reduction in carbon emissions generated by its activities as suggested by its Annual Business and Development Plan. Whilst the NAO does not require the auditor to assess sustainability, it is hoped that DCC will implement the proposals in its Business Development Plan.

Findings and recommendations – Contract Management

5.63. The auditor identified several instances where DCC has asked its 2nd Tier Suppliers to step outside the Contract Change Policy through the use of Early Engagement Instructions (EEIs). The policy was put in place to ensure both DCC and suppliers are protected when Change Requests, Project Requests and Contract Variations are undertaken, and an appropriated assessment of risks is evaluated prior to implementation. The auditor found there were often changes being started or completed prior to the Change Authorisation Notice (CAN) being issued by the DCC Legal team. Whilst DCC is aware of this issue and is looking into reducing delays, it is expected that DCC will follow the appropriate procedures and protect against the suppliers being subject to undue risk.

5.64. The auditor also notes the Quarterly Executive Review (QER) documents show little evidence of tracking value for money initiatives; however, it is anticipated that this will be picked up by the Supplier Relationship Management (SRM) process which is currently being piloted.

5.65. The auditor observed that DCC has continued to fail in improving supplier performances from the RY21/22 audit, with some suppliers still showing as requiring improvement or as unsatisfactory. The Director of Contract Management is in the process of developing a set of tools to help address the on-going issues observed in the RY21/22 audit and subsequently in this year's audit.

Findings and recommendations – SEC modifications

5.66. The report notes that whilst there has been some evidence of improvements over the past 12 months, DCC continuously fails to meet the required timescales for Preliminary and full Impact Assessments. The auditors again raised the timescales of the SEC Mods as being restrictive as it does not take account of situations where the assessments may not be achievable within the timeframe. The auditor recommends that the SEC Mods process should be reviewed to allow for more flexibility and ensure that compliance is regularly monitored so DCC can be reasonably held to account.

5.67. The auditor also noted that 2nd Tier Suppliers should be provided the opportunity to engage with SEC parties and other key stakeholders to address any concerns they may have.

Our view

5.68. Having assessed the audit report and additional information provided by DCC, SEC Panel and DESNZ, we are proposing to change the auditor's scores of 1.95 and are **minded-to award a score of 1.71 out of 3 to DCC**. **This corresponds to a reduction of £0.489m of DCC's margin from a possible £1.142m available.**

5.69. Whilst we the consider majority of the scores awarded by the auditor to be an accurate reflection of DCC's performance, on the basis of wider assessment, we consider in some instances it was necessary to reduce the scores given DCC's approach in managing its supplier performance and ensuring competition. We note that many of the findings of the audit are similar to those of the RY21/22 audit such that DCC has clearly failed in some areas to act on the findings of last year, justifying our reduction.

5.70. Again, we consider the audit report sets out a comprehensive overview of DCC's contract management activities in RY22/23. We expect DCC to take reasonable steps to address the issues and recommendations presented, including through engaging with industry, DESNZ, SEC Panel and any other relevant stakeholders.

5.71. We note the concerns raised by the auditor on the issues of the DSP being procured through direct award where it should have been through a competition process in line with the licence. We also note this is an area of concern for the SEC Panel and DESNZ.

5.72. We also note the auditors concerns on the current scope and terms of reference of the audit. We are keen to work closely with DCC, SEC and DESNZ to ensure the scope of the audit appropriately assesses DCC's performance in these areas.

Customer Engagement

Context

5.73. This is the second year in which DCC's customer engagement will be financially incentivised under the revised OPR. DCC's performance in this area has been assessed based on qualitative submissions received from both DCC and SEC panel. The assessment covers three sections: timing and frequency of engagement; quality of information provided by DCC; and accountability of customer views.

5.74. The three sections under customer engagement each have three assessment questions, with relative weightings applied. 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.[75]

5.75. To inform the scoring, we received submissions from both DCC and SEC Panel on DCC's performance during RY22/23 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 RY22/23.

DCC and SEC submission

Timing and frequency of engagement

5.76. DCC has continued to follow its Business and Development Plan (B&DP) which sets out opportunities for customers to feed in views to shape its strategic plan across five years. DCC sought customer and stakeholder feedback on the draft B&DP document at

[75] Ofgem (2023), OPR Guidance. Accessible at: www.ofgem.gov.uk/publications/decision-revised-opr-guidance-march-2023 (Subsidiary documents)

two workshops in February 2023 and via a formal consultation. DCC ensured the workshops were presented virtually to increase accessibility for all.

5.77. DCC has stated to have formal engagement plans with the SEC Independent Chairs which has improved visibility and helped set a cadence for better quality information to be provided to customer representatives in the committee meetings. DCC ran additional customer sessions ahead of consultations to ensure customers have an opportunity to clarify understanding. For example, DCC hosted drop-in sessions for the CH&N LC13B replan consultation and the ECoS Transition and Migration Approach Document (ETMAD) in January 2023.

5.78. DCC has started to provide regular updates on key topics via website and social media channels which serve as effective mechanisms for general information sharing in an accessible format. The launch of DCC Twitter has boosted online presence, where weekly posts keep customers up to date with the latest events, performance updates and information on the roll out. DCC declared it monitors its performance of this function monthly across seven operational customer journeys, adopting the Gartner industry-standard scoring system.

5.79. Overall DCC believes it has made efforts to enable customers to feed in their views at appropriate points and at appropriate frequency in RY22/23. Based on this, DCC proposed an average score of 2 for this assessment section.

5.80. SEC Party responses were mixed when assessing the timing and frequency of DCC's engagement. Some Parties note DCC has provided appropriate opportunities to engage with and feed in views on subjects. At other times there is a view that Parties have not been sufficiently engaged or that DCC has not followed up on discussions or provided a further opportunity for Parties to contribute. There is often an unannounced change of DCC personnel attending the meeting and as a result the trust that has built up and corporate memory of prior discussions is lost.

5.81. One respondent noted that "generally information is provided in a timely manner" but caveated their response with concerns that timeliness of information for unplanned issues "seems to be consistently low." The Testing Advisory Group (TAG) reports that the DCC's engagement has been overall positive, especially from the DCC Test Assurance team.

5.82. The Panel has taken steps to put in place improved assurance of DCC programmes of work such as the Communication Hubs and Networks (CH&N) programme.

5.83. As a result of the above, SEC Panel awarded DCC an average score of 2 for this section.

Quality of information provided by DCC

5.84. DCC has started to monitor the quality of information in its papers through monthly feedback from SECAS on 'Paper & Provision Quality'. SEC Panel and its sub-committees have the opportunity to indicate whether papers had clear purpose and recommendations or included any errors. In RY22/23, DCC achieved an average SECAS quality score of 92% across all Sub-Committees and 94% for papers submitted to SEC Panel. DCC developed a new approach of providing a summary 'green' paper for each 'red' paper to give all SEC Parties the opportunity to broadly understand the topic being discussed at SEC Panel. This approach saw DCC strike a balance between commercial sensitivity restrictions whilst still providing industry visibility on key topics.

5.85. DCC recognised the need to tailor both the engagement approach and information it provided as it works with a range of stakeholders with varying interests and needs. For customer impacting change, DCC shared engagement plans which outlined the audiences they plan to engage with during the development and delivery of the programme. DCC sought feedback from the SSF Chair and key small suppliers to better understand their engagement needs and tailor its inputs to the forum accordingly.

5.86. Overall DCC believes the information it provides is of a quality standard and proposed an average score of 2.33 for this assessment section.

5.87. SEC Panel and Sub Committees meanwhile have all experienced instances of both good and poor-quality information provided to them. Feedback from SEC Parties indicates that there continues to be issues with the level of detail in the information shared, particularly around Major Incidents. Parties also note DCC has provided lots of useful information except for costs, and repeated concerns that DCC is not open enough about cost drivers and challenges.

5.88. There are concerns again raised from SEC Parties about the process that DCC uses to issue communications. More than one Party has noted concerns on how DCC determines which distribution list to use or which Parties receive reports or information on any given subject. It was noted that the Nominated Contact List (NCL) is still not operating effectively and "getting changes made to the NCL is a manual and inefficient process".

5.89. As a result of the above views, SEC proposed an average score of 2 for this section. re

Taking account of customer views

5.90. DCC stated to have utilised multiple engagement methods during RY22/23 to help stakeholders understand which issues they are able to contribute views towards. DCC provided evidence where they facilitated workshops and summits to communicate current positions and sought additional views from stakeholders. One example evidenced by DCC is the CH&N re-plan consultation which provided the opportunity for customer views to be considered. DCC noted that they provide justification where decisions have diverged from customer feedback.

5.91. In Q2 of 2022, DCC implemented a mechanism for sharing business cases with customers in response to feedback requesting greater transparency and granularity of key information, such as drivers for change and options being assessed. DCC state it regularly seeks feedback from customers to inform decisions across strategic, operational and programme related topics.

5.92. Overall, DCC feels it has adequately met the required standard, and proposed an average score of 2.33 for this assessed section.

5.93. One Party claims not to have received any communication from DCC to advise how its views may have informed decisions. Another Party stated that "DCC performed as expected" but is seeking improvement in areas as to "why" something has happened and not just "what." A respondent said there is no forum within which to discuss costs, stating "the quarterly finance forum does not do this" and "data provided to us for costing and billing purposes has been incorrect." A second respondent declared that there are "occasions where DCC initiated change without proactively asking for views to help decision making".

5.94. Another SEC Party respondent cited the Business Continuity and Disaster Recovery (BCDR) Consultation as an example they believe was conducted well and where views were acknowledged and acted upon.

5.95. SEC recommended an average score of 2 for this assessment section.

Our view

5.96. DCC is clearly progressing in its customer engagement strategy with positive examples stated in its submission. We appreciate that DCC has provided some examples of facilitating customer views at appropriate times, however there are raised examples of DCC not always following up on discussions, poor communication/inconsistent messaging across different forums, and DCC presentations at meetings not being up to standard.

5.97. DCC has demonstrated it has given appropriate notice to stakeholders with improvements in place to further decrease their standard response times. However, there have been some examples of inadequate engagement practices around the BCDR and planned maintenance windows.

5.98. We recognise DCC gave examples of providing information to customers regularly and in a timely manner, however there are mixed opinions and views on the consistency with which it does this.

5.99. We also note a difference in quality of information across the organisation. Whilst information does tend to be coherent and clear, it can be deficient in relation to costs associated with change and on the DSP re-procurement exercise.

5.100. We remain concerned with the high consultancy costs given the amount of money spent on customer engagement through payroll. We expect DCC to minimise these costs where possible.

5.101. Overall, we believe DCC has made sufficient efforts to engage and seek views from stakeholders, but there needs to be greater consistency with its quality of customer engagement. Based on the submissions received, **our minded-to position is to award an overall score of 2, corresponding to a BM reduction of £0.381m from a possible £1.142m available.** A breakdown of the scores is provided in Table 5.5 below.

Table 5.5: Customer engagement assessment criteria

Assessment questions	Ofgem Score	SEC Score	DCC Score
Timing and frequency of engagement			
1. Has DCC enabled customers to feed in views at appropriate points and with appropriate frequency in decision-making cycles?	2	2	2
2. Has DCC provided appropriate notice and allowed sufficient time for customers to contribute views?	2	2	2
3. Has DCC provided general information to customers in a timely manner and with sufficient frequency? (Including general updates, reactive engagement on unplanned issues)	2	2	2
Average score	2	2	2
Quality of information provided by DCC			
4. Has DCC provided its customers with sufficient quality of information to allow them to feed into a decision-making process? (e.g. clear costs and benefits and/or consequences of decisions)	2	2	3
5. Has DCC provided sufficient quality of information in its broader engagement (e.g. general updates, reactive engagement etc) for customers to understand the issues and the actions DCC is taking?	2	2	2
6. When engaging with customers, has DCC ensured to engage with relevant audiences, and tailored the information appropriately?	2	2	2
Average Score	2	2	2.33
Taking account of customer views			

Assessment questions	Ofgem Score	SEC Score	DCC Score
7. Has DCC ensured its customers understand on which issues their views will inform decision-making?	2	2	2
8. Have DCC's decisions demonstrated that customer views have been taken into account?	2	2	3
9. Has DCC clearly explained how customer views have informed its decision making, and where relevant why DCC has disagreed with customer views?	2	2	2
Average Score	2	2	2.33
Final weighted score	2	2	2.25

Project Performance

Context

5.102. The Secretary of State may create a Baseline Margin Performance Adjustment Scheme (BMPPAS), defining a Project and an incentive regime, which determines the BM DCC retains based on its performance in the defined Project. BM adjustments which are awarded to DCC for work associated with such a Project are held at risk by the BMPPAS incentive regime.

5.103. Any reductions made due to a BMPPAS incentive regime are made through the application of the BMPPA term contained in the Licence[76].

5.104. Following the completion of the BMPPA Scheme for SMETS1 on 30 June 2022, BEIS required DCC to submit a report to the Secretary of State setting out values of the Project Activity Performance Factors (PAPF) that DCC has achieved for Project Activities 1 and 2, together with supporting information and evidence to support these

[76] LC 28 Part D Calculation of the Value of the BMPPA term

conclusions. The final report, submitted in August 2022, was also accompanied by a statement from an independent auditor validating the data.

5.105. As outlined in BMPPA Scheme rules, the scheme puts 50% of the DCC's relevant Project Baseline Margin at risk depending on the rate of enrolment of SMETS1 Smart Metering Systems and the remaining 50% dependent on the proportion of SMETS1 Smart Metering Systems enrolled by the end of the scheme.

