Decision

DCC Price Control: Regulatory Year 22/23

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Overview:

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

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

In November 2023, we ran a first consultation on our proposals following a review of the report and information submitted by DCC in July 2023 for the Regulatory Year from 1 April 2022 until 31 March 2023. We ran a second consultation to further inform our Price Control assessment and decision-making at the end of January 2024. Our decision to run a second consultation was considered appropriate in light of further evidence having been received from DCC, specifically in relation to the costs associated with 4G Comms Hubs & Networks,[1] and the Service Desk.[2]

This document sets out our decisions and the reasons for them on the costs DCC reported under its Price Control for the Regulatory Year 2022/23 and its application to adjust the Baseline Margin and External Contract Gain Share values under the Licence.

[1] Agreement for the provision of services in respect of the Network Evolution Programme relating to the Smart Metering Programme.
[2] Agreement for the provision of Service Desk services.

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

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

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

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Executive Summary

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

These are our[3] final determinations for the DCC Price Control for the Regulatory Year 2022/23 (RY22/23). Our decisions reflect our conclusions on the economic and efficient level of costs incurred in RY22/23 and in the cost forecasts; DCC's performance under the Operational Performance Regime (OPR) and Baseline Margin Project Performance Adjustment scheme (BMPPA); and adjustments to the Baseline Margin (BM) values set out in the Licence and the External Contract Gain Share (ECGS) term. Our final determination follows from our assessment and November 2023 consultation on DCC's costs and performance, as well as a second consultation that we ran with DCC only at the end of January 2024. We ran that second consultation to further inform our Price Control assessment and decision-making. This was considered appropriate in light of further evidence having been received from DCC, specifically in relation to the costs associated with 4G Comms Hubs & Networks,[4] and the Service Desk.[5] Due to the commercially sensitive nature of the information received from DCC, the follow-up consultation was undertaken solely with DCC. We have set out our position and reasoning for our decision on these areas within this document. Our decision takes into consideration all stakeholder views that we have received in response to the consultations.

Cost Assessment

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, as approved as part of our decision on the RY21/22 Price Control. Over the Licence term (RY13/14- RY25/26), total costs are now forecast to be £5.48b, 13% greater than last year's forecast.

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[3] The terms 'we', 'us', 'our' refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.
[4] Agreement for the provision of services in respect of the Network Evolution Programme relating to the Smart Metering Programme.
[5] Agreement for the provision of Service Desk services.

After considering all consultation responses, including from DCC, **we have determined a total of £14.926m, split between £11.212 Internal Costs (including the associated shared service charge) and £3.714m External Costs, incurred in RY22/23 as Unacceptable**.[6] Our determination on Unacceptable Costs comprises of inefficiencies in a portion of External Costs associated with service providers in the SMETS1 and 4G Comms Hubs & Networks (CH&N) Programme, inefficiencies in External and Internal Services, costs surrounding Non-Competitive Procurements (NCPs) as well as projects that we considered not to be resourced in the most economic and efficient way, the Business Accuracy Programme (BAP), the application of Shared Service Charges, contractor benchmarking, the Service Desk contract and costs incurred as a result of inadequate planning and scoping. There are also Unacceptable Costs based around the lack of clarity over forecasts, in particular forecasts related to the Network Evolution and SMETS1 programmes and the internal resource cost centres.

In our decision, we have also considered additional evidence provided by DCC as part of their consultation response to justify the costs associated with our proposed disallowances. We partially reduced the disallowance amount from our consultation position where further satisfactory evidence was received. This is for example the case for a proportion of the External Costs associated with service providers in the SMETS1 and 4G Comms Hubs & Networks (CH&N) Programme; as well as a portion of the costs associated with of the External Services, NCPs, as well as some of the payroll costs.

In addition, we have also determined a total of £22.452m (RY23/24), £26.927m (RY24/25) and £133.820m (RY25/26) in forecast Internal Costs (including the associated shared service charge), and £14.395m (RY23/24), £9.171m (RY24/25) and £14.123m (RY25/26) in forecast External Costs as Unacceptable. In addition, we have also decided to disallow all forecast costs (£44.514m in total, of which £13.432m of Internal Costs and £31.082m of External Costs) associated with the Switching programme for RY23/24 onwards. DCC has not sufficiently justified these costs, and we consider these costs are not certain enough to include in DCC's future Allowed Revenue.

We expect DCC to take steps to improve its forecasting and provide clear and transparent cost forecasts for its customers and stakeholders, and as part of the price control. As DCC is now considered to be a well-established organisation, we would expect DCC to be in a position to forecast with more certainty, and to be able to justify costs further into the future.

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

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 BMPPAS.

We have reviewed all responses and are maintaining our consultation position which corresponds to a reduction of baseline margin 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[7]
- A reduction of £6.955m due to DCC's performance in the SMETS1 Project between RY18/19 and RY22/23

Baseline Margin Adjustment (BMA)

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

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. We have reviewed all consultation responses and have decided to maintain our consultation position (an adjustment of £10.424m) with the exception of a change in

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

margin associated with a change in the total disallowed Internal Cost. We are directing a reduced adjustment of **£13.055m** to reflect:

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

External Contract Gain Share (ECGS)

The DCC Allowed Revenue formula includes an ECGS term that allows for an upward adjustment to DCC's revenue in recognition of a reduction in External Costs that DCC helped achieve. Between RY15/16 and RY22/23, DCC has secured cost reductions of £263.42m in External Costs based on DCC's ECGS applications and brought benefits including this year's application of £150.3m (57% of total cost reductions) to DCC's customers through lower charges.

DCC has applied for a Relevant Adjustment of £5.208m across RY22/23 to RY25/26. We maintain our consultation position, which is 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.

Switching Programme

Separately to the BM, DCC receives margin on the Switching Programme, which is at risk under a separate performance regime. We have considered stakeholder responses, and our position remains unchanged. All forecast costs for RY24/25 to the end of the Licence period will be disallowed due to a lack of justification for these costs.

The fifth delivery milestone under the Design, Build and Test Phase of the Switching Programme occurred this year in RY22/23. DCC will retain 100% of margin associated with this milestone as all targets were achieved. As the Design, Build and Test Phase has now concluded, the final value this milestone represents in terms of margin retained is £2.74m.

In RY22/23, we also made a final determination on the Discretionary Recovery Mechanism (DRM), a project specific incentive that allowed DCC to recover up to 30% of any margin lost under the DBT incentivisation framework, contingent on performance in its stakeholder engagement activities. We further decided on 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 data quality. We award DCC 17.25% of its lost margin under the DBT equating to £0.099m (from a total lost margin of £0.576m) of the DRM and an upward adjustment of £0.105m under the DDR.

Future Proposals for Baseline Margin and Shared Services Charges

As part of our November 2023 consultation, we also consulted on proposals to adjust DCC's Baseline Margin (BM) level from 15% to a value in the range of 7-9%; a lowering of the existing Shared Services Charge (SSC) from 9.5% to 4.5%; and our proposal for services provided to DCC by Capita to no longer attract any additional baseline margin.

We have reviewed all responses and accept the view that our proposal for services, provided to DCC by Capita, to no longer attract any additional baseline margin, could potentially constitute an unjust distortion of competition and an imposition of an arbitrary competitive disadvantage on Capita against its rivals. We have decided not to implement this proposal on those grounds but will instead impose additional reporting requirements on DCC for where services are being procured from Capita.

We will be seeking further evidence from DCC and Capita to inform our decisions on the adjustment of DCC's BM levels as well as our proposal to lower the SSC.

Allowed Revenue Decision

Our decisions on the various components outlined above results in a total Allowed Revenue over the entire Licence period of **£4.97bn**[8,9] (including Pass-Through Costs). Please see Appendix 1 for Allowed Revenue as proposed by DCC and the impacts of this year's decision.

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

1. Introduction

Context

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

1.2 DCC was awarded a Smart Metering Licence[10] in 2013 to undertake this activity. Under this Licence DCC is entitled to an Allowed Revenue which is the total amount of revenue determined on an accrual's basis in relation to each Regulatory Year in accordance with the Principal Formula set out at Part C of Condition 36 (Determination of the Licensee's Allowed Revenue) after the deduction of Value Added Tax (if any) and any other taxes based directly on the amount concerned.

1.3 Licence Condition (LC) 36, supplemented by LCs 35-41, sets out how DCC's Allowed Revenue is determined. These conditions enable the Authority to assess whether costs should be excluded from any future calculation of the Licensee's Allowed Revenue under Condition 36 on the basis that they have not been economically and efficiently incurred in the relevant Regulatory Year ("the Unacceptable Costs").

1.4 In determining the Licensee's Allowed Revenue, the Authority is under a statutory duty to do so in a manner that it considers best furthers our principal objective[11] - namely, when carrying out its functions in such a way as to protect the interests of existing and future consumers. In addition, and specifically when determining the Licensee's Allowed Revenue, it must have regard to the need to ensure that the Licensee is able to finance the activities which are the subject of the obligations imposed under the relevant Acts and the Licence.

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

1.5 Under this legislative and regulatory framework,[12] we have a role in ensuring that DCC's costs are incurred economically and efficiently. We review DCC's costs and performance after the end of the Regulatory Year in which the costs were incurred, as well as forecast costs that DCC deem certain enough to include in its forecast Allowed Revenue. This approach is referred to as an 'ex-post' price control. DCC must submit price control information by 31 July following each Regulatory Year in line with the Regulatory Instructions and Guidance (RIGs).[13] Price Control reporting covering the Regulatory Year from 1 April 2022 until 31 March 2023 was submitted on 30 July 2023.

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

1.7 All other costs incurred by DCC in relation to the provision of the service are either Internal Costs, Pass-Through Costs,[14] or costs associated with the Centralised Registration Service.[15]

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

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

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

1.10 DCC also applied to amend the ECGS term of its Allowed Revenue as a result of External Cost savings. The ECGS is a mechanism within the price control that allows DCC to apply to increase its Allowed Revenue in recognition of its instrumental role in reducing External Costs.

Related Publications

1.11 DCC's Licence is at: Smart Meter Communication Licence

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

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

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

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

1.16 This year's consultation document is at: DCC Price Control consultation: Regulatory Year 2022/23

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

Our decision-making process

1.18 The DCC Price Control process should be viewed in the wider context of helping to achieve Ofgem's key priorities and principal objective:[16]

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

[16] See *Our Strategy and Priorities:* www.ofgem.gov.uk/about-us/our-strategy-and-priorities

1.19 As required by the DCC Licence,[17] our assessment of DCC's costs is justified by comparing DCC's incurred costs and revised forecast with DCC's Licence Application Business Plan (LABP) and the previous year's forecast. Our guidance document[18] sets out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient.

1.20 We published a consultation in November 2023[19] with our detailed proposals concerning RY22/23 and conducted a stakeholder meeting on the consultation in December 2023. This document sets out our decisions on DCC's:

- Incurred and forecast External Costs for RY22/23 (Section 2)
- Incurred and forecast Internal Costs for RY22/23 (Section 3)
- Performance under the Operational Performance Regime (OPR) (Section 4)
- Application for an adjustment to its Baseline Margin and External Contract Gain Share (Section 5)
- Switching Programme, Costs and Performance (Section 6)
- Future Baseline Margin and Shared Services Charges (Section 7)

1.21 We received eleven responses to the November 2023 consultation. There were two confidential responses with the remainder non-confidential. All non-confidential responses are published on our website.[20] We have fully considered all responses received to our consultation. We have summarised the key points received from the responses and provided an explanation of the reasons for our decisions.

Following publication of our November 2023 consultation, we ran a second, seven-day, consultation at the end of January 2024 to further inform our Price Control assessment and decision-making. This was considered appropriate in light of further evidence having been received from DCC, in relation to the costs associated with 4G Comms Hubs & Networks,[21] and the Service Desk.[22] Due to the commercially sensitive nature of the information underpinning our proposals,

[17] Licence Condition 37 of the Smart Meter Communication Licence
[18] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[19] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122
[20] Ibid.
[21] Agreement for the provision of services in respect of the Network Evolution Programme relating to the Smart Metering Programme.
[22] Agreement for the provision of Service Desk services.

the follow-up consultation was undertaken solely with DCC. However, for transparency we have set out our position and reasoning for our decision within this document.

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

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

1.24 For further context to these decisions please read this document alongside our November 2023 and February 2024 consultations on the RY22/23 Price Control. Both consultation documents describe how DCC's costs have changed since the previous year and outlines our view on whether we think DCC's explanation in its Price Control submission justifies the cost variances. It also summarises our proposals on whether to accept DCC's application to adjust the BM and ECGS terms.

Decision-making stages

Date	Stage description
08/11/2023	Stage 1a: Consultation (I) open
29/12/2023	Stage 2a: Consultation (I) closed, Deadline for responses.
15/01/2023	Stage 3a: Responses Consultation (I) reviewed.
30/01/2024	Stage 1b: Consultation (II) open
09/02/2024	Stage 2b: Consultation (II) closes, Deadline for responses.
16/02/2024	Stage 3b: Responses Consultation (II) reviewed.
28/02/2024	Stage 4: Consultation decision and responses published.

General feedback

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

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

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

2. External Costs

Section summary

Most responses to our consultation were supportive of our proposals on External Costs. Stakeholders generally agreed with our positions on proposed cost disallowances in the context of, in many cases ongoing, concerns around DCC's contract management and procurement processes, performance issues in the SMETS1 service, and the quality of DCC's forecasting and reporting. DCC disagreed with all of our proposals and submitted further evidence and clarifications in support of its arguments. DCC's counterarguments were made both on procedural and methodological grounds.

Following consideration of all representations, we have decided to amend some of our positions, while maintaining others. First, in respect of DCC's procurement of an interim solution for the SMETS1 supply chain, we have maintained our consultation position for a partial disallowance of build costs paid to the original service provider; however, we have accepted DCC's additional evidence and explanation and reduced to zero our disallowance proposal for 'dual payment' of running costs, deferred disallowance of service uplift and management charges to April 2024, and reduced the disallowance for future running costs of the replacement solution post-April 2024. Secondly, we have reduced our proposed disallowance of costs associated with SMETS1 service stabilisation accepting DCC's explanation for previously unjustified costs. Thirdly, following a second consultation with DCC in January 2024, which reflected new evidence, we have amended our disallowance of inefficient resource costs of directly awarded contracts in the 4G Comms Hubs & Networks programme. This decision considered DCC's arguments around the impact of indexation on data in our model. Finally, we have accepted DCC's evidence and clarifications for previously unexplained costs and decided to reduce our proposal for disallowance of DSP and CSP-C&S forecast External Costs.