DCC's submission

5.106. DCC submitted results for the two Project Activities (PA 1 and 2) which comprise the BMPPAS SMETS1 incentive regime. For RY22/23 DCC retain £4.490m of margin associated with this scheme. The total reduction to the BM this year is £6.995m, 61% of the total possible £11.445m. Table 5.6 gives the proportion of margin lost for each activity, and the overall percentage.

Table 5.6: DCC's submitted BMPPA SMETS1 performance values for RY22/23

Project Activity	BM at risk (£m)	BM reduction (£m)	% margin lost
1	5.723	1.419	24.8
2	5.723	5.536	96.7
Total	**11.445**	**6.955**	**61**

5.107. Due to the nature of the project performance mechanism in the Licence (Condition 38), any reductions made due to performance below the targets in this year will also lead to reductions in future years where BM is associated with the project activity. DCC will have its BM reduced by a minimum of an additional £1.224m next year because of this.

5.108. DCC requested for this BM reduction to be distributed over a three-year period on the basis that:

- This would be consistent with the approach for awarding margin - which is awarded for work done in multiple years and is recovered across the same number of years. DCC argues that margin loss should follow the same principle, *ie* the loss is distributed over the same number of years as the programme (in the case of SMETS1, the incentive scheme was assessed over 38 months).

- This approach also has the benefit of more fairly distributing the impact to customers through charges - for example, this approach avoids an abrupt decrease in charges one year and then a purportedly large rise the following year.

- It is also important for DCC that any significant cash outflows from outcomes regarding incentive awards are deferred over an extended period to allow DCC to manage its cashflow effectively.

- This approach would be consistent with the precedent set by Ofgem in RY2017/18 in relation to the recovery of margin under the OPR. In particular, DCC pointed to the following statement in our RY17/18 Decision document: "We are redistributing the Baseline Margin adjustment from the RY16/17 price control so that the amount awarded for work done in multiple years is recovered across the same number of years, rather than in a single year. As the margin is at risk against DCC's performance, we believe that this places a more consistent incentive on DCC to perform well. We have taken the same approach with this year's Baseline Margin adjustment and, going forward, we intend to continue to distribute the Baseline Margin in the same manner."

Our view

5.109. We have identified no issues with DCC's reporting of its performance in the SMETS1 project but note that DCC has performed poorly in meeting the targets set out in the BMPPAS.

5.110. In relation to DCC's request to distribute the BM reduction over a three-year period, our views are as follows:

- The principle and methodology for awarding margin under the BMPPAS is very clearly set out in LC38: the margin reduction will be applied when the Project

Activity (PA) is first completed, and this will include the margin accrued in the years before the completion of the PA[77].

- Customers might prefer to recover these costs sooner rather than later, even if it means charges vary from year to year. However, we seek stakeholders' views on this question as part of this consultation.

- DCC was, or should have been, aware of the BMPPAS SMETS1 performance and expected outcomes well before the finalisation of the scheme in June 2022, and it has been well aware since then. Therefore, we consider that DCC has had enough time to manage its cash flow in relation to any impacts from the BMPPA SMEST1 scheme. In any case, DCC has not provided any specific information on how the deferral of this margin reduction would be necessary for cash flow reasons.

- We disagree that we set a precedent in relation to BMPPA in our RY17/18 Price Control Decision document. This is because that decision was strictly in relation to the development of the Baseline Margin Operation Performance Adjustment (BMOPA). This distinction is crucial, because while LC38 clearly defines the BMPPA mechanism, the provisions around the BMOPA were left for the Authority to be developed and populated (LC38.9). In addition to this, whilst is true that putting margin at risk under the OPR in future years can incentivise DCC's performance, the same cannot be said about the BMPPA. This is because the performance level of BMPPAS SMETS1 is already set, and therefore, DCC would not have any incentive to improve its performance. It would simply be a matter of delaying when the margin is returned to customers.

5.111. Given the above arguments, **our minded to position is to not accept DCC's request for a distribution of the margin adjustment. Therefore, the value for the BMPPA term for RY22/23 should remain unchanged as £6.955m.**

[77] Paragraphs A16 and A17, LC38, Schedule 1, Appendix 1, Part C.

6. Baseline Margin and External Contract Gain Share

Section summary

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

DCC applied for an adjustment to its Baseline Margin of £24.021m for RY22/23 to RY24/25. We are minded-to reject the adjustment application for some of the grounds and activities, reducing the Baseline Margin adjustment by £4.662m. In addition to this, DCC cannot receive a Baseline Margin adjustment on costs that are not economic and efficient. We calculate the effect of the proposed disallowances in the cost assessment on the Baseline Margin application to be £10.279m. Thus, we propose to amend DCC's Baseline Margin application and allow £9.080m.

DCC applied for an adjustment to its External Contract Gain Share (ECGS) of £5.208m across RY22/23 to RY25/26. This adjustment relates to the continuation of re-financing arrangements, the financing of Communication Hubs (CHs) and the operation of DCC's in-house test lab service. We propose to accept DCC's ECGS Adjustment application of £5.156m relating to the continuation of re-financing arrangements, CHs financing and DCC's in-house test lab service. We are minded-to reject £0.051m relating to the temporary increase in CHs costs.

Consultation questions

Question 18: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

Question 19: What are your views on our assessment of DCC's application to adjust its ECGS?

Baseline Margin

Background

6.1. The Baseline Margin Adjustment (BMA) mechanism allows DCC to apply for a Relevant Adjustment to the Baseline Margin values specified in Appendix 1, Condition 36 of the Licence. The adjustment mechanism itself is detailed in Appendix 2, Condition 36 of the Licence.

6.2. The Baseline Margin 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 of the conditions and requirements for a Baseline Margin Relevant Adjustment can be found in the RIGs, and the processes and procedures document.[78]

6.3. DCC's Baseline Margin (including adjustments) is subject to DCC's performance regime under which its Baseline Margin may be reduced for poor performance. 100% of the Baseline Margin recovered this year is held to account by the Operational Performance Regime.

DCC's Application

6.4. Alongside its RY22/23 Price Control submission, DCC has applied for a £24.02m Relevant Adjustment to its Baseline Margin for work performed (or forecasted) in RY22/23, RY23/24 and RY24/25. This represents a significant increase compared to previous years' applications. For example, last year DCC applied for 13.27m.

[78] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, Section 4: Baseline Margin Adjustment Section. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

6.5. DCC has identified 12 grounds for BMA this year. 11 of them were included in previous years' BMA applications and are associated with the existing drivers: increased cost certainty, changes to DCC's supply chain structure, operational change, supporting a changing business and technology driven change. One of the grounds was raised for the first time in this application within an existing driver (supporting a changing business): increase in Customer Service Expectations.

Table 6.1: Activities and their corresponding drivers as identified in the Baseline Margin Application

Change Driver	Grounds (resource and non-resource)	Driver first raised
Certainty	ECoS	RY18/19
	Facilitating Additional Relevant Service Capability	RY18/19
	MHHS	RY20/21
	Network Evolution	RY19/20
	People Transformation	RY17/18
	SMETS1	RY16/17
Change to DCC's Supply Chain structure	Increase in Commercial Activity	RY18/19
Operational Change	Ops - Service Standard Expectations	RY18/19
Supporting a Changing Business	Increase in Customer Service Expectations	RY22/23
	Supporting a Changing Business - Support - Resourcing Planning and Management	RY17/18

Change Driver	Grounds (resource and non-resource)	Driver first raised
Technology Driven Change	Security Driven Change	RY17/18
	Technology Driven Change - Tech Trans - General	RY17/18

Certainty

6.6. DCC first applied for adjustment of Baseline Margin for the Enduring Change of Supplier (ECoS) programme in RY18/19. In RY22/23 work in this area included: Pre-Integration Testing, Systems Integration Testing, System Capacity Testing, Business Acceptance Testing, Operational Process Testing, and User Integration Testing. The basis for application is largely in-line with those in previous years. DCC is applying for an adjustment over the next three years of £0.897m for both resource and non-resource activities due to increased cost certainty for this ground.

6.7. DCC first raised the 'Facilitating Additional Relevant Services' driver in RY18/19 which was justified in relation to the Brabazon House costs (which hosts both DCC's test lab and the Technical Operations Centre – TOC). This year, together with the Brabazon House activities, DCC is applying for an adjustment based on 'other accommodation' costs and 'other activities facilitating additional relevant services', which are not related to the Brabazon House activities.

6.8. The 'other accommodation' costs relate to DCC's refurbishment and workspace experience improvements under Project Gold. Project Gold was initiated to encourage return to DCC's offices post Covid-19 pandemic, as well as to make a number of improvements that could not be made during the pandemic.

6.9. The 'other activities facilitating additional relevant service capability' (which was also included in last year's submission) relates to a number of additional resource and non-resource activities stemming from:

- Significant increase in the demands on project, programme and portfolio management activities arising from DCC providing a range of new capability and Programme services.

- Work to analyse potential cost savings on resources within DCC through piloting Managed Service Provider activities and offshoring of certain functions.

- Material changes to the nature of the testing activities that DCC is now required to perform.

- System engineering and other technical device on the design of amendments to DCC's systems.

- Additional obligations on DCC arising from DESNZ taking powers under LC13 to require DCC to develop HMT Green Book compliant business cases.

- Additional activities to manage capacity on the network arising from a significant increase in the size and type of messages traversing DCC's systems, that were not provided for in the original LABP or in prior BMA applications.

6.10. DCC is applying for a total adjustment over the next three years of £5.040m due to increased certainty for this ground.

6.11. DCC first applied for adjustment of Baseline Margin for the Market-Wide Half-Hourly Settlement (MHHS) programme in RY20/21. The application was based on the grounds that DCC is expected to play a central role in the MHHS solution, as its network would need to be able to accommodate the increased volume and regular retrieval of the data. In RY22/23 activities under this programme mostly related to DCC engaging with Ofgem, SEC parties and Service Providers in the context of discussion around the new Meter Data Retrieval (MDR) role from the capacity uplift. DCC is applying for a total adjustment of £0.055m (mostly in RY24/25) due to increased certainty for this ground.

6.12. The Network Evolution Programme (NEP), first raised in RY19/20, is aimed at supporting the long-term enhancement of DCC platform, simplifying the network design with greater resilience and enabling faster change. This year's structure of the programme includes: DSP, Communication Hubs & Networks (CH&N), Trusted Services Provider (TSP), and Test Automation. The basis for application is largely in line with those in previous years DCC is applying for an adjustment over the next three years of £3.485m due to increased certainty for this ground.

6.13. The People Transformation ground was first raised by DCC in RY17/18. Since then, the transformation of this function has been based on: the requirement to proportionally increase the level of resourcing in light of DCC's overall headcount increase; and to define and maintain DCC's culture and ways of working. As was the case in RY21/22, this year there are resource and non-resource costs associated with additional pay and reward work, as well as welfare and additional staff training. DCC is applying for a total adjustment over the next three years of £1.413m due to increased certainty over the costs for this ground.

6.14. The SMETS1 ground, first raised in RY16/17, relates to a continuation of SMETS1 resource and non-resource activities around three main workstreams: Maximising Migrations, Device Swap Out, and FOC Stabilisation. The basis for application is largely in line with those in previous years. DCC is applying for an adjustment over the next three years of £2.708m due to new activities and increased certainty associated with this ground.

Change to DCC's Supply Chain structure

6.15. This year's application for adjustment of Baseline Margin under the 'Change to DCC's Supply Chain structure' driver is based on the grounds of increase in commercial activity. The Commercial function is responsible for the commercial management of DCC's strategic External Service Providers including contract and supplier relationship management, contractual frameworks, and procurement of new service contracts. The activities driving additional costs in RY22/23 are:

- Procurement activity – for example, activity related to DCC's major programmes, including CH&N, DSP, PKI Enduring Services, Test Automation Framework, DSMS; specialist consultancy resource required to support Project Diamond activity; and increased levels of tactical/operational procurement.

- Commercial Transformation – continuation of the process of maturing DCC's Commercial Function for example through: work on a new designed "To-Be" organisation structure and operating model; new senior leadership and oversight across Supplier Relationship Management, Contract Management and Procurement; and adoption of new technology to support DCC's core processes, including automation and other improvements for the Procurement processes.

6.16. The criteria and basis for application remain the same as previous years, however DCC noted that the certainty level of this activity has materially increased. DCC is applying for a total adjustment over the next three years of £1.687m for the Increase in Commercial Activity ground.

Operational Change

6.17. DCC is applying for adjustment of Baseline Margin under the 'Operational Change' driver based on one previously approved ground (first raised in RY18/19): 'Ops Service Standard Expectations'.

6.18. This ground relates to investments in DCC's operational capacity. DCC stated that over the last few years the operations function has grown with the introduction of new services such as NEP, ECoS and MHHS, and the challenges and complexities that these bring in terms of operational requirements are different to those for the existing services (such as SMETS2, SMETS1 and Switching). Also, because of these complexities, engagement between DCC and its customers has become much more technical and frequent.

6.19. In addition to these underlying drivers, this year DCC has reported activities in relation to the need to use SMETS1 and SMETS2 emulators to model device-specific behaviour without impacting the live system; and the cost associated with purchasing and testing Landys and Gyr meters. The basis for application in terms of volume and complexity remain similar to last year. DCC is applying for total adjustment over the next three years of £2.750m due to new activities associated with this driver.

Supporting a Changing Business

6.20. This year's application for adjustment of BM under the 'Supporting a Changing Business' driver is based on two different grounds – an existing 'Resource Planning and Management' ground, and a new 'Increase in Customer Service Expectations' ground.

6.21. The 'Resource Planning and Management' ground was first raised in RY16/17. The basis for this application remains similar to previous years: increased volume and complexity of stakeholder engagement as well as the complexity of managing a multi-programme business. According to DCC, this has fundamentally changed the nature of DCC and the requirements for its systems, processes, and methodologies. In particular, DCC said that it is critical that it continues to deliver accurate and transparent plans to its stakeholders and easy to use and clear processes to its own staff. DCC is applying for a total adjustment over the next three years of £2.505m for predominantly non-resource activities under this ground.

6.22. The 'Increase in Customer Service Expectations' is the only new ground raised by DCC in this year's application and relates to the activities of the Customer Engagement team. The Customer Engagement team ensures DCC's customers have a clear and common understanding of DCC's strategy, the changes it is delivering, and ensuring customers have sufficient opportunity to input and shape how these changes are delivered. The team also manage DCC's input to the SEC governance arrangements and delivery of key customer meetings such as the Quarterly Finance Forum. The application includes both resource and non-resource activities.

6.23. The criteria and basis for the application of this ground relates to the increasing complexity and number of customer engagement activities DCC now undertakes. In particular, DCC argued that the material increase in complexity is explained by:

- The expectations of customers having become more ambitious with each passing year.
- The highly complex environment with multiple non-SEC users and a large and variable cadre of energy suppliers, combined with the higher standard of

communication required on LC16 business cases, has put huge pressure on DCC's staff, processes, and procedures.

- The impossibility of improving its activities without first having high quality information on customers' attitudes and perceptions and having a well-developed way of measuring and reporting on it so DCC can act.

6.24. DCC is applying for a total adjustment over the next three years of £1.352m under this ground.

Technology Driven Change

6.25. DCC is applying for an adjustment of Baseline Margin under the 'Technology Driven Change' driver based on two different and previously approved grounds (first raised in RY17/18): 'Security Driven Change' and 'Technology Transformation'. The Security Driven Change relates to activities enabling the transformation of DCC's security model. The main activities in the Security function over the RY22/23 are split into specific Security-related activities (eg completion of the Security Operations Centre (SOC) capability, security compliance enhancement etc.) and Enterprise IT. The basis for application remains similar to previous years. DCC is applying for a total adjustment over the next three years of £2.432m for the Security Driven Change ground.

6.26. This year, the 'Technology Transformation – general' ground relates to resource and non-resource costs for sourcing cloud skills to support commercial, legal, regulatory and technology developments. DCC argues that these skills are necessary to ensure consistent use of cloud solutions over the next 5 years. DCC is applying for a total adjustment for RY22/23 and RY23/24 of £1.138m for this ground.

Our view

6.27. We consider that the conditions for DCC to make a Relevant Adjustment to the Baseline Margin have been met mostly. However, DCC has not provided sufficient evidence to support the full amount for which it has applied.

6.28. In relation to the new grounds raised by DCC this year: **'Increase in Customer Service Expectations'**, we do not think it meets the LC criteria for a BMA. This is because, in our view, DCC has not been able to demonstrate a material increase in volume and/or complexity of its activities. In particular:

- We disagree with DCC's argument that the expectations of its customers have "become more ambitious", and that this could be considered a material increase in the complexity of its activities.

- We disagree with DCC's characterisation that the activity from 'Other Users' is something that was not expected at the time of the LABP, as this was an existing role recognised in the SEC. DCC provided further evidence around the volume of activity from 'Other Users' ('Other User' Service Reference Variance – SRV-figures), and how it has increased over the last few years. However, this data lacked context, as, in isolation, these numbers do not demonstrate unexpected and material pressures on DCC systems.

- Finally, DCC did not address how it met the application window requirement in the LC. This is important because DCC's justification for this ground is based on issues that are not new. For example, expectations of customers becoming more ambitious "with each passing year", or pressure on staff due to the higher standard of communication require on LC16 Business cases. It is worth noting here that last year we rejected BMA on Business Case activities, among other reasons, because we considered that DCC missed the application window for that. Therefore, we do not consider that the grounds identified here were first identified in RY22/23.

6.29. In light of the above, **we are minded-to reject the application of a margin adjustment for the ground 'Increase in Customer Service Expectations' on the basis that we do not consider it met the LC criteria for a BMA**. In particular, it is our view that it did not meet the criteria of a material increase in volume and/or complexity of its activities. Furthermore, we do not consider the application to meet the application window requirement, as we do not consider those grounds to have been first identified in RY22/23. **This amounts to a proposed reduction of £1.352m over the period RY22/23, RY23/24 and RY24/25.**

6.30. In this year's application for BMA, DCC is requesting margin adjustment for an important number of non-resource activities with relatively low or immaterial costs. For example, DCC applied for a margin adjustment on 165 activities with a cost variance below £150k in RY22/23. Typically, activities with cost variances below the £150k threshold are not justified by DCC as part of the Price Control submission.

6.31. After receiving this year's submission, we informed DCC that we would expect all activities for which DCC is applying for margin to be properly justified, either as part of the Internal Cost submission or the BMA application. DCC explained that it has expanded the scope of the application (by including activities with immaterial or low-cost variances) this year for two different reasons:

- to ensure that it does not miss the application window for some activities when more material spend is forecast, and

- to return overpayments to DCC from last year's BMA where costs have not been incurred in full.

6.32. However, DCC did not provide further justification for the cost variances of these activities. **Therefore, we are minded-to reject the positive margin application for all non-resource activities with cost variances below the £150k, for which we have no justification of the cost variances. This amounts to a proposed reduction of £1.588m over RY22/23, RY23/24 and RY24/25.** However, DCC would be able to re-apply for margin on these activities in future years.

6.33. Finally, we note that in some instances DCC is including activities with negative cost variances to adjust for over-estimates from previous applications. It is indeed important that DCC adjusts its BM for underspend, and therefore we are not proposing to reject these adjustments. It is worth noting, however, that DCC typically includes these adjustments as a 'cost reduction' driver for resource activities. We would encourage DCC to consider using a similar approach to non-resource activities to avoid confusion in future.

6.34. Similarly, to last year's application, DCC has included the sub-ground 'Other Activities' under the ground 'Facilitating Additional Relevant Service Capability' which was originally raised in relation to the Brabazon House / Test Lab Operation costs. This sub-ground, however, is not related to Brabazon House activity, and therefore, needs to be justified on its own merits. This year DCC has provided further justification for this sub-ground. In particular, it explained that the basis for application was an increase in both the volume and the complexity of DCC activities:

- Volume: DCC argued that as it had grown as an organisation it has had to expand its capability in several areas, as well as respond to changing obligations on the business arising from material changes to the licence, the SEC and the introduction of the REC.

- Complexity: DCC argued that it was not provided ex-ante funding allowances to recognise the complexity of running a multi-programme business. Furthermore, it was also not funded for investing in taking analytical and remedial action arising from significant changes in the expectations on the system, and specifically message size in CSP North, which has resulted in extra costs as DCC proactively takes steps to improve performance for customers.

6.35. DCC did not, however, address how this sub-ground met the application window for a BMA as set out in the BMA. In relation to the justification provided by DCC, it is our view that the justification around the increase in the volume of its activities is simply too vague to demonstrate how it meets the LC criteria for a BMA. However, we consider that the justification provided around the increase in complexity criterion has merit, and we have further considered it in relation to the activities included by DCC under this sub-ground. This analysis is presented in the following paragraphs.

6.36. In terms of the activities included under this sub-ground (reported in paragraph 6.9 above), is worth noting that it covers a range of unrelated activities. As we explained last year, all activities for which DCC applies for a margin adjustment need to meet the LC criteria for such an adjustment.[79] This justification is typically done for each application ground but not for each individual activity included under those grounds.

[79] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs 5.20-5.21. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

For that reason, it is essential that the activities are related to the grounds, otherwise we cannot consider those activities to have been justified in relation to the LC criteria for a BMA.

6.37. In this case, it is our view that only the additional activities 'to manage capacity on the network' (last bullet point in paragraph 6.9 above) can be considered justified. This is because it is the only activity for which it is clear how it relates to the valid justification provided by DCC for the sub-ground. This is, it is clear how it relates to the 'increase in complexity' criterion for a BMA.

6.38. In light of the above, **we are minded to only accept the activities related to managing capacity on the network, and therefore, reject the rest of activities included under the sub-ground 'Other Activities' under the ground 'Facilitating Additional Relevant Service Capability'. This amounts to a proposed reduction of £ 0.49m over RY22/23, RY23/24 and RY24/25.**

6.39. It is important to note, however, that the cost variances for these activities still need to be justified, as explained in paragraphs 6.29 – 6.31 above.

6.40. Alongside the activities under the ground 'Facilitating Additional Relevant Service Capability' discussed above, we consider that a few **other activities included under different grounds have not been properly justified for a BMA.** These activities are:

- Commercial Transformation ('Change to DCC's Supply Chain Structure - Increase in Commercial Activity' ground): whilst we agree that this activity was necessary, we do not consider it meets the LC criteria for a BMA. This is because an efficiently run commercial function is something that DCC should have expected at the time of the LBAP.

- 'Conference, forums, events' ('Support - Resourcing Planning and Management' ground): we do not consider the activity to be related to the ground it has been applied under. DCC provided further justification for the activity and argued that as DCC has grown as an organisation its staff needed to come together, for example to ensure sharing of knowledge and awareness of strategy. We do not think this meets the criteria of material increase in volume or complexity, and that DCC should have expected the need for its staff to come together at the time of the LABP.

- 'DCC culture project' ('Support - Resourcing Planning and Management' ground): similar to the activity above, we do not consider this activity to be related to the ground it has been applied under. DCC provided further information and explained that this activity was related to the change in DCC staff working patterns, moving from permanent on-site presence to significantly less occupancy. We do not think this can be characterised as a material change in DCC's activities as required by the LC for a BMA.

- MSA (Support - Resourcing Planning and Management' ground): similar to the two activities discussed above, this activity has not been properly justified in relation to the grounds it has been applied under. When asked to provide further justification for it, DCC explained that this activity related to a "range of small works including procurements to support DCC staff's productivity". We consider this justification too vague for us to assess whether it would meet the LC criteria for a BMA.

6.41. **In light of the above, we are proposing to reject the BMA for these four activities. This amounts to a proposed reduction of £0.289m over RY22/23, RY23/24 and RY24/25.**

6.42. As in previous years, we remain open to receiving additional evidence from DCC to justify its application for Relevant Adjustments and would consider such evidence to revisit the proposed reductions where appropriate.

6.43. When determining any Relevant Adjustments to DCC's Baseline Margin, the Licence Condition 36.A10 (b) requires us to have regard to DCC's expected rate of return on its activities over time. As in previous Price Controls, we considered a 15% margin acceptable for RY22/23.

6.44. **For RY22/23, we continue to award a margin level of 15%.**

Other Reductions and Proposed BM Adjustment

6.45. DCC cannot receive a Baseline Margin adjustment on costs that are not economic and efficient. We calculate the effect of the proposed disallowances in the cost assessment on the Baseline Margin application to be £10.279m.

6.46. Similar to last year, a significant proportion of BM reduction due to cost disallowances is due to forecast cost disallowance for RY23/24 and RY24/25. Furthermore, this year, due to the difficulty in reconciling the numbers in the BMA model submitted by DCC with the Internal Costs (IC) submission, we had to calculate the margin reduction adjustment for IC cost disallowances based on the cost variances reported in the IC submission directly. This means that we might be overestimating the total margin reduction. We will keep working with DCC to ensure our calculations are as accurate as possible. DCC will be able to reapply for the Baseline Margin associated with these forecast costs. If these forecast costs are justified in future Price Control submissions, DCC will be able to keep the Baseline Margin associated with these costs.

6.47. Due to the ex-post nature of the Price Control, the Baseline Margin adjustment is recovered by DCC after the year in which the work on which it is based was performed. The years to which we are proposing the adjustment is made to are RY24/25, and RY25/26.

6.48. Taking all of these disallowances into account, **we propose reducing the adjustment by £13.597m, therefore amending DCC's application to an adjustment of £10.424m which would be applied between RY24/25 and RY25/26**, as shown in Table 6.2.