Altogether we have determined that £3.714m of External Costs incurred in RY22/23 and further £37.689m in forecast External Costs over RY23/24-25/26 have been Unacceptable and shall be removed from DCC's Allowed Revenue.

Questions from the consultation

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

3. **What are your 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?**
4. **What are your views on our proposal to disallow £44.054m in forecast FSP External Costs?**
5. **Do you have any other views on External Costs?**

Q1 SMETS1 supply chain

Background

2.1 In 2021, a subcontractor of one of DCC's service providers (SP) experienced financial difficulties – to ensure continuity of service DCC stepped in, directly procuring a new service provider to deliver the service as an 'emergency interim measure'.

2.2 DCC sought to justify associated set-up ('build') costs and enduring charges ('run costs'). We have consulted on cost disallowances in four areas of concern: dual running costs paid to the original SP, build costs paid to the original SP, enduring costs paid to the new SP, and service uplift and management charges paid to the original SP. Our decisions on each of these are set out below.

Summary of views from respondents (other than DCC)

2.3 Due to the commercially sensitive nature of the proposals, particularly in relation to contractual arrangements between DCC and its service providers, some details were deemed not to be appropriate for wider consultation. As such we did not receive comments on the specific cost disallowances from most respondents.

2.4 Nonetheless, some industry stakeholders, acquainted with the details of the case, agreed that circumstances were exceptional, acknowledging the speed with which the new solution was developed and transitioned to, the successful protection of service continuity and the constraints DCC faced in finding a suitable replacement provider. One respondent observed that any assessment of value for money and continuity of service should be carefully balanced, giving consideration to circumstances outside DCC's control.

2.5 However, others questioned the economy and efficiency of associated costs, with several respondents supporting our position on any dual running costs and future costs following the expiry of the interim emergency solution. One respondent was of the view that the proposed cost disallowances would incentivise DCC to drive down future costs. We have provided any specific comments we received in relation to individual issues below.

Issue 1 – Dual running costs

Proposals at consultation: *disallow any charges paid to the original SP following commencement of service provision by the new SP which would have constituted a double payment (proposed disallowance of £1.716m in RY22/23 and £0.858m in RY23/24)*

Decision: *accept DCC's evidence and reduce the proposed disallowance to zero*

2.6 While the new SP had commenced providing the service from August 2022, DCC did not change its contract with the original SP until July 2023, when charges for the defunct solution were formally removed from the agreement. We said we did not consider dual running charges to be economic and efficient, and consulted on their disallowance.

Respondents' views

2.7 DCC contested our proposal, arguing that despite the contractual changes were not executed until July 2023, DCC was not billed for any service for the defunct service from October 2022. DCC provided evidence of billing records showing that the contracted charges were set against zero volumes, therefore resulting in no actual expenditure.

2.8 DCC then sought to justify a small overlap in service provision resulting in dual running costs of £0.29m for a period of five weeks. DCC argued that this overlap was required to de-risk the transition.

2.9 One respondent supported DCC's position, acknowledging the critical nature of the service being transferred.

2.10 Two respondents supported our view that DCC should not be in a position of making duplicate payments for the same service.

Reasons for our decision

2.11 We are satisfied that DCC's additional evidence proves that no costs were incurred under the original agreement from 1st October 2022. Whilst we maintain our position that such dual costs would not have been economic and efficient, given no payments were made by DCC, the effective disallowance is reduced to zero.

2.12 We accept DCC's argument, and acknowledge support from another respondent, that a short period of overlap between the two solutions was appropriate to ensure an orderly transition and mitigate against the risk of service disruption post 'switch-off' of the outgoing service. We acknowledge that DCC and its SPs managed the transfer well and without any service interruption. We are therefore not removing these costs (£0.29m) from DCC's Allowed Revenue for RY22/23.

Issue 2 – Build costs paid to the original SP

Proposal at consultation: *disallow a portion of build costs paid to the original SP (proposed disallowance of £2.443m in RY22/23).*

Decision: *unchanged from our consultation.*

2.13 Although we accepted the full amount of build costs paid to the incoming SP for the set-up of, and transition to, the new solution, we proposed to disallow a portion of build costs associated with two project requests (PRs) paid to the original SP. One PR related to the procurement of third-party licences for a private cloud emergency interim capability, the other PR covered equipment and service costs for a second (back-up) data centre. We were particularly concerned about the lack of evidence of any risk and cost sharing between DCC and its contracted SP, and considered that the costs, relating to service replacement, should have been borne by the contractor.

Respondents' views

2.14 One respondent expressly agreed with our proposal, noting that in a competitive market a party should rectify a failure of its subcontractor so as not to lose customers. This principle should apply to DCC and its SPs. As such, the set-up costs of the new SPs should not be passed on to consumers.

2.15 DCC disagreed with our proposal. DCC argued that the costs were necessarily incurred to meet the DCC Business Continuity and Disaster Recovery obligations imposed under the Smart Energy Code (SEC); specifically, requirements for having in place two separate data centres. DCC stated that it drove value for money through effective contract management, *eg* by ensuring a tightly defined scope and monitoring expenditure.

2.16 More generally, DCC acknowledged that a failure of a subcontractor would have been the responsibility of the SP to resolve, including associated liabilities; however, DCC stated that in this instance it had to act in advance of the subcontractor's default on the direction from the Government and Ofgem to protect business continuity. In its view, DCC had no option but to remove financial liabilities and come to a negotiated agreement with the SP. Furthermore, DCC explained that since October 2021 it had been working on a longer-term replacement solution accepted by the SP. However, that solution was rendered impossible to implement due to the accelerated demise of the subcontractor and the need to find a suitable replacement on a constrained timeline during spring and summer 2022. DCC's contract did not require the SP to provide any of the services associated with the move to the DCC-selected emergency provider.

Reasons for our decision

2.17 We do not dispute the necessity of the expenditure in meeting disaster recovery requirements and setting up of the new solution. However, based on evidence of DCC's contractual position and its approach to negotiating with the SP, it is our view that DCC failed to appropriately mitigate against the risk of the subcontractor's failure.

2.18 DCC and its SP were aware of the risk of the default of the relevant subcontractor at the time of negotiations of contract extension in October 2021. However, DCC agreed that the continuation of the full contract should be conditional on the adoption of a solution preferred by the SP. The execution of this solution would take significant time to implement. When the insolvency risk reached critical levels in the spring 2022 and DCC proceeded with the emergency 'lift and shift' transfer to its selected SP, the negotiated solution had to be abandoned (as it was unimplementable until 2023).

2.19 By predicating the continuation of its contract on the successful implementation of a specific solution, DCC in effect left itself, and its customers, exposed to the risk that the subcontractor's failure may occur before the solution could be executed. The removal of financial liabilities was not justified by DCC.

2.20 We reject the argument that DCC was put in this situation by a direction from the Government or Ofgem to protect business continuity. DCC was, or should have been, aware that the subcontractor was providing a critical service which would have to be maintained in any event and should have acted accordingly when negotiating the contract extension with its SP. It is DCC's responsibility to ensure that its contracts protect business continuity[23] and balance it against cost

[23] In line with LC 16.12

efficiency and value for money. DCC failed to strike this balance on this occasion by accepting 100% of costs.

2.21 Finally, we are concerned that DCC may have acted in breach of its Licence by not seeking a 'non-objection' from the Secretary of State for its proposed amendments and extension to the contract.[24] This additional scrutiny may have alerted DCC to the risks of its strategy. We will engage with DCC further to understand the reasons for its decision to not follow the expected process.

2.22 For these reasons, we maintain our proposal and consider £2.443m to be Unacceptable Costs which shall be removed from DCC's Allowed Revenue for RY22/23.

Issue 3 – Enduring run costs

Proposal at consultation: *accept higher run costs incurred by the new SP but disallow all costs following the expiry of agreed emergency solution in April 2024 (proposed disallowance of £4.471m in RYs 24/25 and 25/26).*

Decision: *reduce the disallowance of future run costs to the levels prior to the change of the SP: Disallow £1.036m in RYs 24/25 and RY25/26.*

2.23 To quickly stand up a suitable replacement solution and avoid service disruption, DCC negotiated directly with a preferred SP, adopting a 'lift and shift' approach. We acknowledged that DCC was constrained in its options to find a suitable replacement SP and accepted the overall interim emergency measure, including its higher run costs, until, but no longer than, its contracted end-date in April 2024, whereafter DCC should have a competitively reprocured enduring solution in place.

Respondents' views

2.24 Several respondents explicitly supported our proposal to disallow forecast costs. One respondent stated a competitive reprocurement should run as soon as possible.

2.25 DCC disagreed with our proposal on two grounds:

- First, DCC argued that due to the complexity of the solution, contracts with both the original and the new SPs were not finalised until August – it would be impractical to launch reprocurement 'whilst baseline was in flux'. DCC said

[24] LC 16.6A-C

that a reprocurement would commence in early 2024. In DCC's view, therefore, April 2024 should not be regarded as the 'earliest possible date' for the implementation of a newly procured service.

- Secondly, DCC contended that Ofgem should not disallow the forecast costs in their entirety. DCC expects to require contract extensions until end-2026 to conclude the procurement exercise and will necessarily incur at least some economic and efficient costs.

Reasons for our decision

2.26 We have not received any satisfactory explanation for the delays in reprocurement: neither for the 12-month period required to 'finalise' the old and new contracts, nor for the more than 6-month delay since August 2023 to issue an RFP. Moreover, given DCC's decision to opt for a 'lift and shift' solution for the interim service, it is unclear why DCC has been unable to articulate baseline requirements for the procurement and engage the market.

2.27 We recognise that pending the implementation of an enduring solution, DCC will continue to incur costs to keep the service operable. Nevertheless, given the lack of market testing and competition, hastily agreed terms and conditions, and, in DCC's own admission, technical inefficiencies inherent in the solution compared to the original integrated design, we do not consider the cost of the current arrangements to be fully economic and efficient. In the absence of a competitively procured contract, following the end of the emergency term in April 2024, we will only accept the previously justified economic and efficient costs, being the costs of the service under the original contract. We have therefore decided to amend our consultation position and reduce the disallowance from the full £4.471m per annum (pa) to £1.037m pa from RY24/25. This will allow DCC to recover £3.434m pa, in line with the previous costs of this service. We will continue to engage with DCC on this issue to ensure a sustained progress towards a compliant and efficient reprocurement.

Issue 4 – Service uplift and management charges

Proposal at consultation: *disallow newly introduced service uplift and management charges paid to the original SP (proposed disallowance of £0.731m in RY23/24, £0.973m in RYs 24/25 and 25/26).*

Decision: *defer disallowance of service uplift & management changes to RY24/25 in line with decision on enduring run costs.*

Background

2.28 In July 2023 DCC executed an amendment to its original contractual agreement which introduced new monthly charges for service uplift and management. We did not see sufficient justification for these additional costs, particularly given the elevated enduring costs and high build costs and consulted on their removal from DCC's forecasts.

Respondents' views

2.29 DCC disagreed with our proposal, explaining that the charges result from a shift from an integrated contractor-subcontractor environment to a solution involving two separate SPs. Specifically, DCC set out the following drivers:

- Service Uplift and Management (2 FTEs) to monitor and ensure performance of the new SP
- The loss of Control Plane software
- Functional differences including charged service and technical model resulting in increased incidents and operational issues, and different code change hours increasing out of our support provided by the original SP

2.30 DCC further argued that Ofgem should explain how DCC could have delivered this service more efficiently.

Reasons for our decision

2.31 We accept DCC's explanation that the move to a new operating model may have resulted in challenges that these additional services sought to address. However, the fact that DCC required, after 10 months following the service transfer, the inclusion of these additional costs, shows that the replacement solution has been overall less efficient than the previous arrangement.

2.32 Our decision is to accept these charges as part of the overall package of interim measures. However, in line with our decision not to accept the net-increase in costs following the due expiry of the interim emergency solution, we have decided to remove these costs from DCC's Allowed Revenue from RY24/25, thus deferring our disallowance proposal from July 2023 to April 2024.

Final observations

2.33 We recognise that the overall execution of the service transfer was successful and prevented service disruption. We also acknowledge the time constraints DCC faced when putting in place the emergency measures. For those reasons, we are allowing DCC to recover:

- All of the set-up costs incurred by the incoming SP
- Most of the set-up costs paid to the original SP, save for a portion of costs disallowed as per paragraph 2.22
- All enduring charges, which are 30% higher than under the previous solution, until the end date of the interim period in April 2024
- Further charges associated with service uplift and management until the end of the interim period in April 2024

2.34 However, we do not believe DCC's actions in managing the risk around the subcontractor failure, and associated build costs, were fully justified. Our decision to disallow a portion of the build costs represents the *minimum* amount of cost sharing that DCC should have achieved. We have ongoing concerns about DCC's ability to effectively hold its SPs to account and will continue to focus on this area in future price controls.

2.35 We are also disappointed by the lack of progress DCC has made towards a re-procurement of the service and associated contracts. We would remind DCC that the existing solution remains non-compliant with the Licence.[25] We will continue our engagement with DCC on this matter; as set out in our recent letter dated 13 February 2024, we expect DCC to produce and follow a rectification plan towards putting in place a compliant enduring solution. We will keep DCC's expenditure on the interim arrangement under review in the upcoming price control cycles.

2.36 The summary of our decisions is set out in table 2.1 below. The highlighted cells mark where we have made changes to our consultation positions.

[25] LC 16.4-6

Table 2.1: Disallowance decisions per RY, in [£m] – changes to our consultation highlighted

	RY22/23	RY23/24	RY24/25	RY25/26
Dual running charges	-	-	-	-
Build costs	2.443	-	-	-
Run costs of new solution	-	-	1.037	1.037
Service uplift & management	-	-	0.937	0.937
TOTAL	**2.443**	**-**	**1.974**	**1.974**

Q2 SMETS1 service stabilisation

Background

2.37 In RY22/23 the SMETS1 programme continued to experience technical issues and slower migrations with performance of relevant SPs at times falling below expected levels and additional costs required to support the service.

2.38 DCC sought to justify new costs associated with:

- Operational Maintenance Releases carried out throughout the year, incl. work on resolving solution defects
- Operational incidents in areas of incorrect implementation of the solution design
- A design change to account for higher-than-expected failures
- Technology refresh and end of life service to ensure continued operational support
- Improvements to operational capacity to meet industry demand

2.39 We have identified issues and consulted on disallowances across two areas: costs attributable to a service failure or poor delivery by a service provider; and unjustified costs incurred by SPs whose poor performance had demonstrably contributed to the additional costs. We set out our decisions on each issue below.

Summary of views from respondents (other than DCC)

2.40 Five respondents who commented on this area agreed with our proposals, with most highlighted continued issues with the service:

- One respondent observed repeated incidents and outages affecting the ability of suppliers to enrol SMETS1 meters; another pointing out that numerous initiatives to uplift the service did not result in overall improvement in performance

- Two respondents agreed with our view that DCC customers should not have to bear the costs associated with under-delivery or poor performance of DCC's service providers, while another pointed to apparent failings in DCC's contract management, evidenced by DCC's inability to apply service credits to the SPs

2.41 One party commented on the quality of information provided by DCC in the RIGs, noting that a disallowance of unjustified costs could be an effective incentive on DCC to make improvements.

2.42 DCC's own arguments are set out below in relation to each issue.

Issue 1 – Costs attributable to a service failure/poor delivery

Proposal at consultation*: (1) disallow £0.693m in costs of Maintenance Releases where DCC identified the root cause of issue a service provider; (2) Disallow £0.651m and £0.085m in costs of PRs associated with design change required to remedy 'rollback failures' and an operational incident within DCO, respectively.*

Decision*: reduce proposed disallowance to 50%, £0.714m, in RY22/23.*

DCC's response

2.43 DCC disagreed with our proposals. Regarding the proposed disallowance of costs associated with Maintenance Releases and a DCO operational incident, DCC explained that those costs were 'consequential', that is incurred by providers within the supply chain impacted by another SP's failure. DCC explained that its contracts do not allow for a passthrough of consequential costs. DCC posited that introduction of SP liability for consequential costs would risk increasing the overall costs of the contracts due to risk pricing.

2.44 DCC further explained that defects are a standard part of any software release process with the use maintenance releases being 'routine'. DCC observed that the rate of defects was in line with industry average and argued that it had shielded customers from most additional costs by successfully challenged 69 out of 77 defects, which were subsequently paid by the SP at fault.

2.45 With respect to design change costs for rollback failures, DCC argued that Ofgem had not considered the counterfactual: to identify the true scale of rollback failures would have required testing in a preproduction environment (PPE). DCC explained that this option had not been found to be economic as DCC had been quoted at minimum £4m for a PPE, without a guarantee that the PPE testing would identify all potential issues. DCC therefore considers that costs of fixes and design changes provide overall better value for money.

2.46 DCC stated that the inclusion of the DCO functionality in the design of the SMETS1 architecture had been on government's insistence. DCC considers that its proposed solution (to build a new head-end) would have reduced the amount of SMETS1 migration issues.

Reasons for our decision

2.47 In line with our decision on a related issue in RY21/22,[26] DCC customers should not pay for poor performance or delivery of DCC's SPs where issues are within DCC's or its SPs' control or where DCC should be recovering such costs under its contract – passing costs to customers must be demonstrably the only or the most economic and efficient option. We do not consider a cost passthrough to be justified in this instance as (a) singular or shared responsibility can be determined, and (b) DCC has not showed it had acted in line with risk sharing principles and exercised its contractual provisions.

2.48 **Determining responsibility:** First, we consider that these issues were within control of DCC and its SPs. In two of the three cases (Maintenance Releases and DCO operational incident), DCC itself was able to assign the root cause to a SP. In the case of the design change, DCC had carried out the initial testing and assured its outcome. We have seen no evidence that DCC had objected to proceeding with the cohort on account of a lack of PPE. The subsequent implementation of the solution has then been the responsibility of the contracted SP. DCC and the SP therefore share in the responsibility for addressing the higher-than-expected occurrence of the rollback failures.

2.49 **Utilising contractual provisions:** Effective risk sharing is one of key principles of good contract management. This includes a principle that a contractor should fix own defects and assume responsibility for associated additional costs (a 'polluter pays' principle). DCC's contracts include provisions that require SPs to provide fixes at own cost and permit DCC to seek financial remedy under various circumstances, including for adverse impacts on SMETS1 SP. Moreover, despite DCC's own argument that treatment of consequential costs could lead to increase in the risk price-in, we understand that DCC is already enhancing the 'polluter pays' provisions in its newly negotiated contracts, which is a welcome

[26] Ofgem (2023), DCC Price Control Decision Regulatory Year 2021/22, 2.14-2.21. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202122

development. However, we have not seen evidence of DCC effectively using these provisions and principles in relation to the costs subject to this disallowance proposal.

2.50 It is DCC's responsibility to derive value for money from its contracts on behalf of customers and, by extension, consumers. We recognise that the appropriate level of risk and cost sharing will depend on the specific merits of each case, and we accept that there may be limitations to DCC's ability to ascribe responsibility and/or enforce its contracts. Nonetheless, we are not satisfied that DCC has struck the right balance by accepting a 100% passthrough of the 'consequential' costs and design change costs. On account of the shared responsibility between DCC and its SPs and, and in the absence of DCC's justification on appropriate level of risk sharing, on this occasion we conclude that risk should be shared at minimum equally. As such, we have determined that 50% of the impacted costs (£0.715m) should be considered Unacceptable and consequently removed from DCC's Allowed Revenue for RY22/23.

2.51 For the avoidance of doubt, it remains for DCC to decide how it chooses to structure or enforce its contracts. However, we would expect DCC to be able to demonstrate how risk and costs have been shared fairly in each instance. We will continue to engage with DCC further on this issue.

Issue 2 – Unjustified costs

***Proposal at consultation**: disallow up to £1.246m in RY22/23 in costs incurred by SPs whose poor performance demonstrably contributed to the identifiable Unacceptable Costs, and which lacked any justification.*

***Decision**: accept DCC's evidence and reduce this disallowance proposal to zero.*

DCC's response

2.52 DCC disagreed with our proposal. First, DCC explained that £0.523m of the costs were related to activities *not* associated with service stabilisation and had been reported as such by mistake due to a 'coding error'. DCC provided an itemised breakdown with an explanation for each activity.

2.53 DCC then sought to justify the remaining £0.746m incurred on service stabilisation activities, which included a platform upgrade before a due expiry of tech support, and three small items covering: testing carried out for an incident fix, identifying a server problem and fix of top-up vends issue (together these accounted for less than £100k).

Reasons for our decision

2.54 We are disappointed that DCC's regulatory reporting continues to be prone to errors resulting in inaccuracies which lower the confidence in the submitted information. Nonetheless, we are satisfied with DCC's justification for the activities *not* related to service stabilisation and, consequently, do not proceed with a disallowance of the associated costs.

2.55 We also acknowledge DCC's additional evidence in support of the missing stabilisation activities. We note that over 90% of those costs were driven by a single PR for a necessary platform upgrade. We are satisfied that this expenditure was not incurred as a result of that supplier's failure or poor performance and therefore doesn't meet the grounds for our disallowance proposal. We are therefore revising our consultation position in this area and do not proceed with a disallowance. However, we would stress that DCC should be able to accurately report and justify all costs. We will continue to closely monitor this area in future RYs.

Q3 4G Comms Hubs & Networks: Procurement of new Fundamental Service Capability

Proposal at consultation*: disallow up to the full amount of costs associated with one of DCC's newly procured contracts.*

Proposal at second consultation:[27] *disallow a portion of resource costs across two contracts above an efficient benchmark totalling £5.695m, of which £0.827m in RY22/23.*

Decision*: accept DCC's argument regarding adjustment for indexation: reduce disallowance to £3.384m across both contracts, of which £0.557m in RY22/23.*

First consultation

2.56 In RY22/23 DCC entered into two separate contracts with a new service provider for the provision of services for the 4G Comms Hubs & Networks programme. DCC negotiated these directly with a selected SP on account of insufficient time to carry out a full competitive procurement. In one case, this was after a withdrawal of two bidders from the competition; in the other case, no competition had

[27] At the end of January 2024, reflecting further evidence obtained from DCC, we issued a second consultation to DCC which included a modified set of proposals for the new 4G CH & Network contracts.

initially been envisaged as DCC had expected to be able to provide this capability from own resources.

2.57 In our November 2023 consultation, we expressed concerns in relation to one of the contracts (Component Integrator) across three areas: DCC's approach to the non-competitive procurement and the extent to which circumstances were within or outside DCC's control, the impact of the direct award on DCC's negotiation position, and the resulting costs and value for money of the contract. Subject to further information provided by DCC, we consulted on disallowing up to the full amount of associated costs.[28]

2.58 Our proposal received support from respondents – of those who commented on the issue, all except DCC agreed with our approach; specifically:

- Three respondents expressed concern about DCC not following the correct procedures and processes for procurement of Fundamental Service Capability
- A couple of respondents commented on the lack of transparency afforded to industry stakeholders in scrutinising DCC's costs and procurements
- One respondent noted that the disallowance amount should represent the portion of excess costs of the direct award over than from a competitively awarded contract
- One respondent proposed that the programme should become the focus of future audits

2.59 DCC disagreed with our proposed position on the grounds that it would not be reasonable for Ofgem to disallow all costs of a contract, arguing that "there is a market price for such a service". DCC further noted that "if Ofgem disagrees with [DCC's] position, the [Price Control] Guidance entitles Ofgem to carry out its own benchmarking exercise".

2.60 To help our cost assessment, we sought further information on these contracts throughout November 2023-January 2024. We obtained and were able to interrogate, among other evidence, detailed financial models underpinning both contracts, which revealed costs associated with the service resource profile, tech priming costs, discretionary and non-discretionary contingencies and agreed contractor margin. We were also able to confirm that both contracts shared the same rate cards, although specific resourcing requirements differ. DCC sought to

[28] Ofgem (2023), DCC Price Control consultation: Regulatory Year 2022/23, paragraph 3.82. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202223

justify the negotiated price by explaining that the contractor's margins were market competitive and that the rate cards behind the resource costs had been negotiated on the basis of recently negotiated rates for another service, reached through a competitive process. DCC further argued that the contractor will be expected to utilise offshore resources at significantly lower rates, and that additional secured investment should result in current and future cost avoidance.

Second consultation

2.61 Having obtained further evidence, we carried out our own benchmarking exercise to test DCC's negotiated price against an efficient counterfactual.[29] Both contracts were for heavily resource-focused services; as such, we have focused on benchmarking the rate cards underpinning the resource profile driving the vast majority of the cost.[30]

2.62 To calculate an efficient benchmark, we considered DCC's internal rate card data submitted to us through the price control. These rates were obtained from contractors working for companies within DCC's supply chain and could provide a rich dataset of rates for different roles and skillsets at various seniority levels. We considered these to be representative of the market for services in which DCC operates and from which it procures. Had DCC been procuring the contracts competitively, it is reasonable to assume that it would have engaged service providers within this mix or offering comparable rates. The rates were inclusive of fees. While each supplier will set their own fees and these cannot be inferred from the rates alone, the overall rate profile will be market reflective.

2.63 Using the internal rate card data, we established an efficient benchmark for roles within 19 distinct job families each consisting of six grades of seniority. Our model then compared the agreed rate individual roles within the resource profile against a corresponding role and seniority at the efficient benchmark. This comparison was made separately for onshore and offshore roles. By applying this methodology, we were able to reconstruct the resource profile of each contract. We considered this to be the economic and efficient price (cost + margin) of resource for each contract.

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[29] In line with paragraph 2.57(vi) of our Price Control Guidance. See Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[30] This means that our exercise did not test other aspects of the agreed price, specifically tech prime or non-discretionary contingency, which have been removed from the comparison.

2.64 The outputs of our model revealed a material deviation in the *expected* and agreed resource price within each contract. We acknowledged model limitations in calculating the efficient benchmark for offshore rates and proposed a partial disallowance in onshore rates above our benchmark.

DCC’s response

2.65 DCC strongly disagreed with our new proposals arguing on procedural and methodological grounds.

2.66 DCC’s key procedurals arguments were:

- Ofgem has not consulted other stakeholders
- Ofgem should have only used information form DCC’s consultation response
- Ofgem had the necessary information prior to its November 2023 consultation
- DCC wasn’t afforded sufficient time to review Ofgem’s model and respond accordingly

2.67 The main methodological arguments were as follows:

- Ofgem should have only used rate cards of organisations similar to the incumbent SP
- Ofgem’s approach of setting the efficient benchmark at an average deviate from its contractor benchmarking methodology used for assessment of Internal Costs, where Ofgem accepts a 10% uplift on contractor day rates and has previously accepted the 75th percentile for specialised roles
- The data used by Ofgem is out of date as it comes from RY20/21 submission. As such it does not reflect indexation
- Ofgem disregarded benchmark provided by DCC comparing the rates to a previously negotiated contract with the same SP, awarded in a competition

Reasons for our decision

2.68 We disagree with DCC’s procedural arguments:

- First, under LC 37.9(a) in deciding whether to make a direction to exclude certain costs from DCC’s Allowed Revenue under LC 37.6, Ofgem is required to consult with the Licensee. Ordinarily, we seek wider views to inform our positions and to provide transparency for our decision making as we did through our November 2023 consultation. However, we judged that in this instance, given the narrow scope of the second consultation and the highly confidential nature of the underlying cost assessment, a public consultation was on balance not required. To provide additional transparency, we are publishing relevant details as part of this decision.

- Secondly, the purpose of our information request issued to DCC in November 2023 was to obtain information in areas that have not been responded to by DCC, either in part or in full, during the price control process. The information was obtained to enable us to carry out our regulatory duty in respect of price control assessment pursuant to LCs 35-39.
- Thirdly, the information used to construct our benchmarking model came from the financial models obtained in December 2023. It was not available to us before 8th November 2023.
- Finally, DCC was provided with a full copy of our model including assumptions, was invited to ask questions about or proposals, and, despite the shorter timeline, was ultimately able to respond to our consultation without requesting further deadline.