Table 6.2: Proposed Baseline Margin compared to Baseline Margin as of the RY21/22 Price Control decision

Baseline Margin (£m)	RY24/25	RY25/26	Total
Baseline Margin as of RY21/22 decision	7.117	4.710	**11.828**
Adjusted by RY22/23 application (Difference from RY21/22)	15.947 (8.829)	19.902 (15.192)	**35.849 (24.021)**
Adjusted by RY22/23 consultation proposal (Difference from RY21/22)	12.185 (5.068)	10.067 (5.356)	**22.252 (10.424)**

Figure 6.3: Comparison between DCC's application and our proposed adjustment

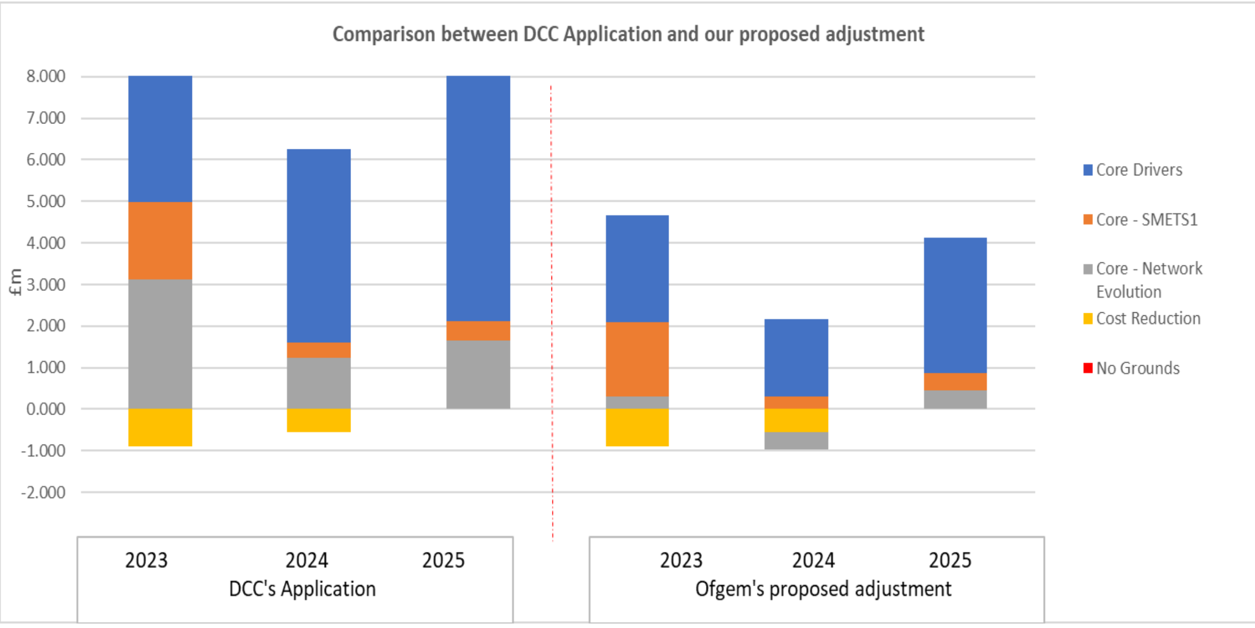

Figure 6.3: Data Table

Driver	Application			Proposal		
	RY22/23	RY23/24	RY24/25	RY22/23	RY23/24	RY24/25
Core Drivers	4.740	4.667	7.357	2.576	1.846	3.256
Core - SMETS1	1.873	0.367	0.468	1.786	0.311	0.408
Core Network Evolution	3.113	1.232	1.645	0.300	-0.420	0.458
Cost Reduction	-0.896	-0.545	0.000	-0.896	-0.545	0.000
No Grounds	0.000	0.000	0.000	0.000	0.000	0.000
Total	**8.829**	**5.721**	**9.470**	**5.068**	**1.235**	**4.121**

Table 6.4: Proposed Baseline Margin adjustment compared with DCC's Application

Driver/ grounds	Application			Proposal		
	RY22/23	RY23/24	RY24/25	RY22/23	RY23/24	RY24/25
* Cost reduction	-0.90	-0.54	0.00	-0.90	-0.54	0.00
* Missed window	0.00	0.00	0.00	0.00	0.00	0.00
* No change	0.00	0.00	0.00	0.00	0.00	0.00
Certainty - ECoS	0.25	0.29	0.36	0.22	0.29	0.36
Certainty - Facilitating Additional Relevant Service Capability	1.98	1.22	1.83	1.33	-0.45	0.07
Certainty - MHHS	0.00	0.00	0.05	0.00	0.00	0.05
Certainty - Network Evolution	1.68	0.72	1.09	0.89	-0.77	-0.01
Certainty - People Transformation	0.30	0.61	0.51	0.22	0.17	0.15
Certainty - SMETS1	1.87	0.37	0.47	1.82	0.31	0.41
Change to DCC's Supply Chain structure - Increase in Commercial Activity	0.39	0.66	0.64	0.17	0.61	-0.39
No Grounds	0.00	0.00	0.00	0.00	0.00	0.00
Operational Change - Ops - Service Standard Expectations	0.53	0.66	1.57	0.43	0.66	1.57
Supporting a Changing Business - Increase in Customer Service Expectations	0.35	0.45	0.55	-0.04	0.00	0.00
Supporting a Changing Business - Support - Resourcing Planning and Management	1.44	0.51	0.55	0.43	0.39	0.47
Technology Driven Change - Security Driven Change	0.32	0.58	1.53	0.14	0.42	1.19
Technology Driven Change - Tech Trans - General	0.61	0.19	0.33	0.37	0.15	0.26
Total	**8.83**	**5.72**	**9.47**	**5.07**	**1.24**	**4.12**

External Contract Gain Share

Background

6.49. The formula for DCC's Allowed Revenue includes an External Contract Gain Share (ECGS) term, which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the FSP contracts.[80] 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.

DCC's Application

6.50. DCC has applied for a £5.208m Relevant Adjustment to its ECGS term for RY22/23 to RY25/26 on the basis of £14.020m savings to industry as a whole and £8.412m being returned to customers, reflecting a reduction in External Costs. This year's Relevant Adjustment application is based on the same activities that were approved last year.

6.1 DCC has applied for a Relevant Adjustment for the continuation of **re-financing arrangements**; these are previously renegotiated and approved interest rates, which have generated a further ECGS saving of £0.731m across both Communication Service Providers (CSPs) from RY22/23 to the end of the contracts. These savings are a continuation of reduction in financing costs across the various components and FSPs of the Smart Metering Implementation Programme (SMIP). Following Ofgem's guidance, payment milestones associated with financing of milestones that are yet to be achieved are not within scope of this year's application. The exact level of saving associated with these future milestones will only be known at the time that they have been achieved. In relation to the continuation of these re-financing arrangements, in RY22/23 DCC applied for a Relevant Adjustment of £0.221m based on £0.731m total savings to industry and £0.457m being returned to customers.[81]

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[80] The terms and conditions through which DCC is able to apply for an adjustment under the ECGS is set out in Condition 39 of the Smart Meter Communication Licence.
[81] DCC's gain share ranges from 25% to 37.5% depending on the CSPs. Customer share ranges from 50% to 62.5%.

6.51. In RY19/20, DCC successfully managed to secure alternative, value for money, funding arrangements for **the financing of Tranche 2 Comms Hubs**, which has continued to generate savings in each RY since. The significant reduction in interest rates for both CSPs have resulted in £5.014m savings in RY22/23. This financing relates to Tranche 2 CHs which represent approximately 85% of all CHs. In relation to CHs financing, DCC have applied for a Relevant Adjustment of £1.880m (37.5% DCC's gain share) on the basis of £5.014m of total savings to industry and £3.133m being returned to customers (62.5% customer gain share).

6.52. DCC has also applied for a Relevant Adjustment for the savings made from **in-house test lab service** DCC is providing at the Brabazon House. The provision of testing services originally sat within the FSP contracts. The design, build and operation of the in-house test lab service in 2018 has made it possible for DCC to provide a fully integrated end-to-end test facility that better meets customers' needs, at a cost cheaper than the testing services that were initially provided by the CSPs. In RY22/23 DCC applied for a Relevant Adjustment of £3.106m (37.5% DCC's gain share) on the basis of £8.282m of total savings to industry and £5.176m being returned to customers (62.5% customer gain share).

6.53. DCC provided justification of its proposed distribution of the savings, which included benchmarking against comparable gain share arrangements in other regulated industries.

Our view

6.54. In line with previous decisions, we are minded-to accept the Relevant Adjustment related to the continuation of re-financing arrangements. We consider the Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence.

6.55. In line with last year's decision, we are minded-to accept most of the Relevant Adjustment related to the financing of Tranche 2 CHs. We consider that, for the most part, DCC's application is duly made and that DCC has provided sufficient evidence that it was instrumental in the arrangement. DCC's application justified that the overall saving from the refinancing and financing arrangements would not have been achieved without DCC's involvement.

6.56. However, as was the case in last year's submission, we note that there has been a temporary increase in CH unit prices above and beyond of what was stipulated in the standard contractual terms, which has had the effect of slightly inflating the savings used to calculate this Relevant Adjustment to the ECGS term (for a more detailed discussion around the temporary increase in CH unit prices, please see paragraphs 2.52-2.60 in Chapter 2 of RY21/22 Consultation document).[82] The purpose of ECGS is to reflect cost reductions that DCC helped to achieve. As we said in our RY21/22 Consultation document, awarding ECGS stemming from a temporary increase in costs outside the standard contractual terms would go against the intended purpose. Therefore, we propose to reject the amount of Relevant Adjustment due to the temporary increase in CH unit prices. We have calculated this amount to be £0.051m. This means that we are proposing to accept a Relevant Adjustment related to the financing of Tranche 2 CHs of £4.963m.

6.57. In line with previous year's decisions, we are minded-to accept the Relevant Adjustment related to the realised savings made from DCC's in-house test lab service. We consider this Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence. This is a Relevant Adjustment of £3.106m. We acknowledge that DCC has followed our guidance that ECGS applications should be made on the bases of certain savings.

6.58. **We therefore propose to reduce the Relevant Adjustment to the ECGS term by £0.051m, therefore amending DCC's application to an adjustment of £5.156m between RY22/23 and RY25/26.**

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

7 Switching Programme

Section summary

This section provides our assessment of DCC's costs associated with its roles in the Switching Programme and under its live Switching operations (18 July 2022 onwards) in RY22/23. We also provide our assessment of its forecast costs in RY23/24 and RY24/25.

We find that the costs incurred in RY22/23 are economic and efficient.

We propose to disallow DCC's forecast costs through to the end of the Licence which totals £44.514m (Internal costs of £13.432m and External Costs of £31.082m due to cost uncertainty and insufficient justification).

This section also gives our view on the three incentive frameworks relevant to Switching including the fifth incentivised delivery milestone of the Design, Build and Test (DBT) phase incentivisation framework: Delivery Milestone 5 (DM5). Having met the requirements of the milestone, we propose that DCC should retain all margin associated with DM5.

Consultation questions

Question 20: What are your views on our proposed position on DCC's costs associated with Switching?

Question 21: What are your views on our assessment of Delivery Milestone 5 of the Switching Programme?

Switching costs

Context

7.1 The Switching Programme was established to improve consumers' experience of switching between energy suppliers, resulting in faster and more reliable switching.

7.2 DCC played a central role in delivering the new Switching systems, which went live on 18 July 2022. DCC continues to play a key role in live operations under the new Switching arrangements through the provision of the Central Switching Service (CSS), the Certificate Authority (CA) and the Switching Operator (SO) services.

7.3 The costs and performance incentive mechanisms associated with DCC's roles in the Switching Programme and in live operations are dealt with separately from the rest of DCC's business. All Switching costs must be justified as the Business Plan was not competitively tendered, and therefore cannot be considered innately economic and efficient.

7.4 Switching has no agreed baseline, and as a result, all incurred costs are reported as variances.

DCC's justification

7.5 DCC incurred total costs of £21.392m in RY22/23, comprising £5.106m of Internal Costs and £16.286m of External Costs. This represents a reduction from the RY21/22 figure of £25.429m (£5.366m of Internal Costs, £20.063m of External Costs), reflecting the move from the DBT phase into live operations part-way through the year.

7.6 The majority of the Switching Internal Costs were Payroll, with some costs attributed to External Services and some to Service Management, representing DCC's provision of the Switching service desk. Internal Costs are forecast to reduce in RY23/24 and remain steady into RY24/25, reflecting a reduction in resource required from early life support into steady state operations of the new Switching arrangements.

7.7 There were no material CRs/PRs reported against the External Cost figure of £16.286m.

Our view

7.8 We consider that DCC have appropriately justified all costs incurred in RY22/23 as economic and efficient. We are therefore not proposing any disallowances.

7.9 However, in line with previous years we propose to disallow all internal and external forecast costs for Switching for RY23/24, RY24/25 and RY25/26, amounting to £44.513m in total, due to uncertainty and insufficient justification.

Switching Performance

Context

7.10 There were three performance incentive frameworks relevant to RY22/23:

- The DBT incentivisation framework, which placed DCC's earned margin of £2.74m within the DBT phase of Switching against five delivery milestones. The fifth and final of these delivery milestones, DM5 – Transition Stage 2 Exit, occurred in RY22/23. The four previous milestones were reported against in the relevant price control submissions.

- The Discretionary Recovery Mechanism (DRM), a one-off mechanism that allowed DCC to recover up to 30% of any margin lost under the DBT incentivisation framework (see above), contingent on performance in its stakeholder engagement activities.

- The Discretionary Data Reward (DDR), another one-off mechanism that allowed for a discretionary adjustment of +/- £200k to be paid to DCC contingent on performance in improving address data quality.

7.11 We have already published our decision on the DDR and DRM awards in July 2023.[83] As outlined in that decision, we awarded DCC 17.25% of its lost margin under DBT, equating to £0.099m (from a total lost margin of £0.576m). We also awarded an upward adjustment of £0.105m under the DDR.

[83] Link here to our July 2023 decision on the DRM and DDR awards.

7.12 Going forward, from the start of RY23/24 DCC will have its Switching margin incentivised against the Switching Incentive Regime (SIR). We published our decision to introduce the SIR in January 2023.[84]

DCC's submission

7.13 DCC provided evidence of meeting the requirements of DM5 in the submission of the DM5 Milestone Achievement Report. The certificate confirms that all criteria for the milestone as set out in the Product Description were met.