2.69 We acknowledge DCC's comments about our methodology. Below we address each of DCC's arguments in turn:

- First, whilst our dataset includes a blend of rates, we consider that this provides an appropriate benchmark – had DCC competed the services on the market, it would have engaged a range of organisations, each potentially offering a different resource profile and rate structure. DCC elected to directly approach a specific type of organisation with potentially higher rates, but this decision should not have a bearing on the selection of data used for benchmarking
- Secondly, wherever our model required an element of rounding or subjective judgement, we have consistently chosen an approach favourable to DCC. We consider that this in-built bias in favour of DCC justifies our approach to setting the efficient benchmark at the average rate without an additional upward adjustment
- Thirdly, we accept DCC's argument that our dataset has not accounted for inflation. The data had been submitted to Ofgem for RY20/21. We have therefore applied an indexation uplift between April 2021 (the first month in which the dataset can be considered out of date) and May 2022 (when DCC negotiated the rate cards for its newly procured contracts) to the raw data used in our model

- Finally, we recognise that, in aggregate, the contracted rate cards appear to be in line with the rate card information from a previously awarded contract to the same organisation in competition against other service providers. However, we consider that our approach allows for a wider comparison against the full supply chain, as opposed to a comparison derived from a single procurement resulting in the award to the same SP

2.70 Upon inflation adjustment in recognition of DCC's counterargument, our model has revealed a diminished, nonetheless significant, variance between our efficient benchmark and the negotiated resource price. We maintain our consultation position that costs above this benchmark should not be considered economic and efficient and should be disallowed. Our decision is to remove from DCC's Allowed Revenue £3.384m over the Licence term, with £0.557m in RY22/23. Table 2.2 below sets out the breakdown of our disallowance determination.

Table 2.2: Disallowance decisions per RY, in [£m]

	RY22/23	RY23/24	RY24/25	RY25/26
Contract 1	0.155	0.358	0.198	-
Contract 2	0.402	0.816	0.392	1.063
TOTAL	**0.557**	**1.174**	**0.590**	**1.063**

Final observations (as communicated to DCC in January 2024 consultation)

2.71 As set out in our November 2023 consultation, as well as previous determinations, facilitating effective competition is one of the DCC's main objectives under the Licence. As part of this, under LC 16, DCC is expected to drive a fair and effective procurement process. On this occasion, we are not satisfied that DCC was able to fully deliver value for money through this process. Notwithstanding this disallowance proposal, we remain concerned about the negotiated terms and conditions, in particular a "painshare/gainshare mechanism", which may result in DCC's exposure to potentially high liabilities in future. DCC should take active steps to avoid, or minimise, any such exposure. Any costs thus incurred would be subject to price control scrutiny and may be found Unacceptable. We also expect DCC to take advantage of all available contractual measures to secure continued value for money.

2.72 Furthermore, we remain concerned about the circumstances of the direct awards of these contracts. We expect DCC to conduct a full competitive procurement of the larger contract *before* its first breakpoint, and a full competitive procurement for the enduring service for the smaller contract before the expiry of the current agreement for Design, Build and Test stage. Nothing in this decision shall prejudice any potential future action we may take in relation to these procurements.

Q4 Forecast costs (FSPs)

Proposal at consultation*: (1) disallow £32.912m of DSP forecast costs on account of insufficient justification; (2) disallow £11.142m of costs associated with SECMP0007 (Firmware updates to IHDs and PPMIDs) for which we had not received satisfactory evidence and which we had been unable to reconcile in DCC's regulatory reporting.*

Decision*: (1) accept DCC's evidence in respect of UIT and SMETS2 PR/CR: reduce DSP disallowance to £27.165m; (2) accept DCC's evidence in respect of SECMP0007: reduce disallowance to £3.749m on the grounds of continued misalignment with DCC's regulatory reporting.*

Respondents' views

2.73 Respondents generally supported our position. One respondent welcomed the proposal, noting that forecast disallowances should provide a downward pressure on DCC's costs.

2.74 One respondent felt unable to provide a view on the cost disallowance due to a lack of transparency of the forecasting processes. Nonetheless, they observed that inaccurate forecasting by DCC has presented a cashflow burden on DCC's users. They also highlighted the issue of DCC's repeated over-recovery of revenue in the past RYs and expressed concerns about DCC's contingency being set too high.

2.75 Throughout the responses, as well as at our December 2023 stakeholder event, we found a strong ongoing concern about DCC's forecasting ability and dissatisfaction with the quality of DCC's forecasts presented to customers – for example through the Quarterly Finance Forums. Several respondents expressed support for a move towards an *ex-ante* price control regime, with the expectation that it should provide incentive on DCC to improve its forecasting and improve confidence in costs.

2.76 One respondent commented on industry's ability to challenge costs of SEC mods, noting challenges in obtaining clearer reporting of costs from DCC.

2.77 DCC acknowledged stakeholder concerns expressed at the stakeholder event but disagreed with our proposals. DCC opined that costs should not be disallowed in their entirety. It also provided arguments for each item as follows:

- **User Integration Testing (UIT):** Costs which relate to the extension of the UIT-B environment were justified in previous price control and should form a part of the approved baseline forecasts for UIT
- **UIT: SP Onboarding**, **ECoS CR**: DCC acknowledged a level of uncertainty; however, it noted that it is likely that some of these costs will be incurred and suggested that a realistic forecast should be identified to create a reasonable expectation for stakeholders and reduce regulatory burden
- **SMETS2 PR:** DCC referred back to its submission which set out the negotiated price for RY22/23 and a comparison to previous periods adjusted for inflation. DCC argued that its forecast should be compared to that counterfactual
- **SMETS2 CR:** DCC submitted a final impact assessment (FIA) and an accompanying price breakdown in support of this CR
- **Network Evolution:** DCC acknowledged that the submitted forecasts may not meet the required certainty threshold but pointed out that some costs will be incurred in this area which will feature in RY23/24 price control
- **SECMP0007:** DCC provided a detailed breakdown of the costs per SP and PR/CR, arguing that the total costs remained within the original budget of £28-30m, totalling £28.765m as of RY22/23. Upon further requests, DCC also set out how these costs should align to its reporting in the RIGs Supplementary Schedules

Reasons for our decision

2.78 Our decision on each of the proposal is as follows:

- **UIT:** We have reviewed DCC’s RY21/22 submission and are satisfied to allow these forecast costs, which are in line with previous forecast and justification. We have therefore decided to remove this disallowance proposal from our final determination
- **UIT: SP Onboarding**, **ECoS CR:** We maintain our consultation proposal. We appreciate DCC’s position; however, we have not seen any justification for the proportion of costs DCC considers to be meeting both the certainty and efficiency thresholds. It would have been welcome for DCC to include such

evidence alongside its consultation response. As such we are unable to allow these costs in DCC's forecast and determine that they should be disallowed. We understand that this will manifest as a larger variance in RY23/24 when we will be expecting to receive justifications for the level of actual spend as well as any further forecasts

- **SMETS2 PR:** Upon review of DCC's submission, we are satisfied that there is sufficient evidence for these costs to be included in DCC's forecasts. We have therefore decided to not proceed with a disallowance in this area. We note DCC's positive pressure on costs between RY21/22 and 22/23 and observe that the forecast for RY23/24 is in line with the renegotiated pricing for RY22/23. Nevertheless, we expect DCC to continue to review and revise this PR to ensure the right scope and pricing on an ongoing basis with any material variance duly justified
- **Network Evolution:** In the absence of any further evidence, we maintain our consultation position and determine that these costs should be disallowed. DCC should explain all incurred costs and further forecasts in RY23/24 price control submission
- **SECMP0007:** We accept DCC's evidence showing the historic, current and future breakdown of costs associated with this multiannual SEC mod. However, despite repeated requests, we have not received a satisfactory reconciliation with the RY22/23 RIGs reporting, which continues to be misaligned with higher forecast values reported for two SPs. We have decided to modify our proposal on the basis of DCC's evidence and direct that excess forecast costs above the level justified by DCC shall be removed from the regulatory reporting and DCC's future Allowed Revenue in RY23/24 and 24/25. We will continue to monitor this area in the upcoming price control cycle.

2.79 The summary of our decisions on forecast disallowances is presented in Table 2.3 below with highlighted changes to our initial proposals.

2.80 In our August 2023 DCC Review consultation response,[31] we confirmed our intention to move towards *ex-ante* price control arrangements with the ambition to bring in interim changes from 2025. We agree with stakeholders that DCC's forecasting must improve for this transition to be successful, and we will continue

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

our engagement with both DCC and industry on the design and implementation of the reform.

2.81 Nevertheless, irrespective of changes to cost control arrangements, we would urge DCC to actively respond to the very clear concerns expressed by its customers. At minimum, DCC should seek feedback on what information its customers are currently missing and take steps to increase transparency in those areas; DCC should also improve its communication with stakeholders about the nature of its forecasts.

2.82 Finally, we would reiterate that all costs meeting the materiality threshold above, including forecast costs, must be accompanied by an appropriate justification *within DCC's submission.* To date we have had to resort to seeking justifications for many and, in some areas the majority of, forecast costs through clarification questions. We would welcome a change in DCC's approach and an inclusion of a forecast cost section in its narrative submission from RY23/24.

Table 2.3: Forecast cost disallowance per RY, in [£m] – highlighted cells mark changes from our consultation position

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	-	-	-
SMETS2 PRs: *Production Support Testing*	-	-	-
SMETS2 CRs	-	-	-
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	1.388	2.361	-
TOTAL	**13.222**	**6.606**	**11.086**
GRAND TOTAL			**30.914**

Q5 Other views on External Costs

Respondents' views

2.83 Several respondents commented generally on a continued increase in DCC's External Costs and, in that context, expressed concerns about the **quality of DCC's submission**, referring to the amount of clarification questions and additional evidence required for Ofgem to carry out its assessment. Two respondents noted that this raised questions about the rigour and seriousness DCC applies to its price control submission.

2.84 One respondent observed a **continuation of issues** highlighted by Ofgem in previous price control consultations and decisions, with a suggestion to review the drivers and incentives for DCC.

2.85 Several respondents also commented on DCC's key role and competency in **effective contract management** to drive value for money:

- A couple of respondents raised concerns about DCC following the right procedures and processes in its **procurements** with one respondent commenting specifically on DCC's non-competitive procurements within the 4G CH & Networks programme
- One respondent suggested that Ofgem offer examples of best practice or benchmarking in contract management to improve DCC's performance

2.86 Looking ahead, one party highlighted a potential **future issue** around inefficiencies in handling of GBCS 4.1 Firmware which may arise in RY23/24. We found support for our ongoing review of the regulatory arrangements for DCC, in particular a move towards an ***ex-ante* price control regime**.

Our actions in response to respondents' views

2.87 DCC is required to provide Price Control Information in a manner that will enable Ofgem to perform its duties under the Price Control.[32] DCC's regulatory reporting should be complete, accurate and submitted in a timely manner. As set out in our consultation, whilst DCC's submission was acceptable to justify the majority of its costs, there were significant shortcomings and omissions in a number of areas.[33] We would invite DCC to reflect on these and make improvements in the next price control cycle. A good quality submission will reduce the burden on both

[32] LC 32.1
[33] See paragraphs 3.46-3.50 of our 22/23 consultation

Ofgem and DCC to seek and provide additional information. We will engage with DCC to discuss lessons learnt and how to address ongoing reporting issues; however, we would re-iterate that where costs are not justified, they may be subject to disallowance.

2.88 In relation to repeated issues, where DCC fails to demonstrate improvements despite previous commitments, as set out in our previous decision,[34] we may take action under the price control. This year DCC's Baseline Margin (BM) has been reduced by £0.489m against the OPR contract management incentive. On account of DCC's recurrent failures to uplift SP performance and follow proper procurement and contract change processes, we consulted and decided on reducing DCC's score against this performance measure.[35] Recognising contract management as a key aspect of DCC's role and to strengthen the incentive on DCC in this area, we are further consulting on revisions to the OPR, which will, amongst other, increase the proportion of DCC's BM put at risk against the contract management measures.[36]

2.89 We welcome respondents' intelligence on any potential issues that may be relevant to our current or future price control assessment. We are open to further bilateral engagement with respondents to discuss specific issues.

2.90 Finally, as discussed above, as part of our ongoing work on future regulatory framework for DCC ('DCC review'), our aim is to move towards an *ex-ante* regime for determining DCC's Allowed Revenue. We welcome respondents' engagement and expect to consult on proposed changes in the spring 2024.

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[34] See, for example, Ofgem (2022), DCC Price Control Decision Regulatory Year 2020/21, paragraph 2.29. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021
[35] See paragraph 4.24 in this document
[36] Ofgem (2024), Revised OPR Guidance consultation January 2024, see esp. Chapter 3: Contract management, pp.14-18. www.ofgem.gov.uk/publications/revised-opr-guidance-consultation-january-2024

3. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY22/23. We have reviewed all responses and determined a total of £11.212m incurred Internal Costs in RY22/23 (including the associated Shared Service Charge) as unacceptable. Our decision is based on various costs related to inefficiencies in resourcing activities, as well as inefficiencies in External and Internal Services, costs surrounding Non-Competitive Procurements (NCPs), the Business Accuracy Programme (BAP), the application of Shared Service Charges, contractor benchmarking, costs incurred as a result of inadequate planning and scoping, as well as a proportion of the costs directly linked to the Service Desk contract.

We have also decided to maintain our position on DCC's forecast costs over RY23/24 and RY24/25 due to a lack of clarity and certainty over forecasts, and in particular forecasts associated with the Network Evolution and SMETS1 programmes, as well as with the Corporate Management, Security, Service Delivery and Operations cost centres.

Questions from the consultation

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?**
7. **What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?**
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?**
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?**
10. **What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?**
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?**

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

13. What are your views on our proposal to disallow forecast cost variances in RY22/23 and RY23/24; and all baselines forecast costs for RY24/25 onwards?

Q6 Payroll cost disallowances for internal costs

Proposal at consultation*: disallow a total of* ***£1.714m*** *incurred payroll costs across four cost centres: Corporate Management, Design and Assurance, Security and Network Evolution Programme.*

Decision*: adjust our position to allow costs for Design and Assurance sub-team and half the proposed disallowance associated with the Security sub-team but maintain our positions for the remaining cost centres. This corresponds to a total disallowance of* ***£1.5205m*** *with a total reduction of* ***£0.194m****.*

Respondent's views

3.1 Half of the respondents supported our minded-to position, with one stating they felt a greater disallowance for the Network Evolution Programme could be necessary.

3.2 Another respondent suggested for Ofgem to propose a 100% disallowance of the incurred payroll costs based on the lack of sufficient evidence provided by DCC.

3.3 Out of the five respondents who did not provide their views on proposed incurred disallowances, three of them cited a lack of sufficient information provided in the consultation.

3.4 DCC stated that Ofgem cannot disallow costs simply based on costs not falling within the reported forecasts. DCC also noted that Ofgem had not provided any reason as to why the costs incurred are not economic or efficient. DCC stated the reasoning for the variance in costs is based on the fact the CH&N programme is currently in the 'post contract award delivery stage, which is more resource intensive and required the establishment of a delivery team.'

3.5 For Design and Assurance, DCC raised concerns over Ofgem's view that 50% of the team is engaged in Permitted Business. DCC provided further clarification on the Technology Innovation sub-team stating the team is not involved in Permitted Business work and that it is instead tasked with handling matters like the SEC Mods. According to DCC, it is therefore incorrect to that the incurred costs were spent on innovation.

3.6 Under the Security cost centre, the CISO had incurred a total of £0.178m over a duration of six months which we had proposed to disallow in full. DCC provided further clarification on this, stating that the costs were incurred due to the appointment of a new CISO role which resulted in a handover period of six months. DCC explained that given the importance of the role and the retention issues associated with this role, it was important to ensure a thorough handover period.

Reason for our decision

3.7 We disagree with DCC's view that Ofgem is not entitled to disallow a cost merely because it varies from a forecast. LC 37.4 and LC 37.5[37] require DCC to submit a price control report that details the comparison between (for internal and external) the amount that was actually incurred for the relevant Regulatory Year and the amount that was estimated to be likely to be incurred in the LABP (and in all updated forecasts of expenditure submitted in accordance with LC 32[38]). LC 37.6[39] also requires DCC's submission provides an 'explanation of any material divergence' between the incurred and forecasted costs and requires the DCC to provide a statement of any material revision it thinks is necessary to make to the LABP as a result. Our assessment of DCC's incurred costs is based on whether DCC has provide sufficient evidence to show that the costs incurred were economic and efficient. This is further complemented by the RIGs guidance[40] that states that the "updated forecasts should reflect economic and efficient costs as submitted by DCC and reviewed by the Authority at the previous price control review." Finally, the Guidance itself explicitly states[41] that "*…updated forecasts should only contain economic and efficient costs, so that they represent a reasonable baseline against which to compare costs at the next price control… If DCC fails to justify any forecast costs as being economic and efficient we will remove them from the forecasts as part of the determination*."

3.8 We note the respondents' views to increase the disallowance for Network Evolution and for the potential for Ofgem to propose a disallowance of 100% of the incurred payroll costs based on the lack of evidence provided by DCC. Whilst we appreciate the views of the respondents, Ofgem has a duty to ensure DCC is

[37] LC37.4 and LC37.4 – Part A: Submission of annual report on cost performance
[38] LC 32 – Reporting of Price Control Information
[39] LC 37.6 – Part A: Submission of annual report on cost performance
[40] Ofgem (2023), Data Communications Company (DCC): Regulatory Instructions and Guidance. www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2023
[41] Paragraph 2.17 of the Guidance

being judged fairly and objectively on the evidence that it has submitted on the incurred costs. We believe, as previously mentioned, it is for DCC to provide us with evidence to show the costs incurred are economic and efficient. We will then assess the evidence provided to determine if this is the case. In this instance, DCC failed to provide sufficient evidence to show how the incurred costs for the Network Evolution Programme were economic and efficient, and therefore, our consultation position remains unchanged, and we have decided to disallow the costs incurred. As for some of the other cost centres, namely Design and Assurance and Security, DCC has provided further satisfactory evidence to show either some or all the costs incurred were economic and efficient, therefore, we are happy to award either some or all the money back. This is discussed further below.

3.9 In the RY22/23 Price Control submission, DCC claimed the reason for the incurred cost of £0.09m was due to an increase in staff needing to respond to the large volume of external queries and that the incurred costs were necessary in order to be complaint with LC 17[42]. As part of our RY21/22 Price Control process, we raised concerns over DCC's decision of creating additional roles to support and/or engage with government or stakeholders on policy development. As per our position last year, we remain concerned that DCC is a placing a disproportionate amount of resource into such type of activities. We remain of the view that it is not appropriate for DCC's customers to fund DCC increasing its headcount to support policymaking.

3.10 Also, we did not receive any satisfactory evidence from DCC to justify the material variances on the Network Evolution programme. In its explanation, DCC merely provided some high-level explanation into the increase in resource for the CH&N programme, as it has transitioned into the post contract stage. Going forward, we expect DCC however to justify in more detail the drivers that have led to a material variance in resource together with an explanation as to how the increase in resource meets the demand to resource particular activities. We maintain our consultation position and have decided to disallow the incurred cost of £1.341m.

3.11 DCC provided further clarification on the individual roles within the Design and Assurance sub-team. We are satisfied that the team does not take part in any

[42] LC 17 - Requirement for the Provision of Services

Permitted Business and is instead focused on managing SEC mods and Impact Assessments. We have therefore decided to allow the incurred cost of £0.105m.

3.12 DCC did provide further information for having in place a six-month handover period for the CISO role. We remain of the view that it is not economic and efficient to have in place a handover period of six months. We do however understand the importance of the role and agree a handover period of some significant length is needed to ensure the new candidate is prepared for the role. We therefore consider it appropriate to allow the incurred costs relative to a three-month handover period. This would mean DCC would retain a total of £0.089m of the originally proposed disallowance of £0.178m with the new disallowance totalling to £0.089m.

Q7 Benchmarking

Proposal at consultation: *no disallowance of any permanent staff payroll or permanent staff benefits costs, however a disallowance of £0.402m of contractor costs for RY22/23 due to DCC hiring some contractors above the 50P10 benchmark without sufficient justification nor the provision of any relevant business cases.*

Decision: *no change from consultation position.*

Respondents' views

3.13 Of the eight respondents, five agreed with our position, two did not hold a strong view, and DCC disagreed with our proposal to disallow some contractor costs.

3.14 Two concerns were raised by multiple respondents. The first was over the increase in DCC staff numbers. One noted that staff count had risen in areas such as finance which had recently undergone an improvement programme (referring to the Business Accuracy Programme). One respondent highlighted another area of concern, namely around the use of Capita consultants, which appear to have a significant mark up on the rate.

3.15 The second was the perceived high rate of staff turnover at DCC. Respondents detailed the consequences of this turnover that they had experienced, namely a loss of corporate knowledge and memory leading to covering old ground in industry forums. Multiple respondents suggested that DCC's staff attrition rate should also be benchmarked against other monopoly businesses such as DNOs.

3.16 One respondent suggested that DCC should report on contractor headcount as a trend across each calendar month, which would allow Ofgem and DCC Users to scrutinise contractor usage across the year.

3.17 DCC disagreed with our proposed disallowance of £0.402m of contractor costs that fell above the 50P10 benchmark. They argued that their efforts to typically hire below the benchmark are what allow it to hire above market rates in certain instances where they consider it beneficial to do so.

Reasons for our decision

3.18 Having considered all responses, we have decided to proceed with our consultation positions.

3.19 As we stated in our consultation, we recognise that DCC may have to deviate from the 50P10 benchmark at times in order to hire certain staff. However, we would expect appropriate justification in these instances beyond generic references to skill, seniority, or a simple job description, such as an internally approved business case for the role.

3.20 Following receipt of its price control submission, we issued a Request for Information (RFI) to DCC in which we requested it submit to us the business cases for a sample of contractors hired above the 50P10 benchmark. DCC did not submit any of the business cases requested at the time and has not submitted anything further as part of its consultation response. Accordingly, we are proceeding with our disallowance of **£0.402m** of contractor costs for RY22/23 that materially fall above market rates and were not properly justified.

3.21 It is disappointing that DCC did not provide any business cases for the roles requested, or any other documents showing it has followed its own internal hiring policy – especially so given that, since last year, DCC has claimed to have improved its governance in this area, with the declared intention of providing better justification in its price control submissions. Additionally, given that DCC is increasingly hiring contractors from its parent company, Capita, we would expect DCC to provide far more robust documentation of the business cases for these contractors.

3.22 Lastly, DCC reports inconsistent staff and contractor numbers across the various elements of the price control in which they are reported. This, together with the lack of transparency on business cases for contractors, has made it difficult to ascertain the number of contractors employed by DCC. We will keep monitoring this in detail in the future.

3.23 Our positions to make no disallowances to DCC's permanent staff and permanent staff benefits costs remain unchanged.

Q8 Continued costs linked to disallowed activities in RY21/22

Proposal at consultation: *disallow the continued costs* ***(£0.981m) that are linked to the cost of activities that we disallowed in RY21/22****. These include additional costs associated with the executive leadership training programme, innovation, and growth (Living Pillars and DCC Boxed) as well as a continuation of the RY21/22 non-competitive procurements. We also proposed to disallow continued costs in RY22/23 of £0.049m and £0.303m respectively linked to the Order Management System (OMS) and Customer Engagement Portal (CEP) projects; 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.*

Decision*: to* ***adjust*** *the disallowance* ***downwards*** *to* ***£0.789m*** *following further satisfactory evidence from DCC around the costs associated with the "innovation and growth"; we are also adjusting our consultation position on CEP downwards.*

Respondents' views

3.24 All respondents, except DCC, agreed with our consultation position.

3.25 Two respondents specifically expressed disappointment in DCC trying to pursue activities that are not mandated. Both respondents urged DCC to prioritise the delivery of its core mandatory business.

3.26 DCC clarified that the disallowed cost associated with the disallowed "innovation and growth" activity had been incorrectly identified; instead, DCC stated that the spend related to continuation of DCC's simulated testing environment (DCC Boxed) which had previously been approved by Ofgem in RY20/21 and RY21/22.

3.27 DCC disagreed with Ofgem's proposal to disallow expenditure related to Living Pillars project in RY22/23, including expenditure around its Proof of Concept, on the premise of it not falling under DCC's Mandatory Business. According to DCC, LC 5.10(b), DCC is required to carry on the Mandatory Business in a manner that is most likely to facilitate "…*such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation."*

3.28 In regard to the executive training programme, DCC claimed that the proposed disallowance of the entire programme is not only contrary to the terms of the Licence, but also restricts DCC's ability and autonomy to assess and deliver on the training and development needs of our leadership and wider staff.

3.29 In response to our proposal to disallow the continued costs relating to contracts that were procured on a non-competitive basis in RY21/22, DCC commented that the use of a non-competitive procurement in itself is not a reason permitted by the Licence for Ofgem to disallow costs; according to DCC, Ofgem should disallow the portion of cost that it considers not to have been incurred economically and efficiently, not the entire cost of the service.

3.30 Prior to the consultation, DCC noted that it had incurred £0.141m of ongoing charges for the CEP, to retain a number of licences to allow customers to continue to access the CEP. As part of the consultation, DCC however clarified that it had incurred £0.162m in RY22/23 for that purpose, re-emphasising that Salesforce licences are not negotiable. DCC did not provide any evidence in respect of the OMS, other than what it had previously submitted as part of this year and last year's price control.

Reasons for our decision

3.31 We accept DCC's clarification regarding the misidentified activity, associated with the "innovation and growth" cost, and have decided not to disallow this cost. Going forward, we do however request that DCC improves the overall quality of its regulatory reporting, including the naming conventions of cost items, to help avoid such future misidentifications.

3.32 We disagree with DCC's interpretation of LC 5.10(b); we previously, including in our RY21/22 Price Control decision,[43] clarified that facilitating innovation in the design and operation of Energy Networks would be the result of DCC carrying out its Mandatory Business.[44] LC 5.10(b) does not give DCC the regulatory scope to carry out activity which is not part of its Mandatory Business. We remain concerned that DCC appears to be placing undue focus on innovation activity and the development of new products and proof of concepts; as repeatedly stated before, we require DCC to focus on the delivery of the Mandatory Business before expanding into exploring additional areas of activity.

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

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

3.33 We have not received any further evidence from DCC to demonstrate that the executive leadership training was delivering value for money compared to this service previously being offered by Capita. We have therefore decided to maintain our consultation position and disallow the costs associated with this programme. For the avoidance of doubt, we do not discourage DCC to run training for its staff; we believe DCC staff should receive appropriate training and learning & development opportunities. However, we expect DCC to ensure any learning offerings are providing value for money and any expenditure is economic and efficient, and for DCC to evidence this under the Price Control.

3.34 We do not disagree that, when a cost has been incurred in way that is non-compliant with the procurement provisions of the Licence, that then entitles Ofgem to disallow that cost. However, we did previously explain in our November 2023 consultation[45] that we cannot assume that DCC's costs are economic and efficient by default. We expect DCC to demonstrate to us that the choices it makes in running its business are economic and efficient and represent value for money for consumers; we would remind DCC that the burden of proof for cost justification is on DCC and that any costs, including incurred costs, may be subject to a disallowance if found unacceptable in absence of satisfactory evidence that they are economic and efficient.

3.35 We have reviewed the additional context that DCC has further provided in respect of the additional incurred costs against the RY21/22 non-competitive procurements, however we have not received any satisfactory evidence to demonstrate that the decision to procure these services was the most economic and efficient option.

3.36 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.

3.37 Having reviewed DCC's arguments, we would like to re-iterate that reasons of urgency do not de facto constitute a justification for the use of a direct award; we expect 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. We would also emphasise that the fact that a particular

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

service provider has an understanding of DCC's processes and systems is not in and of itself, a justification for opting to follow a non-competitive procurement process.

3.38 As per our consultation position, we regret that both the OMS and CEP are continuing to incur costs despite these projects being stopped and/or re-designed. Notwithstanding that, we accept the ongoing CEP charges on the basis that these are necessary to retain a number of licences. Taking into account the additional explanation, we are proposing to adjust the disallowance downwards, from £0.162m to £0.113m. We maintain our position on OMS.

Q9 Planning, Scoping and Resourcing of Projects

***Proposal at consultation**: disallow £3.335m and £0.312m in respectively RY22/23 and RY23/24, that are linked to activities that we consider not to have been resourced in the most economic and efficient way.*

***Decision**: remains unchanged from consultation proposal in respect of the activities that we consider not to have been resourced in the most economic and efficient way.*

Respondents' views

3.39 All respondents, except DCC, agreed with our consultation position.

3.40 One respondent explicitly highlighted that where DCC's re-procurement exercises and the resulting programmes can be reasonably foreseen, it is expected to take steps to resource these activities appropriately.