Our view

7.14 We note that DCC correctly reported the figures relevant to the DDR and DRM awards in the RIGs.

7.15 We also agree that DCC has met the requirements of DM5 and is therefore entitled to earn the 30% of its DBT margin at stake against that milestone. This means that DCC has earned 70% of its DBT margin in total under the DBT incentive framework, having met four of the five milestones available (DM2 to DM5). As reported in previous years, DCC missed DM1, resulting in a 30% loss of its DBT margin. Again, we confirm that DCC correctly reported the figures relevant to the DBT incentivisation framework and is reflected in the RIGs.

[84] Link here to our January 2023 decision to establish the SIR.

8 Proposals to amend future Baseline Margin and Shared Services Charges

Section summary

This section summarises our proposal to adjust DCC's Baseline Margin (BM) level from 15% to a value in the range of 7-9%. We are simultaneously proposing to lower the existing Shared Services Charge (SSC) from 9.5% to 4.5%. Finally, we are also proposing that the services provided to DCC by Capita should not attract any additional baseline margin.

We are proposing that these changes take effect from 01 April 2024 onwards.

Consultation questions

Question 22: Do you agree with our proposal to apply a margin somewhere in the range of 7-9% when calculating BM adjustments from 01 April 2024 onwards? Do you have a specific figure that you think should be applied?

Question 23: Do you agree with our proposal to adjust the Shared Services Charge (SSC) from 9.5% to 4.5% from 01 April 2024 onwards?

Question 24: Do you agree with our proposal that any services provided to DCC by Capita, whether through a services contract or through the SSC arrangements, should not be eligible to earn any additional BM through the adjustment process from 01 April 2024 onwards?

Baseline Margin Adjustment

Context

8.1 DCC is permitted to earn a margin on its economic and efficiently incurred Internal Costs as part of the calculation of its Allowed Revenue (AR) each year.[85] The monetary value of this margin, known as the Baseline Margin (BM), was agreed with DCC as part of the competitive licence award process and fixed for each year of the licence term up to and including 2025/26.[86] The values applicable to each year are set out in Licence Condition 36.22.

8.2 The monetary value of the BM is based on a margin on DCC's internal costs of 15%, calculated as a rate of return of 17.6%. This is the figure applied for by DCC in its Licence bid documentation.

8.3 As part of its Price Control submission each year, DCC is able to apply for an adjustment to the value of BM for the year in question through a mechanism known as the Baseline Margin Adjustment (BMA) process. This mechanism was provided in the Licence in order to recognise the inherent uncertainty present at the time of the Licence award of the nature and risk of DCC's Mandatory Business over time, and to protect DCC against its margin being diluted over time due to material changes in the activities it carries out, the risks it faces, or the timescales or deadlines that it is required to meet.

8.4 Any BM adjustment proposed by DCC through this process must be associated with a material variation that has taken place, or is likely to take place, in certain aspects of its Mandatory Business as defined in the Licence. The Licence defines a set of criteria related to likely and material changes to its business activities, risks and timescales or deadlines, which DCC must demonstrate are relevant in its application. We then assess

[85] As defined in Licence Condition 36.7

[86] Each year the value of Baseline Margin defined in the licence is multiplied by the price index adjuster (PIBM) to correct for changes in the value of money over time.

any application received for BM adjustment as part of the Price Control determination process.

8.5 There are two key aspects to the BM adjustment figure that DCC applies for. Firstly, it must relate to internal costs that are over and above those forecast at the time of Licence award. Secondly, it must apply for a particular percentage margin figure to be applied to those costs.

8.6 DCC has applied for a BM adjustment in each of its Price Control submissions since its Licence award, beginning with the RY13/14 submission. In each case DCC has applied for a margin value of 15% to be applied to qualifying additional internal costs, on the basis that this was the percentage figure used at the time of the Licence award.

8.7 We consulted in November 2015, as part of the 2014/15 Price Control determination process, on the percentage of margin that we should accept for use in the calculation of the BM adjustment.[87] We noted that within that consultation it was appropriate to consider a commercially reasonable margin for the variations which DCC has applied for each year, on the basis that these costs were incurred in the absence of a competitive process. This would include consideration of the risks faced by DCC in incurring those costs, as well as the margins earned by comparator companies. The consultation proposed two figures for the margin, 10% and 15%.

8.8 We ultimately determined that the margin established as part of the original competitive tender process, i.e., 15%, remained a reasonable estimate of the return that the market would have determined for those additional costs incurred. We noted the difficulty of benchmarking DCC, given a lack of perfect comparators and the unique nature of its ex-post price control framework.

8.9 We then noted in our November 2016 consultation as part of the 2015/16 Price Control process that we would continue to consider the percentage value of the margin on any future BM adjustment applications on a year by year basis, and that we would expect

[87] Link here to our 2014/15 DCC Price Control consultation

DCC to be able to justify the figure it proposes.[88] We said that, as DCC's business evolves from the initial scope as set out in the LABP into an established and mature business, we did not necessarily consider that 15% would continue to represent an appropriate margin to apply on an ongoing basis.[89]

8.10 Note, 100% of DCC's margin, including relevant adjustments, has been put at risk each year through performance incentive mechanisms. Since 2018/19, this has been through the Operational Performance Regime (OPR) and the BMPPA. The OPR financially incentivises DCC's performance in three main areas: system performance, customer engagement and contract management. Under-performance in any of these areas results in a portion of the margin being sacrificed, up to a maximum of 100% of the margin; the Secretary of State may also create a BMPPA scheme, defining a Project and an incentive regime. It determines the BM DCC retains based on its performance in the defined Project. BM adjustments which are awarded to DCC for work associated with such a Project are held at risk by the BMPPA scheme.

Our proposal

8.11 We consider that it is now an appropriate time to assess the percentage value of margin that DCC earn on BM adjustments going forward.

8.12 Whilst 15% was considered an appropriate margin through the Design, Build and Test (DBT) phase of DCC and into the early stages of live operations, we consider there is justification to now apply a reduced figure based on the following characteristics of its business:

- The contracts DCC was required to manage in its early years were inherited from the Department for Energy and Climate Change (DECC).[90] who were originally responsible for procuring them. DCC has been managing these contracts for 10

[88] Link here to our 2015/16 DCC Price Control consultation, see paragraph 4.14
[89] Link here to DCC's Licence Application and Business Plan (LABP)
[90] DECC was the Government Department at the time with responsibility for this area. Responsibility has since passed to the Department for Business, Energy and Industrial Strategy (BEIS), and now the Department for Energy Security and Net Zero (DESNZ).

years and procures/reprocures the majority of these contracts. We consider this has resulted in reduced supplier and contract management risk to DCC now, relative to its early years of operation.

- DCC is now a mature organisation with the benefit of a number of years of live smart metering communication service operations and a much greater ability to manage its business, forecast costs and scope work effectively. The costs included within the LABP were based upon several assumptions and the recognised scope at the point of submission of both the DCC Licensing Competition BAFO and the DCC Service Provider Procurements. Throughout the Licence term, and particularly during the implementation period, a number of changes emerged to the scope, timescales, and volumes of the smart metering programme; many of these changes brought risks and uncertainties with them and underpinned the agreed 15% margin. Today, these risks and uncertainties have been significantly reduced or eliminated. We consider that this justifies a lower margin figure being awarded as part of the BM adjustment process.

- DCC continues to have limited fixed and tangible assets, and benefits from low exposure to financial risk through a combination of its user charging model.

8.13 We note that, as set out in our decision in January 2023, DCC has been permitted to earn a margin of 7%, calculated as a rate of return of 7.5%, on its Switching activity from 01 April 2023 onwards.[91] We also set out in our November 2022 consultation we expected the value of that margin for DCC's Switching business to be lower risk than its Smart Metering business and therefore justified a lower margin figure.[92]

8.14 We recognise the lack of suitable external comparators to DCC's Smart Metering business against which we can benchmark to determine an appropriate margin figure, as noted above.

[91] Link here to our January 2023 decision on DCC Switching Incentive Regime (SIR)
[92] Link here to our November 2022 consultation on the DCC Switching Incentive Regime (SIR)

8.15 Finally, we also recognise the need for the margin figure to represent a suitable performance incentivisation measure for DCC. The figure must strike the balance between providing value for money to consumers and appropriately incentivising and rewarding DCC for good performance, to the ultimate benefit of consumers.

8.16 With this in mind, we propose that, going forward, a reasonable margin for DCC to earn through the BMA mechanism should be within the range of 7-9%.

8.17 We are proposing to apply this reduced figure to BMA for costs incurred from 01 April 2024 onwards, meaning the 2024/25 Price Control assessment in late 2025 will be the first process within which the reduced figure may be considered.

8.18 To be clear, this does not impact the underlying BM figures defined in the Licence that DCC will earn until the end of its Licence period, and it does not require any amendments to be made to the Licence or any other aspect of the governance framework. It instead represents the percentage of margin to be earned by DCC through the BM adjustment mechanism that we will consult on as part of the Price Control assessment process from 2024/25 onwards.

8.19 This proposal is also not related to the ongoing work on the DCC Licence review.

Shared Service Charge

Context

8.20 DCC receives a range of benefits from its parent company, Capita, in lieu of the Shared Service Charge (SSC).

8.21 The inclusion of the SSC was part of Capita's competitive bid during the licence tender process. It is calculated as a percentage of eligible internal costs set out in the LABP.

8.22 This arrangement was proposed by Capita on the basis that it provided a number of benefits to DCC and offered value for money for its users. These benefits:

- Enable DCC to mobilise resources within tight timescales and avoid delays, as well as supporting the ongoing operations through drawing on Capita's established teams and systems.

- Provide effective management of DCC through leveraging Capita's group functions on internal audit and advice.

- Offer the ability to attract and retain high calibre resources through Capita group benefits.

8.23 More specifically, DCC previously clarified that the benefits that fall under the SSC, offer access to services such as:

- Training Courses

- Property Function

- Accounts Payable and Accounts Receivable Cashier Function

- Payroll and HR function

- IT Function

- Public Relations

- Senior Management Input

- Policy Development and Monitoring

- Legal Services

- Insurance

- Travel Portal

- Internal Audit
- Other advisory services including tax and treasury issues.

8.24 The services eligible for the SSC are part of DCC's Relevant Service Capability as defined in the Licence. LC 16.4 states that DCC must procure RSC from External Contract Service Providers on a competitive basis and under arrangements to be known as External Service Provider Contracts that are compliant with the Part B Principles (detailed in LC16 Part B). There is an exception to this contained in LC 16.6, in that DCC is permitted to procure RSC that is not FSC from an Affiliate or Related Undertaking (i.e. its parent company, Capita), where it is satisfied that the procurement of such capability by that means: (a) would be the most economical and efficient option; or (b) would be immaterial in terms of its value or use of resources within the overall context of DCC's Mandatory Business.

8.25 DCC are required to demonstrate that this is the case as part of its Price Control submission.

8.26 The value of the SSC was agreed as part of the licence application process as 9.5%, meaning Capita are able to recover a charge of 9.5% of the costs of the eligible services it provides to DCC.

8.27 As with the Baseline Margin adjustment mechanism, DCC must apply for SSC as part of its Price Control submission and justify why it should be applied. We then assess the application and make the decision as part of our Price Control determination. In previous years we have on occasion rejected some elements of DCC's SSC bid that we do not feel meet the criteria. Where appropriate justification has been provided, we have accepted the SSC at 9.5% of the qualifying internal costs.

8.28 For example, as part of the RY13/14 Price Control process we made it clear that we expect DCC to continue to demonstrate that the costs associated to SSC are economic and efficient and that they represent value for money on an ongoing basis.[93]

8.29 We then also set out as part of the RY15/16 Price Control process that, going forward, we would not require further justification for the SSC associated with baseline activity set out in the LABP.[94] However, for any new scope activities, we said that DCC must continue to provide full justification to demonstrate that the SSC is economic and efficient. We have also reiterated the importance to DCC of ensuring that the SSC is not used to cross-subsidise across its affiliates or related undertakings.

8.30 As part of the RY17/18 Price Control consultation[95], we strongly encouraged DCC to actively ensure and demonstrate that it is achieving value for money from the SSC. In response to our consultation, DCC and Capita committed to carry out an in-depth review of Capita Shared Services at the earliest possible opportunity. To date, we have not received a review to that effect.

8.31 Finally, as we noted in our November 2022 consultation as part of the RY21/22 Price Control process, we have been engaging with DCC on the services it should be receiving as part of the SSC arrangements to assess whether it continues to offer value for money. In particular we are concerned that DCC may be duplicating some of the services it should be receiving under the SSC arrangement, either through a separate Capita contract or through outsourcing as an additional External Service.

Our proposal

8.32 We consider that it is now an appropriate time to re-assess the SSC rate that currently applies to eligible internal costs. This is particularly important given that this has been an area of ongoing concern from customers; for some time, customers have expressed concerns about the lack of clarity of the services that should be provided by Capita,

[93] Link here to our RY14/15 DCC Price Control consultation
[94] Link here to our RY15/16 DCC Price Control decision
[95] Link here to our RY17/18 DCC Price Control consultation

and the risk of any duplications in respect to the additional services that have been separately procured from Capita over the years.

8.33 We also no longer consider it appropriate for Capita to recover a rate, which was deemed competitive at the time of the Licence bid some ten years ago; today, DCC is significantly larger in scale and costs.

8.34 With this in mind, we are proposing that the SSC rate is adjusted from 9.5% to 4.5%. We consider that this rate is more reflective of the charges that are associated with the services currently being provided for under SSC.