3.41 DCC raised concerns that Ofgem had failed to state within its consultation how much cost, for each of the associated activities, it was proposing to disallow, nor on what grounds it was proposing to do make that disallowance. DCC claimed that this makes it difficult for DCC or other stakeholders to respond to Ofgem's proposal in a meaningful way, and raised concerns over Ofgem's use of inappropriate counterfactuals to determine to what extent a procurement exercise was economic and efficient. DCC also stated that in some instances, the counterfactuals used by Ofgem herein, significantly underestimated the costs of using permanent staff; it did not, for example, include non-base staff costs such as pension, bonus, national insurance and other benefits, nor did it include any recruitment costs.

3.42 DCC also highlighted risks that Ofgem retrospectively adjudicating on whether an activity should have been outsourced, severely limits DCC's autonomy to plan the best resourcing approach based on the facts at the time; DCC noted that this could have serious unintended consequences, such as incentivising the over recruitment of permanent staff resulting in long-term inefficiencies.

3.43 Finally, DCC provided an explanation for each of the associated projects, of why it considered the chosen approach for resourcing to be economic and efficient.

Reasons for our decision

3.44 We reviewed the additional explanation provided by DCC against each of the associated projects individually, however, we remain of the view that these projects were not resourced in the most economic and efficient way. We are maintaining our consultation position and will exclude these costs from the Allowed Revenue.

3.45 As explained at the consultation phase, we accept that there are circumstances where 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. We do not believe that this this should be the case for activities (as are the ones that are subject to our proposal in this regard) 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.

3.46 Going forward, we would like DCC to adopt an approach that carefully trades off alternative options before defaulting to the outsourcing of an activity. We disagree with DCC's assertion that this could result in incentivising the over recruitment of permanent staff, risking therefore long-term inefficiencies; DCC is expected to determine the most economic and efficient way forward which could include using existing staff, hiring additional permanent staff or contractors, or a combination of both.

3.47 It is important that the requirement and use of External and/or Internal services is carefully considered, particularly in a context of increasing internal costs. We will continue to closely monitor this area in future Price Control assessments, and expect DCC to share with us, upon request, any evidence of due diligence in this area.

3.48 We do not accept DCC's comment that we did not share sufficient information around our consultation proposals in this area and have appropriately justified, as a part of this process, our reasoning to stakeholders so that they are able to respond in a meaningful way. Whilst the consultation did not include the underlying calculations for each of the proposed disallowances, we did explain our methodology for arriving at, what we consider to be, an economic and efficient counterfactual. For clarity, that methodology consisted of either comparing DCC's own contractor benchmarks against the corresponding consultancy day rates, or by disallowing the difference between the project cost and the resource costs previously forecasted and approved as part of Price Control. We consider that this information was sufficient to allow stakeholders to respond in a meaningful way.

Q10 Business Accuracy Programme

Proposal at consultation*: reject all costs (£3.845m and £0.243m for respectively RY22/23 and RY23/24) associated with the Business Accuracy Programme (BAP) on the grounds of insufficient evidence of benefits realisation and concerns related to lack of transparency in customer engagement and overlap in scope and Shared Service Charge.*

Decision*: remains unchanged from consultation proposal.*

Respondents' views

3.49 All respondents, except DCC, agreed with our consultation position.

3.50 Two respondents explicitly highlighted that they had seen no benefits being delivered to customers, despite repeatedly challenging the objectives and costs associated with the programme at various events such as at the Smart Energy Code (SEC) Ops sub-committee and the Quarterly Finance Forum (QFF); one respondent further stated that the all the benefits presented of the programme related to either DCC and/or Capita only.

3.51 DCC claimed that the BAP has already delivered, and will continue to deliver, tangible benefits to the way the business operates and functions, as well as the way it collects and reports data. DCC further noted that the programme had already delivered a business planning and performance management framework (the Lock process) which will improve the ability to deliver business outcomes in an economic and efficient manner, understand and track its cost base, and more accurately predict resource requirements.

3.52 DCC also expressed its disappointment that Ofgem is proposing to disallow a programme that intends to directly address the criticism that Ofgem has levied against DCC in respect of its forecasting and internal reporting.

3.53 DCC further disagreed with Ofgem's argument that there "*…remains insufficient evidence of a robust cost benefit analysis that precisely sets out when and how such savings will be realised, including a methodology for monitoring, and tracking them*". DCC states that it has provided Ofgem with all necessary evidence, including the original business case, which contained a thorough cost-benefit analysis (CBA), as well as the BAP Closure Report, which contained an updated CBA with actual costs and a detailed benefits realisation plan. DCC further explained that the BAP Closure Report contains a comprehensive approach for monitoring and tracking the direct benefits of the programme. Finally, DCC highlighted that while the indirect benefits cannot be directly measured and completely attributed to BAP, the benefits realisation plan details how the cost benchmarking project will be used to provide a baseline against which future cost-efficiencies can be measured.

3.54 In response to Ofgem's concerns around the lack of customer engagement towards this programme, DCC noted that this does not constitute a reason for Ofgem to disallow costs; DCC reiterated that the sole basis for disallowing costs is that Ofgem determines that a cost was not economically and efficiently incurred.

3.55 Finally, DCC also challenged Ofgem's assertion of there being a potential overlap between the scope of the BAP and "several other workstreams", without explicitly stating which activities it was referring to. DCC clarified that if Ofgem was referring to that effect to the projects that are linked to cost benchmarking as well as integrated activity planning, then it should be clarified that these projects are fully distinct from the BAP.

Reasons for our decision

3.56 We have not received any further evidence that demonstrates that the costs associated with the BAP are economic and efficient. We are maintaining our consultation position and are directing that these costs are excluded from the Allowed Revenue.

3.57 In previous years, we always welcomed and encouraged DCC's efforts to realise cost efficiencies, across all of its programmes and activities. Where it does set up initiatives to that effect, we expect and however require DCC to ensure that the scope of such projects is clearly defined and that customers are presented with a robust cost benefit analysis that supports the investment. We have explained before, as part of last year's Price Control process[46][47], as well as via our November 2023 consultation[48], why we consider that the BAP does not meet these requirements. Neither last year's cost benefit analysis, nor this year's BAP

[46] Ofgem (2022), DCC Price Control Consultation: Regulatory Year 2021/22. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122
[47] Ofgem (2023), DCC Price Control Decision Regulatory Year 2021/22. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202122
[48] Ofgem (2023), DCC Price Control consultation: Regulatory Year 2022/23. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202223

closure report unequivocally demonstrates how and when the programme's benefits will be tracked and monitored, realised, and returned to customers. We cannot assume that these efficiencies will be realised, especially when DCC, itself, claims that the indirect benefits (making up £10m of the £11.8m total projected benefits) cannot directly be attributed to the programme.

3.58 We also disagree with DCC's view that the lack of customer engagement constitutes a ground on which Ofgem may disallow costs. Our Guidance list down some principles that we may apply when we are reviewing the DCC's costs. One of those principles[49] requires DCC, for decisions that have substantive cost impacts, to show robust evidence on how the governance framework has been applied to inform decision-making. As part of last year's price control decision, we set out our concerns in this regard, namely that customers did not have full visibility of the BAP's costs, scope, deliverables, and benefits realisation.

3.59 In response to DCC's assertion that we did not explicitly elaborate on the areas of potential overlap between the BAP's scope and that of other workstreams, we would like to refer to the concerns we set out in last year's Price Control consultation;[50] we explained that multiple services, similar to the scope (or a sub-set of that scope), had been procured alongside the BAP in recent years, which raises concerns that the outputs of each of these individual activities may not have necessarily been coordinated and adopted in the most optimal way, risking therefore a possible duplication of costs. We also raised concerns that by not including the costs of these additional activities into the overall business case, the actual cost benefits analysis could in effect be flawed or misrepresented.

Q11 Non-Competitive Procurements

Proposal at consultation*: disallow £1.240m for RY22/23 which is 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.*

Decision*: adjust our disallowance downwards to £0.352m in light of further evidence submitted by DCC.*

[49] Paragraphs 2.78 – 2.81 of the Guidance
[50] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122

Respondents' views

3.60 All respondents, except DCC, agreed with our consultation position.

3.61 More specifically, two respondents raised concerns around DCC's status as a monopoly provider, and the expectation that it must transparently demonstrate to stakeholders that its procurement activities are economic, efficient, and deliver benefits to energy consumers. One respondent particularly urged Ofgem to investigate whether DCC has breached its Licence as a result of its recent approach to procurements.

3.62 DCC responded that it continues to be concerned by Ofgem's approach to disallowances in relation to non-competitive procurements. DCC explained that it is of the view that Ofgem's interpretation of LC 16[51] is particularly flawed regarding the circumstances in which DCC must procure competitively.

3.63 DCC has misinterpreted our view by claiming that we require DCC to undertake a competitive procurement exercise even where it is impracticable or disproportionate for DCC to do so. According to DCC, this is at direct odds to Ofgem's principal objective, as it only serves to increase costs for consumers without any tangible benefit; it also at odds with the efficient and economic deployment of costs.

3.64 DCC further reiterated that Ofgem is not entitled to disallow costs purely because they were not incurred through a competitive process; DCC responded that the sole basis upon which Ofgem may disallow a cost is that it was not economically and efficiently incurred.

3.65 DCC further noted that if Ofgem considers that an alternative means of procurement would have resulted in DCC achieving a more economic and efficient costs, then it should assess and disallow whatever portion of the cost that is uneconomic and inefficient cost, not the entire incurred cost. DCC produced to that effect, and shared with us, further analysis to benchmark the specific direct award costs that Ofgem proposes to disallow against a plausible range of counterfactuals. DCC explained that the counterfactuals were based on the average rate for the same grade consultants, from a range of service providers within one of DCC's consultancy frameworks.

[51] Licence Condition 16: Procurement of Relevant Service Capability

Reasons for our decision

3.66 We do not agree with DCC's assertion that we require it to undertake a competitive tender even where it is impracticable or disproportionate for DCC to do so. On the contrary, we have previously acknowledged to DCC that there may be circumstances where it is not practical to carry out a competitive procurement. This may be, for example, the case 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. Where this is the case, we will always take this into account whilst making a decision.

3.67 We are disappointed that DCC continues to pursue direct awards, notwithstanding the clarifications given by us regarding our expectation of what is required by DCC under the Licence.

3.68 We reiterate that these obligations require DCC, as a default, to facilitate competition through the procurement process. DCC must drive a fair and effective procurement process that delivers value for money and ensure DCC customers achieve the best possible outcome; competitive procurements should be treated and used as the primary and default vehicle to that effect. Going forward, we require DCC to make significant improvements in this area; we intend to closely monitor and scrutinise how DCC conducts procurements in accordance with the requirements set out in the Licence.

3.69 As explained above, we agree that a failure on the part of DCC to have competitively procured a service cannot be automatically equated with it having incurred uneconomic or inefficient costs. However, DCC is expected to manage its costs appropriately and ensure that the best possible outcomes for consumers are achieved. As previously explained, the burden of proof for determining whether a particular approach is the most economical and efficient option lies with DCC. In the event that DCC however decides not to procure a service competitively, the bar of providing that evidence essentially increases as we will expect DCC to nevertheless demonstrate that it has obtained the most economic and efficient terms for that service on the market, including an explanation of the process that it has followed to arrive at that decision.

3.70 We have reviewed the additional justification against each of the four non-competitive procurements, however, we remain of the view that a direct award in each of these instances was not the most economic and efficient option. Notwithstanding that, we welcome DCC's effort to produce and share with us a range of counterfactuals for each of the respective disallowed procurements. We regret that DCC has not done this benchmarking exercise *ex-ante* and encourage DCC to conduct robust benchmarking prior to entering into contracts. On this occasion we have decided to accept these counterfactuals and reduce our disallowance in this area to £0.352m for RY22/23.

3.71 For the avoidance of doubt, going forward, we will only accept such evidence where DCC is able to demonstrate that it has carried out the analysis in advance of the procurement. Alongside that, we will continue to apply the same level of scrutiny as before and expect DCC demonstrate that a direct award was the most economic and efficient option (taking into account the factors above); as part of that process, we require DCC to ensure that it is able to retain and share with us on request all key documentation in relation to <u>any</u> procurement, including for direct awards.[52]

3.72 Finally, in response to DCC's use of framework or "call-off" contracts, that have been previously competitively tendered, we would like to reiterate our position that these are mainly appropriate for the purchase of goods and services with a pre-defined scope and contract term; also, the use of a framework contract does not exempt DCC from having to benchmark and evaluate service providers, nor does it exempt DCC from following the level of due diligence and governance as described above.

Q12 Shared Service Charge

Proposal at consultation*: reject Shared Service Charges on non-resource costs for additional baseline activities.*

Decision*: reject Shared Service Charges on non-resource costs for additional baseline activities. Disallowances have been adjusted in line with the unacceptable Internal Costs. The revised total disallowance amounts to* ***£0.917m*** *in RY22/23 and* ***12.431m*** *in forecast costs to the end of the Licence term.*

Respondents' views

3.73 All respondents, except DCC, agreed with our consultation position.

3.74 Two respondents raised explicit concerns around Shared Service charges carrying a degree of risk of cross-subsidisation to Capita or the 'double-counting' of DCC

[52] DCC's procurement policy and procedure document requires single procurement submissions to be treated as if a competitive procurement had been undertaken.

services (and costs) that should be provided for by the Shared Service charges paid to Capita.

3.75 One respondent also raised concerns that DCC continues to recruit staff for particular services that were originally supposed to be covered by the Shared Services charge; the respondent in question further stated that, as a result, this could triple the amount of revenue for Capita i.e., through staff's costs, the increased baseline on those costs, as well as an increase by adding a further shared services charge.

3.76 DCC disagreed that there is a difference in eligibility for Shared Service Charges between baseline and additional baseline activities. According to DCC, the LABP clearly provides for Shared Service Charges on additional baseline activities.

Reasons for our decision

3.77 We have reviewed the responses that we received and disagree with DCC's argument that the LABP provides for Shared Service Charges on baseline and additional baseline activities on the same basis. The LABP makes no reference to that effect.

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

Q13 Internal Forecast Costs

Proposal at consultation*: disallow £19.654m in RY23/24, £24.416m in RY24/25 and all baseline forecasts from RY25/26 onwards (£89.613m) across the SMETS1 and Network Evolution programmes and the Corporate Management, Finance, Commercial, Design and Assurance, Service Delivery (Programmes), Security and Operations cost centres.*

Decision*: allow partial forecast costs (Technology Innovation) in light of additional evidence received from DCC but maintain all other positions.*

Respondents' views

3.79 All respondents, apart from DCC, supported our consultation position.

3.80 Respondents agreed it is important for us to disallow these forecasted costs where DCC has not explained its rationale in future regulatory years, especially as costs become more certain.

3.81 Respondents expressed concerns about the proposed amount being disallowed and voiced some of the FTE increases do not align to work that DCC users are benefitting from. There were recommendations for DCC to review forecast costs to ensure greater accuracy.

3.82 One respondent was particularly concerned around DCC's volatility in their cost forecasting and the impact it has on cash flow. The respondent stated that volatile forecasts are one of the reasons why they would be very sceptical about any claims for savings or benefits arising from DCC's various initiatives.

3.83 Another respondent acknowledged that DCC is now a mature organisation with years of experience of live smart metering communication service operations and as such it should have a much greater ability to manage its business, forecast costs and scope work effectively.

3.84 DCC are disappointed that Ofgem has deemed some of these forecast costs to have not been sufficiently justified.

3.85 DCC ask that Ofgem reconsiders its position, especially given the additional evidence submitted relating to the Technology Innovation and CISO sub-teams.

Reasons for our decisions

3.86 We have considered the additional evidence provided by DCC and have decided to accept the forecast costs associated with Technology Innovation but our consultation position on the other forecast costs remains unchanged.

3.87 DCC provided extra context regarding the Technology Innovation team and have outlined the specific roles within this team. DCC confirmed the team is not engaged in any form of Permitted Business, and that 50% of costs have not been spent on innovation. We acknowledge the additional explanation given by DCC and have decided to accept the associated costs with the Technology Innovation team.

3.88 In relation to the CISO team, we still do not consider the costs associated to be economic or efficient. We maintain our position that the handover period between the CISO does not sufficiently justify the variance value provided.

3.89 DCC did not provide any further evidence to justify the forecast costs for the other cost centres. We reiterate that all forecast costs must be justified as economic and efficient. We expect DCC to also ensure that forecast variances meet the certainty threshold as part of the Price Control.

Q25 Service Desk Services (January 2024 Consultation)

Proposal at consultation*: at the end of January 2024, we ran a second consultation, with DCC only, following further evidence being received from DCC, in relation to costs associated with an additional 4G Comms Hubs & Networks contract,*[53] *as well as the Service Desk.*[54] We ran that second consultation to further inform our Price Control assessment and decision-making. This was considered appropriate in light of further evidence having been received from DCC. Due to the commercially sensitive nature of the information received from DCC, the follow-up consultation was undertaken solely with DCC. *In respect of the Service Desk, we decided to consult on a minded-to disallowance of* ***£0.05m****,* ***£0.538m*** *and* ***£0.538m*** *for respectively RY22/23, RY23/24, and RY24/25. We proposed the disallowance based on a proportion of the service's cost increase following the renewal of the contract in RY22/23, which we did not consider to be the most economic and efficient option.*

Decision*: maintain our January 2024 consultation position*

Context

3.90 The DCC service desk operates as a contactable support mechanism for smart metering and switching services. The agreement for the provision of the service desk in relation to the SMIP was for an initial term of four years, starting on the 1st of February 2016. The agreement provided for an option to extend the initial term for a single period of twelve months.

3.91 Alongside our November 2023 consultation, we separately requested from DCC further information on the Service Desk, via a formal Request for Information (RFI). In response to the RFI, DCC confirmed that, a new two-year contract was directly awarded to the existing service provider, Capita plc, at the start of 2021; this was not in line with what DCC has reported to us in its RY22/23 price control submission, namely that "…*the incumbent service provider for Service Desk is Capita, who were initially contracted to provide the service* <u>*from January 2018*</u> *to a contract expiry in January 2023".*

[53] Agreement for the provision of services in respect of the Network Evolution Programme relating to the Smart Metering Programme. For more details, see paragraphs 2.56-2.72 in this document
[54] Agreement for the provision of Service Desk services.

3.92 The value of 2021-2023 contract was £5.9m and covered the provision of 71.2 Full Time Employees (FTE), fixed monthly operational charges as well as telephony charges. No justification as to how this new contract was arrived at, and secured value for money was provided as part of the price control process in the RY20/21.

3.93 Subsequently, the 2021-2023 contract was non-competitively extended with Capita Plc from the 31st of January 2023 to the 31st of January 2024; this new contract also includes a further one-year optional extension from the 1st of February 2024 to the 31st of January 2025. The annual value of this contract is £4.2m, increasing the total headcount for these services up to 86 FTEs to cover both SMETS, as well as Switching.

3.94 DCC explained, as part of the clarification process, prior to the November 2023 consultation, that the Switching specific service desk costs were aligned with the SMETS specific service desk costs; DCC however failed to adequately respond to clarification questions in relation to the overall approach for sourcing and negotiating this new contract, particularly for the SMETS element of the service. The additional context surrounding the 2021-2023 contract, the 2023/24 contract as well as the 2024/25 contract, was obtained from DCC through the December 2023 RFI.

3.95 Prior to the January 2024 consultation and in response to Ofgem's request for further information around the pursued direct award approach, DCC explained that whilst it had initiated a competitive procurement ahead of contract expiry in 2021, one of the two vendors, who were initially willing to provide services on an 'operate-only' basis, withdrew. DCC further informed us that the two-year extension, in 2021, with the incumbent provider would *"… ensure the continued provision of the service desk function…and to provide DCC sufficient time to develop a mature understanding of how to realign the Service Desk services and systems and run a full competitive procurement to select and migrate to a new solution…*".

3.96 Similarly, prior to January 2024 consultation, DCC had shared evidence which suggests that the one-year 23/24 direct contract extension was once again required to "…*ensure the continued provision of the Service Desk function in fulfilment of DCC's regulatory obligations, pending completion of a longer-term competitive re-procurement*".

3.97 In response to why the one-year extensions for 23/34 and 24/25 are relatively more expensive than the 21/23 contract, DCC explained, ahead of the consultation, that this was partially due to an agreed increase in salary of service desk staff between April 2022 and January 2023; the increase was agreed to reduce attrition (which increased during COVID) as well as reduce reliance on the Dearne Valley site. DCC further explained that a 5.7% rate of indexation was also applied to the rate cards, February 2023 onwards, and had been negotiated down from 10%.

3.98 Our consultation position in January 2024 takes account of the relative increase in headcount for the Switching service as well as the indexation for the 23/24 contract.

DCC's response

3.99 DCC disagreed with Ofgem's view that it had not reported on the extension of the Service Desk contract in prior years; instead, DCC explained that in RY20/21 and RY21/22, it had shared forecasts of the ongoing costs of the service, together with the opted for, sourcing approach. DCC notes that, at the time, Ofgem did not express any notable concern at the time, nor did it probe the issue in the Clarification Questions, the Cost Visit, its Consultation, or the stakeholder event.

3.100 DCC further noted that the Guidance emphasises that DCC is required to justify material variances. DCC explained that the Service Desk did not show a material variance in RY20/21; according to the Guidance, DCC is not required to justify an underspend.

3.101 DCC also commented that, as part of its RY20/21 price control decision, Ofgem had evidently considered that the quality of DCC's information for 21/22 was good enough for that forecast to be approved. DCC stated that Ofgem is required to make decisions that are predictable and consistent, and that it is concerned that Ofgem is now seeking to rewrite prior decisions and placing the onus on DCC to re-justify its expenditure several years after the event.

3.102 Finally, DCC also expressed concerns on Ofgem's methodology for calculating the disallowances for the Service Desk. For example:

- Circa half of Ofgem's proposed disallowance in RY23/24 and RY24/25 is associated with a particular resource working on Switching whereas, through the consultation, Ofgem had previously implied that it was "reasonably satisfied" with DCC's justification of the Switching costs
- The calculation of the disallowance, particularly for the Service Desk resource working on Switching, is based on an incorrect assumption that the rate card for that role is the same as that for a SMETS specific Service Desk resource

- Ofgem has made incorrect projections around the annual variable operational headcount by assuming that all resource levels set out in the contract will be deployed over the entire year. According to DCC, Ofgem is therefore proposing to disallow costs it has not and in all likelihood will not incur

Our view

3.103 Having assessed all the evidence submitted to us, we are of view that DCC has failed to adequately report and justify all costs associated with the re-procurement of the 21/23 as well as the 23/24 (and 24/25) service desk services remain unchanged. Whilst we agree that the service desk services costs showed a net underspend in RY20/21, we note that the costs for the two subsequent years held a material, positive, variance that should have been justified. Whilst these costs were reported, the only justification (for forecasts costs) that DCC provided was that "…*the overall variance is material due to a significantly lower baseline".* We also regret that, as part of this price control submission, DCC incorrectly reported to us that the service had initially been contracted <u>from January 2018</u> to a contract expiry in January 2023.

3.104 We conclude that DCC did not provide, as part of its RY20/21 price control submission (when the contract was signed) an explanation of how the new contract had been arrived at and negotiated; nor did it as part of its RY21/22 price control submission.

3.105 Going forward, we would like to remind DCC of its wider obligations under the Licence to report price control information, and more specifically LC32.4(b) to ensure that price control information is reported "in respect of the period comprising each separate Regulatory Year of this Licence by not later than 31st July in the next following Regulatory Year". This is further complemented by our Guidance, paragraph 2.42, which explicitly requires that <u>all material variations</u> are <u>supported by evidence</u> to demonstrate how DCC has ensured value for money.

3.106 Once more, we are not satisfied with the procurement approach that was chosen, namely via a direct award, both in RY20/21 as well as in RY22/23. We acknowledge the importance of ensuring the continued provision of services, including the service desk function; instead, we observe that DCC has missed out on the opportunity to explore any viable alternatives by directly re-awarding the contract to Capita plc on both occasions. Also, whilst we recognise that Capita plc is able to tender for Relevant Service Capability in the same way as other External Service Providers, we would like to remind DCC again of the relevant conditions[55] in the Licence to ensure that it does not unduly prefer itself or any Affiliate or Related Undertaking.

3.107 We note DCC's argument that we had previously, as part of the November 2023 consultation, implied that we were reasonably satisfied with DCC's justification of the Switching specific service costs; however, as referred to above, that view was largely compromised by a degree of incorrect reporting and therefore a lack of transparency around the total costs against this service.

3.108 We also note DCC's concerns around the calculation of the disallowance, namely that we have incorrectly assumed that the rate card for a particular Switching specific role is the same as that for a SMETS specific Service Desk resource; we fully recognise that the 2021-2023 contract did not contain any Switching resources, however our assumption has been based on the fact that rates for all SMETS and Switching roles are identical within the 23/24 and 24/25 contracts. We compared these rates prior to completing our analysis and prior to our January 2024 consultation.

3.109 Finally, we note DCC's view that we have made incorrect assumptions around the level of resource that will be deployed against the contract over the entire year. Whilst we accept that these operational resources are variable, we would like to note that the disallowances are naturally derived from the cost that is reflected in the contract; for clarity, the total cost, as reflected in the contract, equals the costs associated with resources listed in the contract together with a fixed monthly operational charge as well as a telephony charge. In the event that DCC does underspend against the contract, then we will expect DCC to demonstrate this to us so that the cost disallowances can be readjusted for future years.

3.110 We maintain our January 2024 consultation position and are disallowing, in respect of the service desk, **£0.05m**, **£0.538m** and **£0.538m** for respectively RY22/23, RY23/24, and RY24/25.

[55] Part C: Prohibition of undue preference and undue discrimination, Licence Condition 11.7

4. Performance Incentives

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 SMETS1 BMPPAS.

Regarding the system performance incentive, in our consultation we proposed to zero-weight the SRV8.11 performance metric within SDM1 (Install & Commission), which would mean DCC retained its full margin application (£5.328m).

For the contract management incentive, we proposed to reduce the score awarded by the auditor from 1.95 out of 3 to 1.71 out of 3. This corresponds to a reduction of £0.489m of DCC's margin from a possible £1.142m.

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 awarded a score of 2 to DCC, corresponding to a reduction of DCC's BM by £0.381m.

For the SMETS1 BMPPAS, we proposed to reject DCC's proposal to spread the £6.995m BM reduction for RY22/23, linked to the incentive, across a three-year period.

Following consideration of all consultation responses, we have decided to maintain our consultation position and implement a zero weighting for system performance; award a score of 1.71 out 3 for contract management; and award a score of 2 for customer engagement.

Questions from the consultation

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

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

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

17. What are your views on our proposed position on the assessment of the SMETS1 BMPPAS?

Background

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

4.2 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 BMPPAS.

4.3 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, which is covered in Section 6 of this document.

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

4.5 Following consultation, in October 2020 we published our decision to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management.[56] As part of our decision, we also implemented a Licence change to enable Ofgem to publish guidance, regarding the process, procedures, and criteria of the OPR.[57]

4.6 In March 2021, we published the OPR Guidance to enable implementation, and published a revised OPR Guidance document in March 2022.[58] This included setting the performance levels and values for the system performance penalty mechanisms, and detailed processes for the customer engagement and contract management incentives. We did a trial run in RY20/21 for customer engagement, without margin attached, for the incentive to come into effect with margin attached in this regulatory year RY21/22. While we were unable to conduct a trial for contract management, we set out in our RY20/21 Price Control decision that the incentive would come into effect with margin attached to this regulatory year as originally intended.[59] We decided to implement a 12-month grace period ("Transition Year") for system performance measures in RY21/22.

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

4.7 The total BM at risk for RY22/23, under OPR, 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.

Q14 System performance

***Proposal at consultation**: DCC missed its performance targets for SDM1 (Install and Commission) due to underperformance of the Service Request Variant (SRV) 8.11 metric in the North region. It argued this metric was not under its full control and as such, no margin should be put at risk against it. DCC met all other non-dormant performance targets. We accepted DCC's arguments that no margin should be put at risk against SRV8.11 performance and, as a result, proposed that DCC should be awarded the full margin of £5.328m.*

***Decision**: No change from our consultation.*

Respondents' views

4.8 We received six responses to this question. DCC welcomed our proposals to award it the full margin and to zero-weight SRV8.11 performance for RY22/23.