8.35 Our proposal is based on a bottom-up approach, using costs for each of the individual services that make up the SSC that were shared with us in RY16/17. Where applicable, we have adjusted these costs for inflation and to account for current volumes of staff.[96] We have also adjusted all costs in accordance with the interest rate as reported through the RIGs. The proposed SSC rate is deduced by averaging the proportion of these costs, between RY16/17 and RY22/23, against the total internal baseline costs eligible for SSC.

Table 8.1: Comparison of SSC costs compared to Internal Baseline Costs

	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23
SSC	2.307	2.385	2.472	2.564	2.643	2.728	2.872
Internal Baseline Cost	29.439	43.915	51.046	77.468	78.964	77.888	111.563
%	**7.84**	**5.43**	**4.84**	**3.31**	**3.35**	**3.50**	**2.57**

8.36 Going forward we also expect DCC to report to us, as part of Price Control, on a more granular level the services and costs that fall under the SSC arrangements. We will engage with DCC separately to work out the level of detail we expect DCC to report on.

[96] We have assumed the average of the reported number of FTEs in the RIGs for RY22/23 (705) and RY23/24 (806)

8.37 We are proposing to apply the adjusted SSC rate to eligible costs incurred from 01 April 2024 onwards, meaning the RY24/25 Price Control assessment in late 2025 will be the first process within which the reduced figure may be considered.

8.38 As with the value of the Baseline Margin adjustment, this does not require any amendments to be made to the Licence or any other aspect of the governance framework. It instead represents the percentage of SSC to be applied to qualifying internal costs that we will consult on as part of the Price Control assessment process from 2024/25 onwards.

8.39 We welcome views from stakeholders on our proposals.

Baseline Margin on Capita services

Context

8.40 In addition to those services provided into DCC by Capita that are included within the scope of SSC as described above, DCC has also entered into a number of separate contracts with Capita for other services. Capita as an organisation are free to tender for DCC contracts, that are not FSC, in the same way as any other potential Service Provider, and DCC must treat any bids received from Capita consistently with any other bids received from other organisations.

8.41 These contractual services fall into different categories from a Price Control reporting perspective:

- External Services (ES) – services that DCC procures from third party suppliers, including from Capita, such as consulting fees, legal fees, and bank charges.
- Internal Services (IS) – these are information technology and other professional services sourced from the Licensee’s parent group. These services are exclusive of the Shared services, and the costs for these services are charged directly to DCC.

- IT Services (IT) – these are all IT services, including for example billing, Document Management, FTP and Networks, Hosting, Programme and Architectures, Desktop support, Telephony and Website.

- Service Management (SM) – these includes the provision of a first line service desk as well as the Service Management System.

In total, DCC has procured approximately £77.5m of these services from Capita between RY13/14 and RY21/22.

8.42 DCC is able to apply for BM adjustment on costs borne under IS and ES if it is able to demonstrate that the costs meet the criteria, as described in the Baseline Margin section above. As noted, in each Price Control year we have taken the decision to award a BM adjustment of 15%, calculated as a Rate of Return of 17.6%, on all qualifying costs. DCC is also able to apply for BM adjustment on qualifying new scope services provided through the SSC agreement described above.

8.43 We consider that this is inappropriate for the following reasons:

- Service contracts – IS, ES, IT and SM: This arrangement risks distorting competition. It creates a perception that Capita can be at an advantageous position to potentially leverage their ability to earn BM adjustment on qualifying costs borne by DCC on services provided by Capita under contract by under-pricing their bids for DCC contracts. This could place competitors at a disadvantage.

- Shared Service Charge: As Capita are already earning a 9.5% overhead charge on these services, we consider it unreasonable that these DCC costs should also be eligible for the additional 15% margin on top.

8.44 To be clear, we have not seen evidence to suggest Capita are using the BM adjustment to their advantage when bidding for DCC contracts. We understand that all new DCC contract tendering is performed on an arm's length basis from Capita as required, and any margins earned by DCC under licence are not factored into Capita's pricing of their services. However, we still consider this arrangement is inappropriate as it at least in theory risks distorting competition in this manner.

Proposal

8.45 We are therefore proposing that any services procured by DCC from Capita, whether through the SSC arrangement or through a separate service contract, should not be eligible to earn any additional BM through the adjustment process. Capita will still be able to bid for DCC contracts on a competitive basis.

8.46 We are proposing that this takes effect from 01 April 2024.

8.47 Finally, for the avoidance of doubt, these proposals do not require any amendments to be made to the Licence.

Appendices

Index

Appendix 1 – External Costs Assessment

A1.1. In this Appendix to Chapter 3 (External Costs), we provide further context for the drivers of new material costs which DCC justified through its submission – we focus on the change and project requests (CRs/PRs) with value over £1m which DCC progressed within the SMETS2, SMETS1, and ECoS Programmes.

A1.2. Table A1.1 below provides an overview of DCC's main contracts relevant to our assessment of DCC's External Costs.[97] DCC's main role is to effectively manage these contracts to derive value for money and a quality service for its customers.

Table A1.1: Overview of DCC's contracts with External Service Providers

Capacity	Role	Provider	RY of contract
Fundamental Service Providers			
Data Service Provider	DSP	CGI	13/14
SMETS2 Communications Service	CSP-N	Arqiva	13/14
	CSP-C	Telefonica	13/14
	CSP-S	Telefonica	13/14
SMETS1 service providers			
Initial Operating Capability (IOC)	S1SP_1	CGI IE	18/19
Middle Operating Capability (MOC)	S1SP_2	Secure	18/19
Final Operating Capability (FOC)	S1SP_3a	Trilliant	18/19
	S1SP_3b	DXC	18/19
Dual Control Organisation (DCO)	S1_DCOa	Capgemini	18/19
	S1_DCOb	CSW	19/20
	S1_DCOc	Capita	22/23

[97] Please note that service providers for the Switching Programme are omitted from this overview as switching costs are assessed separately from both external and internal costs.

Capacity	Role	Provider	RY of contract
SMETS1 Communications Service	S1_CSP1	Vodafone	19/20
	S1_CSP2	Telefonica	19/20
ECoS service providers			
Technical Application Service		CSW	21/22
Hosting Services and Service Management		Accenture	21/22
CH&N service providers			
Component Integration		Accenture	22/23
Device Manager		Accenture	22/23
4G Comms Hubs		Toshiba	22/23
Wide Area Network (WAN)		Vodafone	22/23
Integration and Assurance		Critical	22/23
TAF service providers			
Test Automation and Robotics Framework Programme		HCL	22/23

Key material variances

SMETS2

A1.3. DCC's FSPs comprise the Data Service Provider (DSP) and two Communication Service Providers (CSPs), operating across three communication regions; together, they provide the core communication infrastructure for smart metering across GB and enable DCC users to send and receive messages to and from smart meters. The FSP contracts were procured by the government on a competitive basis and are managed by DCC.

A1.4. In RY22/23 DCC incurred £302.7m in total FSP costs. DCC justified 13 new material CRs/PRs with a total value of £37.65m.

A1.5. The principal drivers behind were as follows: SEC Release, Enterprise Change for ECoS, SI[98] Release Management, and other activities including security and testing.

SEC Release

A1.6. DCC justified 2 CRs and 2 PRs relating to the 2022 SEC Release. Among these, the largest item was CR4117, which covered the second part of delivery of SECMP0007 (firmware updates to mandated HAN[99] devices).[100] This part 2 consisted of Firmware Distribution to PPMIDs[101] and HCALCS,[102] including, among others, support for new and updated service requests, extension of Firmware Distribution Progress Tracking to cover the new devices, or new device alerts from comms hub to provide notifications of any successes/failures regarding HAN transfers. Related to that, a separate PR7404 was raised to enhance the project to GBCS 4.1.[103] DCC explained that the industry conclusion was that SECMOD007 could not be released without the system uplift to this latest version of GBCS. DCC referred to its last year's price control submission for detailed cost justification, provided updated documentation of its agreement with relevant service providers and responded to our follow-up clarification questions on change in costs.

A1.7. As part of the Release, PR7295 provided cover for System Integration Testing (SIT) and User Integration Testing (UIT) for the deployment of GBCS 4.1 to comms hubs. DCC explained that due to uncertainty and volume of activities, it opted for contracting on a time and materials (T&M) basis, allowing it to track costs each month and stay within budget.

A1.8. Finally, CR4112 was raised to cover the work needed for post-PIT[104] activities required for completion of the SEC June 2022 Release, including SECMP0024 (Comms Hub Firmware Management), SECMP0104 (Security Improvements), SECMP0015 (GPF timestamp for

[98] System Integrator
[99] Home Area Network
[100] For details on Part 1 of SECMP0007, please see Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraphs A1.14-A1.17. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122
[101] Prepayment Meter Interface Device
[102] HAN-Connected Auxiliary Load Control Switch
[103] Great Britain Companion Specification. GBCS describes the detailed requirements for communications between Smart Metering Devices in consumers' premises, and between Smart Metering Devices and DCC.
[104] Pre-Integration Testing

reading instant gas values) and SECMOD007 (Part 2 Firmware Updates). DCC reported cost savings through rate card reductions and challenging the scope of required activities, resulting in total combined costs incurred by all FSPs c.£1.5m below estimates submitted to the SEC Panel for implementation of these modifications.

Enterprise Change

A1.9. DCC justified 2 CRs and 1 PR in relation to Enterprise Change. The larger change request, CR4101, covered SIT and UIT for ECoS. DCC explained that SIT brought all service providers, central switching service, interface infrastructures and DCC's backend systems together to ensure SEC requirements were met; while UIT would provide suppliers with the opportunity to test the new ECoS functionality. DCC outlined how it sought to achieve value for money, which included cost savings through consolidation of leadership and PMO support resources and reduction in expense rates. A further request, CR4106, was raised to allow DCC to host and manage the new ECoS service, specifically to design secure communication interfaces for test and production environments. DCC again benefited from consolidated resource funding to reduce overall costs and hosted several workshops with relevant service providers to clarify the requirements and scope of the change. DCC reported average savings of 32% between initial and final Impact Assessments for these CRs.

A1.10. A smaller PR7449 was raised to test the ECoS solution with CSPs in the SIT environments. DCC explained that this PR was negotiated on a T&M basis with cost based on approved contract rates.

SI Release Management

A1.11. DCC justified 3 PRs for SI Release Management raised with the DSP. DCC explained that SI services are required for each programme where there are multiple parties delivering parts of the solution and to ensure full coordination.

- PR7381 covered the SI function for ECoS for 12 months to June 2023 to coordinate the testing of the service providers and manage any design issues.

- PR7383 provided SI service for the 4G CH&N programme until October 2024.

- PR7463 extended existing SI Release Management for SMETS2, SMETS1 and SEC releases by 12 months to October 2023.

A1.12. DCC reported average savings of 16% across these PRs on account of its negotiations, which included: use of benchmarking against previously negotiated services, charging based on a T&M basis to control scope, or challenging assumptions and effort estimations by the SP.

Other activities, incl. testing and security

A1.13. DCC raised PR7272 with two service providers for extension of provision of Product Support Testing (PST). PST provides a service for testing of maintenance content before production phase, coordinated by the DSP systems integrator function. DCC reported average forecasted savings of c.40% achieved through contracting on a T&M basis and robust planning and tracking of monthly maintenance releases.

A1.14. CR4188 was progressed to expand the range of meters that may be installed in the Central & South Communication Region and protect existing meters by extending a derogation for meter radio frequency interference at 900MHz to March 2022 and ensuring existing derogated meters would be managed until at least 2028. DCC explained that without this derogation, there was a risk that existing non-compliant meters would have to be prematurely removed and replaced, resulting in high costs to the industry.

A1.15. Finally, DCC raised PR7360 to transition to a new 'threat-led' solution for DSP security arrangements – a move away from a subcontractor, whose contract was due to expire, to a new DSP-provided solution. DCC clarified that the build costs of the new solution were below a quote provided by the subcontractor for a service upgrade and that ongoing monthly charges were likewise reduced. DCC expects to raise a further PR to deliver additional requirements in RY23/24, and a CR to cover the live service.

A1.16. Table A1.2 below provides an overview of these newly justified PRs/CRs.

Table A1.2: Overview of newly justified material SMETS2 CRs/PRs

PR/CR #	Description
SEC Release	

PR/CR #	Description
CR4117	Part 2 of SECMP0007: Firmware updates to mandated HAN devices (follow Up to CR1408)
CR4112	June 2022 SEC release: Post-PIT Activities
PR7295	GBCS 4.1 – SIT and UIT cover
PR7404	GBCS 4.1 – PR cover to enable work on CR4452, extension to PR7339
Enterprise Change	
CR4101	ECoS - SIT/UIT Prep and Execution
CR4106	ECoS Gamma Connectivity
PR7449	Support for ECoS SIT (PR7231 part 2)
SI Release Management	
PR7381	ECoS Programme SI Services
PR7383	SI, SI Environment & Release Management Services for CH&N
PR7463	CGI SI Release Management (Nov 22 – Oct 23): follows PR7230
Other activities	
PR7272	Production Support Testing: April 22 – March 25
CR4188	Dispensation for Meter RF Interference at 900MHz
PR7360	Transition from the incumbent legacy solution to a new threat-led DSP solution

SMETS1

A1.17. The purpose of the SMETS1 programme is to integrate first generation smart meters into the DCC service to ensure their interoperability. Under an agreed plan, the enrolment and adoption of the SMETS1 meters happens in three releases – Initial (IOC), Middle (MOC) and Final (FOC) Operating Capability – with each release delivering a capability for a different type of meter installed by energy suppliers. The SMETS1 service went live in July 2019 for IOC meters. DCC then consulted on revisions to the Joint Industry Plan (JIP) to deliver solutions for the MOC and FOC cohorts. The capability to migrate and operate some MOC devices went live in August 2020. In RY20/21 and RY21/22 DCC made progress towards delivering the solution for FOC, however the programme suffered delays due to testing issues and a replan had to be agreed at the end of 2020. Throughout RY21/22 DCC worked on a revised plan and phased commissioning approach with the first phase of the FOC capability commissioned in February 2022.

A1.18. DCC reported the following key planned events and objectives of the SMETS1 programme in RY22/23:

- Maximising migrations with regulatory and maintenance release changes to unblock further SMETS1 meters.

- Device Swap Out (the ability to swap a SMETS1 meter for another SMETS1 meter in certain circumstances).

- Service stabilisation to complete remaining activities post-FOC go-live date, including delivery of maintenance releases, defect fixes, design changes, tech refresh and enduring solution, as well as resolution of incidents.

A1.19. DCC justified 8 new material CRs/PRs with a combined value of £14.02m, of which 5 related to IOC and FOC cohorts, and 3 to changes in the supply chain and appointment of a new service provider.

IOC

A1.20. DCC raised two CRs to extend services for IOC. CR4567 provided access to UIT (B-stream) testing environment until October 2024. DCC argued that this was a necessary extension to existing services due to expire in January 2022. Meanwhile, CR4631 was raised to ensure the continuation of meter migrations until the approval of Decommissioning Timetable for the cohort in May 2023.

FOC

A1.21. DCC justified 3 new material CRs/PRs raised with one of its FOC provider:

- CR4062 extended charges for an existing central logging system to July 2025. DCC stated that this was agreed under discounted rates negotiated in RY21/22; DCC further explained that it required to scale the exiting platform to support a higher number of service request variants (SRVs) per second above the originally contracted number, and provided the SP with requirements for data archiving and retention

- DCC raised a further CR4504 to build upon the existing infrastructure deployed via CR4022 to scale up capacity to account for an increased number of meters in the FOC cohort being migrated, which began to cause incidents. DCC negotiated a scaled solution and reported agreed charges from RY22/23 to RY25/26. DCC argued that this will help mitigate capacity issues going forward.

- PR7497 provided cover for a migration to a new version of a hybrid cloud service provided by a subcontractor of the FOC service provider; this included purchase of a licence to provide an interim extension to existing support.

Supply chain changes

A1.22. Through CR4732 DCC extended the Commissioning Party (CP) Service until at least end-2023. The CP enables the enrolment and commissioning of SMETS1 devices onto DCC systems, as such it is a critical part of SMETS1 migration. DCC explained that the original contract assumed an earlier closure of the SMETS1 programme with the extension driven by the revised planned competition date. DCC reported that the extension had been agreed under similar enduring costs with an option for early termination.

A1.23. PR7399 and PR7411 relate to DCC's procurement of a new service provider to perform a function hitherto provided by a subcontractor of one of incumbent SPs. The project requests were raised as part of a build phase of a new interim solution and covered procurement of emergency licences and set-up of a new data centre.

Table A1.3: Overview of newly justified material SMETS1 CRs/PRs pertaining to IOC and FOC cohorts

PR/CR #	Description
IOC	
CR4567	Support for B Stream environments until 31st October 2024 (Extension to CR4207)
CR4361	Continuation of IOC migration

PR/CR #	Description
FOC	
CR4062	Production Capacity and Central Logging (Uplift) Enduring Support
CR4504	Central logging system
PR7497	OpenShift Migration (Version 3 to Version 4)
Supply chain changes	
CR4732	Commissioning Party – Extension of services
PR7399	Procurement of Licenses
PR7411	Additional equipment and services for a data centre

ECoS

A1.24. The purpose of the Enduring Change of Supplier (ECoS) Programme is to provide an enduring process to facilitate the switching of ownership certificates on devices such as smart meters between suppliers when an energy consumer switches supplier. The solutions developed under the ECoS Programme replace the prior, temporary Transitional Change of Supplier (TCoS) processes. The ECoS Programme is delivered via two service providers, both of which were appointed by DCC in 2021. One service provider is responsible for the DBT phase of the Programme (plus ongoing support), while the other provides hosting services and service management once the Programme is live.

A1.25. The ECoS Programme was originally intended to go live in June 2022. However, following appointment of the two ECoS service providers in autumn 2021, a review of the programme milestone dates led to a revised go-live date of June 2023 (i.e., RY23/24) – a milestone which the programme reached on time. Within RY22/23, DCC reported the following achieved milestones:

- Completion of all Pre-Integration Testing (PIT), Systems Integration Testing (SIT), System Capacity Testing (SCT), Business Acceptance Testing (BAT), and Operational Process Testing (OPT) phases.

- User Integration Testing (UIT) completed prior to go-live in RY23/24

A1.26. DCC reported a variance of £2.052m in incurred costs on last year's forecast. DCC justified the variance in ECoS through two CRs:

A1.27. CR4101 covered the costs associated with developing an enduring PIT environment to replace the existing short-term solution. The enduring solution gives DCC and the service provider an environment to test changes and fixes to the ECoS solution that are intended to be promoted to SIT and UIT environments. DCC explained that it sought to drive value for money in the design of the PIT environment, including by allowing the environment to be scaled up and down to allow for cost minimisation in periods where it is not needed; enduring cloud software service charges on an 'as-used' basis rather than fixed-price; and obtaining a detailed breakdown of the components and services being provisioned. DCC stated that 'as-used' pricing has led to savings of 51% of the initial contracted price of cloud services.

A1.28. CR4560 covers additional costs associated with the ECoS Hosting Services and Service Management service provider following a 4.5-month delay to the Programme's go-live date, from mid-February 2023 to 30 June 2023. The scope of the CR was for the service provider to confirm any impact on delivering against the ECoS Programme's project milestones while also factoring in any existing CRs. DCC said it pursued value for money by working with the service provider to 'lift and shift' existing resources to cover the programme's extended timescales, and negotiating costs with the service provider which led to a deferral of licence renewal costs and removal of capital costs from the CR.

Table A1.4: Overview of newly justified ECoS Programme CRs

CR	Description
CR4101	ECoS - SIT/UIT Prep and Execution
CR4560	New ECoS go-live date

TAF

A1.29. The Test Automation and Robotics Framework (TAF) Programme is new for RY22/23. Its purpose is to improve defect identification during System Integration and User Integration testing phases (SIT & UIT), reducing the impacts on customers arising from changes implemented in the DCC system. A single service provider is responsible for the provision of the Programme, delivering both cloud-based software and robotics elements, as well as incident resolution and maintenance services. DCC remains responsible for the provision of test laboratories, internet connection, and meter sets.

A1.30. DCC followed a three-stage bidding process for the TAF contract, similar to the process used for the procurement of the two ECoS service providers, beginning the tender process in December 2020.[105] DCC performed a 'targeted market engagement exercise', inviting nine suppliers to submit a bid for the contract, from which six submitted a bid.

A1.31. First, these six bids were assessed against both Technical and Commercial criteria. Three bids proceeded to the next stage, with DCC providing details on why unsuccessful bids were not considered further. Second, the three remaining bidders presented their proposals in further detail and provided Best and Final Offers (BAFOs) for the contract in July 2021. The two best bids then progressed onto the third and final stage which consisted of further bid refinement and negotiations between parties, after which a winning bid was chosen in March 2022. The winning bidder was notified in July 2022.

A1.32. DCC did not initially provide documentation around the TAF Programme and its procurement but submitted information on request. As part of our assessment of the Programme and its procurement, we asked further clarification questions on the requirements of the Programme, its drivers, and further details on the procurement process.

[105] See the ECoS section of Appendix 1 of our RY21/22 Price Control for further details on the procurement of the two ECoS service providers.

Appendix 2 – Internal Costs Assessment

A2.1. DCC's internal Baseline costs are reported by cost centre. DCC reports separately on Additional Baseline and New Scope costs.[106] Table A2.1 gives an overview of the types of costs associated with each cost centre.

Table A2.1: Overview of costs associated with each cost centre

Cost Centre	Functions Include
Corporate Management	• Strategy and Regulation • Corporate Affairs • Stakeholder Engagement • Business Improvement and Internal Audit • Accommodation and Test Labs • Price Control support for DCC
Commercial	• Commercial Operations • Procurement • Vendor Management • Contract Management • Relationship management of contracts in DCC's strategic supply chain • Meet Price Control needs.
Finance and People	• Financial Reporting, including producing statutory accounts, Price Control data and managing annual audit. • Commercial Finance activities, including responsibility for producing and managing financial plans and forecasts of the business. • Regulatory Finance and Pricing activities, including preparing and publishing annual charging statements and indicative budget documents.

[106]Additional baseline refers to any costs that are associated with requirements that the Licensee was expected to deliver at the time of the licence award, but were not fully costed in the LABP. New scope refers to activity associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence award. The Centralised Registration Service is considered new scope.

Cost Centre	Functions Include
	• Finance Transformation and Business Operations, including responsibility for ensuring DCC reporting system is maintained and modified, and introducing systems to automate financial processes. • People team, including ensuring DCC attracts and acquires the talent and expertise required. • Legal, including supporting DCC with in-house Legal resource and managing relationships with external law firms
Operations	• Delivers reliable and repeatable service, at scale. • Reports operational performance to DCC's Customers and Regulatory Parties • Supports DCC's focus on customers, including customer relationship management and service desk. • Supports the prioritisation of activity and development effort for DCC through customer insight, process measurement and Industry engagement. • Improves the solutions proposed by DCC through early and effective engagement in the design process. • Protects the margin and reputation of DCC through a focus on service.
Design and Assurance	• Designs the Enterprise Architecture for the DSP re-procurement and Network Evolution comms Hubs. • Works with DCC customers to improve existing ways of working and maximise benefits to be delivered by NEP. • Reviews existing practices, technology and tooling and defines new ways of working to incorporate technology that maximises testing efficiency and quality of deliverables. • Responsible for the design of technical solutions that address new SEC Modifications and Customer-led changes. • Responsible for ensuring DCC executes key services and operates to the standards required by DCC's licence and customers.

Cost Centre	Functions Include
	• Delivers quality and consistency in Design and Testing Services
Security	• Assures the security of all DCC systems. • Ensures the platform and new programmes being added to it are secure and meet with Licence and code requirements. • Addresses the changing threats to the systems through a risk-based approach in line with industry and regulatory guidance. • Provides security assurance to the regulators and DCC customers. • Information governance and data protection
Service Delivery	• Accountable for programme delivery, and professional practices of Business Analysis, Test Assurance and Programme and Project Management that support delivery of the change portfolio for DCC. • Delivers DCC's inventory of Programmes. • Improves Service Delivery Practice Capability and resourcing approach. • Increases the maturity and effectiveness of the business analysis capability to support the evolution of the DCC total system. • Increases the maturity and effectiveness of the Test Assurance practice. • Drives PM performance management via an engaging and supportive approach, with clarity of R&R across Programme and Practice.

A2.2. Figure A2.1 shows the variance over the Licence period in Internal Costs by cost centre compared to the RY21/22 forecast, including the Additional Baseline cost. This shows that the increase in costs over the Licence period compared to last year's forecast are concentrated in Additional Baseline, Programme and Operations cost centres.

Figure A2.1: Cost variance by cost centre - compared to RY21/22 in current year prices

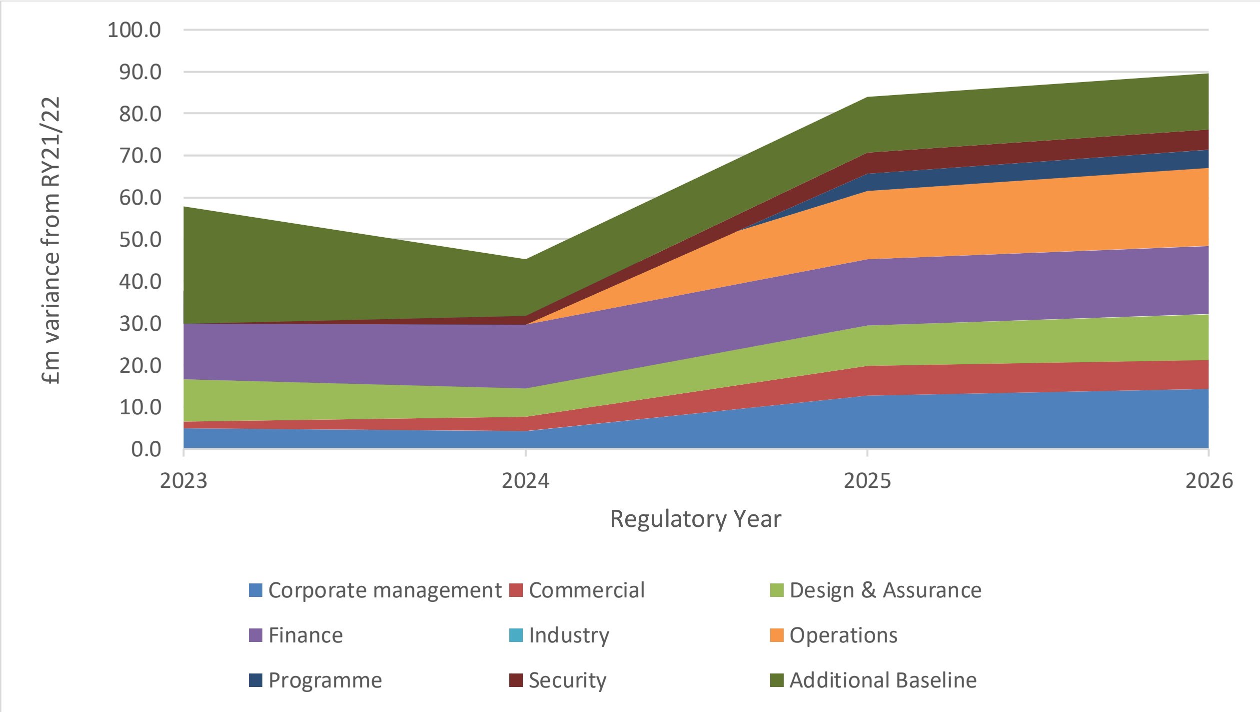

Figure A2.1: data table

Cost Centre	RY22/23 (£m)	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Corporate management	4.97	4.28	12.69	14.30
Industry	1.57	3.35	7.11	6.98
Finance	10.15	6.81	9.76	10.81
Commercial	17.85	15.21	15.66	16.31
Design & Assurance	0.00	0.00	0.00	0.00
Operations	3.11	6.56	16.33	18.69
Security	-7.63	-6.56	4.12	4.28
Programme	-0.18	2.03	5.10	4.83
Additional Baseline	28.04	13.65	13.28	13.41

A2.3. Figure A2.2 shows the variance over the Licence period in Internal Costs by cost centre compared to the LABP. This shows that the forecast cost variances over the Licence period compared to the LABP are concentrated in Additional Baseline, followed by Corporate Management, Programme, and Operations.

Figure A2.2: Cost variance by cost centre - compared to LABP in current year prices

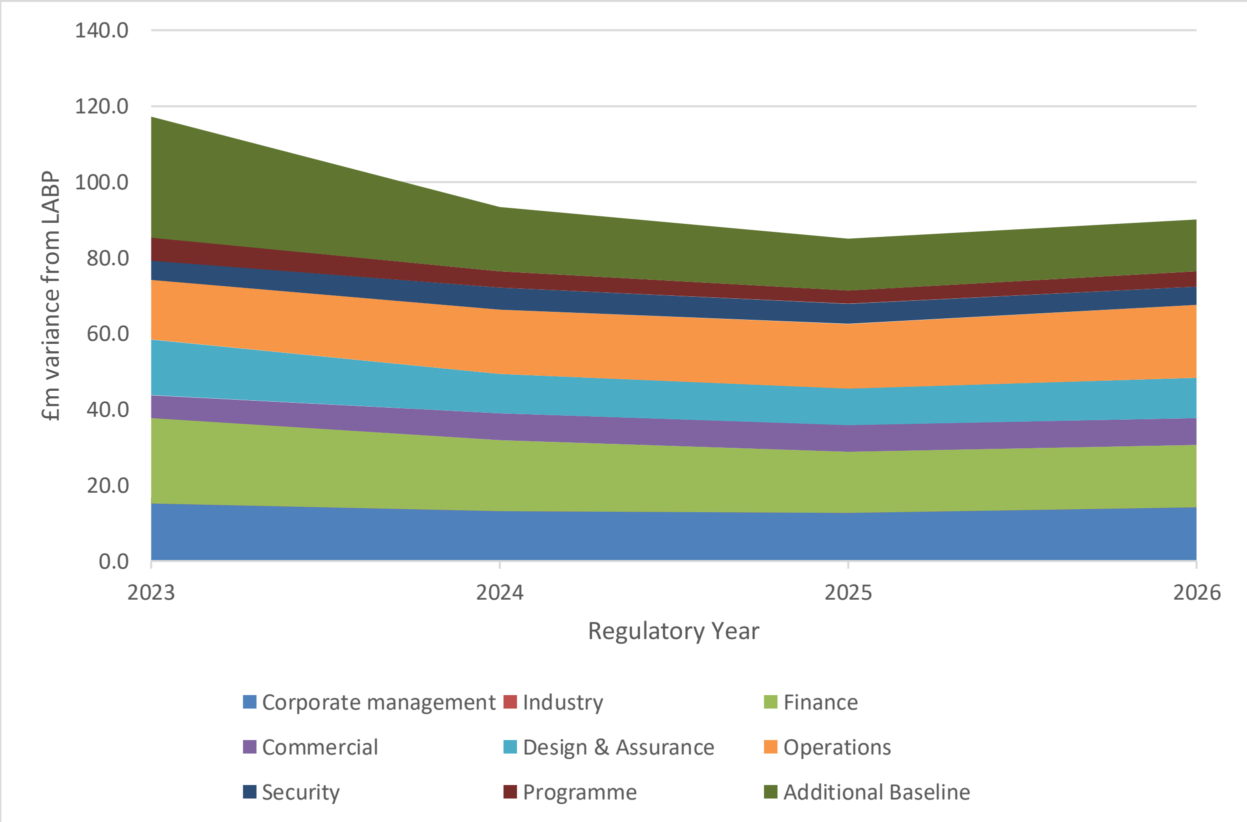

Figure A2.2: data table

Cost Centre	RY22/23 (£m)	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Corporate management	16.75	14.88	14.34	14.89
Industry	-1.65	-1.65	-1.65	-0.69
Finance	22.69	18.55	16.12	16.49

Cost Centre	RY22/23 (£m)	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Commercial	5.92	7.29	7.01	6.94
Design & Assurance	14.70	10.33	9.64	10.76
Operations	15.78	16.81	17.12	19.05
Security	5.15	5.80	5.29	5.04
Programme	6.05	4.44	3.46	4.01
Additional Baseline	31.84	17.00	13.58	13.61

A2.4. Payroll costs are a major driver of Internal Costs across the different cost centres. Table A2.2 summarises DCC's headcount from RY21/22 to RY22/23 as measured in full time equivalents (FTEs) by cost centre. In RY22/23, there is a 5% increase in FTE compared to the RY21/22 forecast for RY22/23.

Table A2.2: FTEs by cost centre

Cost Centre	RY22/23	RY21/22 forecast for RY22/23
Corporate management	75.40	86.18
Industry	-	-
Finance	111.76	67.77
Commercial	41.81	41.63
Design & Assurance	109.60	47.11
Operations	153.88	121.93
Security	38.00	38.56
Programme	29.12	108.85
Additional Baseline	120.00	121.26
New Scope	-	-
CRS	24.20	34.42
Total	**703.77**	**667.72**

Appendix 3

Table A3.1. Proposed Allowed Revenue for each year to the end of the Licence term, in £m

Regulatory Year	RY22/23	RY23/24	RY24/25	RY25/26
LABP (22/23 prices)	272.245	279.934	289.033	122.247
Previous year (22/23 prices)	436.989	521.168	507.693	305.214
Submitted AR RY22/23[107]	561.029	585.608	675.751	540.938
Cost Disallowances				
External costs				
SMETS1: supply chain	-4.159	-1.589	-5.408	-5.408
SMETS1: Service stabilisation	-2.675	0.000	0.000	0.000
FSP forecasts costs	0.000	-20.651	-11.161	-12.242
CRS forecast external costs (switching)	0.000	-10.743	-9.849	-10.490
Total External Costs disallowances[108]	*-6.834*	*-32.983*	*-26.418*	*-28.140*
Internal Costs				
Baseline forecast internal costs	0.000	0.000	0.000	-89.613
CRS forecast internal costs (switching)	0.000	-4.406	-4.461	-4.565
Benchmarking - contractors	-0.402	0.000	0.000	0.000
Cont. RY21/22 grounds/activities	-0.981	0.000	0.000	0.000
Corporate Management - Payroll - lack of evidence/ justification	-0.090	-0.200	-0.250	0.000

[107] Excludes any OPR and BMPPA performance adjustments from RY22/23 onwards.
[108] Please note that this does not include our proposal to disallow, subject to further evidence, *up to* the full amount of costs incurred by DCC in respect of one of its newly procured contracts in the 4G CH&N programme. For more details, please see paragraphs 3.73-3.83.

Regulatory Year	RY22/23	RY23/24	RY24/25	RY25/26
Design and Assurance - Payroll - lack of evidence/ justification	-0.105	-2.208	-4.733	0.000
ES & IS - Planning/Outsourcing of services	-3.337	-0.312	0.000	0.000
ES & IS - Procurement (NCP)	-1.240	0.000	0.000	0.000
Security - Payroll - lack of evidence/ justification	-0.178	-0.721	-1.312	0.000
Business Accuracy Programme (BAP)	-3.845	-0.243	0.000	0.000
Corporate Management - Payroll - forecast	0.000	-0.800	-0.800	0.000
Finance - Payroll - forecast	0.000	-3.599	-4.340	0.000
Commercial - Payroll - forecast	0.000	0.000	-5.186	0.000
Service delivery - professional services practice - forecast	0.000	-3.403	0.000	0.000
Customer Relationship Management - PR - Forecast	0.000	-0.743	-1.765	0.000
SMETS1 - PR - Testing costs - forecast	0.000	-0.291	-0.312	0.000
Network Evolution - Payroll	-1.341	-7.689	-5.718	0.000
Shared Service Charge	-0.963	-1.991	-2.389	-8.006
Total Internal Costs disallowances	***-12.482***	***-26.606***	***-31.266***	***-102.184***
Total cost (internal and external) disallowances	**-19.316**	**-59.247**	**-57.684**	**-130.324**
Performance Adjustment Reductions				
OPR	-0.870	0.000	0.000	0.000
BMPPA - SMETS1	-6.955	-1.224	0.002	0.000
CRS performance (disallowance adjustment)	0.000	0.000	0.000	0.000
Consultation AR excluding BM and ECGS adjustments	***533.888***	***525.137***	***618.068***	***410.613***
Baseline Margin and ECGS adjustments				
BM adjustment	0.000	0.000	5.068	5.356
ECGS adjustment	0.000	0.000	5.156	0.000
Consultation AR with BM and ECGS adjustments	**533.888**	**524.795**	**628.293**	**415.970**

Table A3.2. Total Proposed Allowed Revenue across the whole Licence term

Regulatory Year	Total across Licence term (£m, RY22/23 prices)
LABP (22/23 prices)	**2,376.058**
Previous year (22/23 prices)	**4,615.838**
Submitted AR R22/23[109]	**5,207.956**
Cost Disallowances	
External costs	
SMETS1: supply chain	-16.565
SMETS1: service stabilisation	-2.675
FSP forecasts costs	-44.054
CRS forecast external costs (switching)	-31.082
Total External Costs disallowances[110]	***-94.375***
Internal Costs	
Baseline forecast internal costs	-89.613
CRS forecast internal costs (switching)	-13.432
Benchmarking - contractors	-0.402

[109] Excludes any OPR and BMPPA performance adjustments from RY22/23 onwards.
[110] As above, please note that this does not include our proposal to disallow, subject to further evidence, *up to* the full amount of costs incurred by DCC in respect of one of its newly procured contracts in the 4G CH&N programme. For more details, please see paragraphs 3.73-3.83.

Regulatory Year	Total across Licence term (£m, RY22/23 prices)
Cont. RY21/22 grounds/activities	-0.981
Corporate Management - Payroll - lack of evidence/ justification	-0.540
Design and Assurance - Payroll - lack of evidence/ justification	-7.046
ES & IS - Planning/Outsourcing of services	-3.649
ES & IS - Procurement (NCP)	-1.240
Security - Payroll - lack of evidence/ justification	-2.211
Business Accuracy Programme (BAP)	-4.088
Corporate Management - Payroll - forecast	-1.600
Finance - Payroll - forecast	-7.939
Commercial - Payroll - forecast	-5.186
Service delivery - professional services practice - forecast	-3.403
Customer Relationship Management - PR - Forecast	-2.508
SMETS1 - PR - Testing costs - forecast	-0.603
Network Evolution - Payroll	-14.748
Shared Service Charge	-13.349
Total Internal Costs disallowances	**-172.538**
Total cost (internal and external) disallowances	**-266.913**
Performance Adjustment Reductions	
OPR	0.870
BMPPA - SMETS1	8.177
CRS performance (disallowance adjustment)	0.000
Consultation AR excluding BM and ECGS adjustments	**4,931.996**

Regulatory Year	Total across Licence term (£m, RY22/23 prices)
BM adjustment	9.534
ECGS adjustment	5.156
Consultation AR with BM and ECGS adjustments	**4,946.686**

Appendix 4 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the UK General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name, address, and anything that could be used to identify you personally), not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the UK GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e., a consultation.

4. With whom we will be sharing your personal data

We are not intending to share your personal data with other organisations. We are intending to publish non-confidential consultation responses, including any personal data that may be contained within them.

5. For how long we will keep your personal data, or criteria used to determine the retention period

Your personal data will be held for six months after the consultation closes.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data.
- Access your personal data.
- have personal data corrected if it is inaccurate or incomplete.
- ask us to delete personal data when we no longer need it.
- ask us to restrict how we process your data.
- get your data from us and re-use it across other services.
- object to certain ways we use your data.
- be safeguarded against risks where decisions based on your data are taken entirely automatically.
- tell us if we can share your information with 3rd parties.
- tell us your preferred frequency, content and format of our communications with you.
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas

8. Your personal data will not be used for any automated decision making

9. Your personal data will be stored in a secure government IT system.

10. More information

For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".