4.9 However, all other responses disagreed with our proposals. Respondents disagreed on two fronts:

- First, they disagreed a full margin award was reflective of the levels of performance they had experienced as DCC Users
- Second, they disagreed that zero-weighting SRV8.11 performance was an appropriate course of action

4.10 Generally, respondents said that the current OPR system performance measures do not accurately capture DCC's performance as experienced from a customer's perspective. Respondents detailed the issues, incidents, and unplanned maintenance activities they had experienced in RY22/23, pointing out that these have not fed into an existing system performance measure and therefore have not led to a margin reduction. One respondent said the current measures are focused on percentages and high-level outcomes. Generally, respondents wanted the measures to consider more the impact of DCC's activities/performance on consumers.

4.11 Regarding SRV8.11 performance, two respondents (both energy suppliers) took issue with our proposal to zero-weight its performance, as well as DCC's argument that SRV8.11 performance was impacted by factors outside of its control. They highlighted that Wide Area Network (WAN) intermittency in the

North region leads to their engineers having to send multiple service requests in order to install and commission a smart metering device, and, therefore, DCC were arguing that the consequences of a workaround to an issue within their network should be considered a reason to not measure performance of SRV8.11.

4.12 One respondent said that their attempts to flag the above issue had been met with pushback by both DCC and the CSP-North. They argued that zero-weighting SRV8.11 performance would disincentivise DCC to fix the issue, which would lead to further impacts to consumers.

Reasons for our decision

4.13 We acknowledge that respondents have largely disagreed with our proposals to zero-weight SRV8.11 performance and, as a consequence, award DCC the full margin for OPR system performance. However, having considered all arguments provided, we have decided to proceed with our proposals.

4.14 From the responses received, it is clear that DCC Users have faced a range of issues with the DCC system in RY22/23. However, within the interim OPR system performance measures, these issues have not been captured or quantified. As a result, for this year, there is no mechanism already agreed upon by Ofgem, DCC and DCC Users for us to quantify poor performance and adjust margin accordingly.

4.15 Regarding SRV8.11 specifically, we acknowledge the argument made by some respondents that some degree of SRV8.11 underperformance could be addressed through fixing WAN issues in the CSP-N region, which DCC bears responsibility for. However, as we mentioned in our consultation, there is currently no mechanism in place to determine the proportion of SRV8.11 underperformance that can be attributed to WAN intermittency. In the absence of any further evidence herein, we are unable to partially adjust the margin for SRV8.11 performance.

4.16 We also remind respondents that the current OPR system performance measures are temporary and will be used until DCC and wider industry can agree upon new enduring metrics which better reflect customer experience. We encourage all parties to continue discussions in this area to arrive at such new measures.

Q15 Contract Management

Proposal at consultation*: Reduce the score awarded by the auditor from 1.95 out of 3 to 1.71 out of 3. This corresponds to a reduction of £0.489m of DCC's margin from a possible £1.142m.*

Decision*: Remains unchanged from our consultation position.*

Respondent's view

4.17 The majority of respondents agreed with our proposed position, expressing concerns about DCC's handling of its service provider performance.

4.18 One respondent raised that the audit scope should be broad enough to test and validate the effectiveness of DCC's corporate governance and contract management.

4.19 One respondent raised that DCC should have in place plans to rectify the issues and Ofgem should take steps to scrutinise this.

4.20 While another proposed Ofgem should provide examples of best practice or benchmarking for contract management.

4.21 DCC raised concerns over the level of justification provided for the reduction in the scores provided by the auditor. DCC argued that Ofgem is making decisions based on information it is not 'privy to' and/or based on subjective views. DCC also stated Ofgem should explain the specific areas of DCC's procurement approach that warranted a reduction in the scores.

4.22 DCC also raised concerns that Ofgem and the auditor have not taken into consideration the improvements it has made from RY21/22, nor has not been reflected in the auditors scores.

Reasons for our decision

4.23 We acknowledge DCC's concerns regarding the lack of the information provided in the consultation, specifically pertaining to our decision to lower the scores awarded by the auditor. Our primary concern on the back of the RY22/23 audit report revolves around DCC's poor procurement performance, the absence of effective 2nd tier supplier performance management, and the deviation from standard contract change process.

4.24 We observed a concerning trend of DCC's mismanagement of the procurement process leading to an increased dependency on direct awards, which could have been avoided had DCC allocated sufficient time to the procurement process.

4.25 Regarding the lack of improvement in the performance of its 2nd tier suppliers, we are concerned that DCC has not taken measures to address the issues initially identified by the auditors in the RY21/22 audit report. This has resulted in a second consecutive year of poor supplier performance, as evidenced in the 2023 Annual Service Report.

4.26 In terms of the deviation from the contract change process, the auditor found several instances where DCC had processed change documents with its suppliers without first obtaining a Change Authorisation Notice (CAN), thereby increasing risk for both DCC and its suppliers. While we note DCC is aware of this issue and is working towards making efforts to improve, we remain unsatisfied that the current situation fulfils the requirements of the scoring mechanisms listed in the OPR Guidance document[60].

4.27 We disagree with DCC's argument that Ofgem has reduced the scores provided by the auditor based on information that it is not privy to or that it is based on subjective views. Nor do we agree with the notion that Ofgem is required to uphold the scores awarded by the auditor. As stipulated in the March 2023 OPR Guidance document, Ofgem reserves the right to "*…consider responses and any additional evidence submitted by stakeholders*". [61] This may also include further clarification with the auditor around the scores. On that basis, Ofgem will then determine whether to make any adjustments and publish the final decision. The scores provided by the auditor is based on their assessment of DCC's contract performance based on the information available to them at the time. We, as part of the OPR contract management process, are required to assess DCC's performance and provide the final scores, ensuring to take into consideration any views of stakeholders and further evidence available to us. When making our assessment, we used materials such as the audit report, the Annual Service Report, past consultation, decisions, and information provided to us by DCC through the Price Control submission process. We have based our judgement on the information that is readily available to DCC and have also voiced our concerns on these matters in several forums. Therefore, we believe the decisions made where done so openly and transparently and based on the information that was available to us and DCC.

4.28 We also note DCC's concerns that both Ofgem and the auditor have not taken into account the improvements that have been made by DCC in RY21/22. The auditor is tasked with carrying out an independent audit of DCC's contract management performance. The auditor will and has assessed DCC's performance based on the evidence that has been presented to them. Whilst conversations on improvements may have been had with the auditor, the auditor cannot base their assessment on this and have based their final scores on the evidence that was

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[60] Ofgem (2023), OPR Guidance document. www.ofgem.gov.uk/publications/decision-revised-opr-guidance-march-2023
[61] Ibid

available to them throughout the duration of the auditing process. In cases where the auditor was unable to obtain evidence or request for further information based on it falling outside the timeframe of the audit, the auditor has clearly addressed this in their final audit report. Where the auditor feels that there has been some improvement but needs to see more concrete evidence, the auditor has again stated this in their findings. Therefore, we feel the auditor has taken reasonable steps to assess DCC's performance based on the information and evidence that was available to them at the time of the audit.

Q16 Customer Engagement

Proposal at consultation*: Based on the submissions from both DCC and SEC Panel, we recommend an overall score of 2, corresponding to a £0.381m reduction of margin.*

Decision*: Remains unchanged from the consultation proposal.*

Context

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

4.30 The three sections under customer engagement each have three assessment questions with relative weightings. The individual weighting for each assessment question is calculated as one third of its section weighting, with the overall score calculated using a weighted average of the scores specified for each question. For full details on the scoring methodology please refer to our guidance.[62]

4.31 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.

Respondents' views

4.32 Of the eleven responses we received to our consultation, five respondents explicitly agreed with our score of 2 for DCC's customer engagement. The

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

remaining six respondents either did not have a view or required more information to make an informed decision.

4.33 One of the respondents who agreed with our position would welcome more time and effort by DCC to improve its customer engagement and the associated mechanisms used to communicate with Users in relation to services. This respondent also raised issues regarding DCC representatives at external sessions and forums not being fully engaged on the topic at hand due to these representatives recently joining DCC. This respondent also highlighted the ongoing issues with the Nominated Contact List (NCL) and its inefficiencies as new functions and areas within DCC are unaware of its purpose and hence use ad-hoc mailing lists instead of relying on this single source of data.

4.34 Two respondents felt that information sharing on the DSP Technical Refresh and BCDR Testing activities across 2022 was particularly poor, with DCC Users having to repeatedly request that a single view of maintenance outage dates, times, and durations were provided.

4.35 Several respondents reported issues with DCC's Quarterly Finance Forums (QFF) and its ineffectiveness in evaluating DCC's costs as it lacks transparency. Respondents felt that the QFF does not offer a suitable mechanism to effectively scrutinise DCC's costs, its assumptions, or strategic decision-making. It was concluded that the QFF, as an engagement mechanism, does not represent good value for money given the agenda, materials and discussions are entirely managed by DCC. One respondent noted that greater stakeholder involvement in cost forecasting and the determination phase may be necessary. This respondent suggested that Ofgem chair the quarterly forums to guarantee adequate stakeholder involvement at the appropriate times.

4.36 Two respondents stated that DCC has continued to deliver information and materials of variable quality to industry forums. Another echoed there is still room for improvement especially in areas where there is a lack of cost transparency.

4.37 One respondent recognised that DCC has started using social media channels to share general information, however the level of third-party engagement with DCC's posts appears to be very limited.

4.38 Respondents generally agreed with our position and scoring for DCC's customer engagement. Whilst DCC's overall customer engagement has improved over the last year, there are still 'pockets of poor practice', especially with the lack of transparency of costs and decisions, which ultimately impact consumer bills.

4.39 DCC responded by saying it is pleased that Ofgem and SEC parties have recognised improvements in this area, and it looks forward to working with Ofgem and SECAS to further improve ways of working between DCC, its customers and key stakeholders.

Reasons for our decision

4.40 We have reviewed all the responses received. We maintain our consultation position of assigning a score of 2 for DCC's customer engagement for RY22/23.

4.41 DCC has continued to follow its Business and Development Plan (B&DP) which sets out opportunities for customers to feed in views. DCC has provided evidence of monitoring its quality of information and has recognised the need to tailor both its engagement approach and the level of information it provides to a range of stakeholders with varying interests. DCC has also provided sufficient evidence where it has sought feedback from stakeholders through facilitated workshops and summits.

4.42 We note the ongoing concerns regarding DCC's NCL, thus we urge DCC to ensure this data source is utilised effectively with the right communication going out to the right stakeholders. Although DCC has provided some evidence of how customer views have informed its decision making through closing the feedback loop, there are still examples of DCC not providing feedback to SEC Parties. There remain issues with the quality and detail of information provided by DCC across different forums. We note the inconsistencies and mixed views regarding DCC's overall customer engagement.

4.43 We encourage DCC to note the areas listed for improvements including those in relation to the QFF meetings.

Q17: SMETS1 BMPPAS

Proposal at consultation*: DCC lost £6.995m of the total £11.445m of margin at risk under the SMETS1 BMPPAS for RY22/23, retaining £4.490m. DCC requested that this reduction is equally spread across a three-year period. We proposed to not accept this request and proceed with the adjustment of £6.995m in RY22/23.*

Decision*: Unchanged from consultation*

Respondents' views

4.44 Five respondents supported our proposal to proceed with the BM adjustment as outlined in our consultation. Five did not respond to the question or felt they did not have enough information on the proposal to comment.

4.45 In outlining our reasons for our proposal in our consultation, we explained that customers may prefer to recover costs associated with the BMPPAS sooner rather than later, even if it means charges vary from year to year. We sought stakeholder's views on this but received no specific comments. However, one respondent, in agreement with our proposal, requested that DCC should be required to clearly explain any BMPPAS-related charging changes.

4.46 DCC disagreed with our proposal but did not provide any further evidence or justification – beyond that which it had already submitted as part of the price control process – for their preferred option to spread the BM reduction over a three-year period.

Reasons for our decision

4.47 As DCC did not provide any further information for us to consider in their response, and no other stakeholders disagreed with our proposal, we are proceeding with our consultation position to reject DCC's proposal to spread the BM reduction over a three-year period and instead keep the BMPPA term for RY22/23 at £6.955m.

4.48 Below, we reiterate our views on DCC's proposal to spread the BM reduction over a three-year period, as outlined in the consultation:

- 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[63]
- Customers might prefer to recover these costs sooner rather than later, even if it means charges vary from year to year
- DCC was, or should have been, aware of the performance and expected outcomes of the SMETS1 BMPPAS well before the finalisation of the scheme in June 2022. Therefore, we consider that DCC has had enough time to manage its cash flow in relation to any impacts from the SMEST1 BMPPAS. 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

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

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 the SMETS1 BMPPAS 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. Baseline Margin and External Contract Gain Share

Section summary

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

The BM will be adjusted to reflect changes to DCC's Mandatory Business. After consideration of consultation responses, we have decided to maintain all of our consultation positions. We have adjusted the BM to reflect changes to Internal Cost disallowances.

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

Questions from the consultation:

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

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

Q18: Baseline Margin

Proposal at consultation*: Reduce DCC's Baseline Margin Adjustment (BMA) application by £13.597m, therefore amending DCC's application to an adjustment of £10.424m. This reduction comprises a rejection of the 'Increase in Customer Service Expectations' ground and all associated margin (£1.35m); unjustified margin associated with a range of costs with a value <£150k (£1.57m); margin associated with costs applied for under incorrect sub-grounds (£0.35m); margin associated with additional activities that have not been properly justified (£0.24m); as well as £9.849m of margin associated with disallowed Internal Costs.*

Decision*: Unchanged from consultation except for a change in margin associated with disallowed Internal Costs to reflect updated positions (down from £9.849m to £9.545m) and minor corrections to disallowance calculations.*

Respondents' views

5.1 Seven respondents agreed with our consultation proposals. DCC disagreed with our proposals, while three other respondents did not comment on our proposals.

5.2 Regarding our proposed disallowance of the 'Increase in Customer Service Expectations' ground, the following views were presented:

- Two respondents explicitly supported our proposal to disallow the ground. One found it difficult to understand DCC's view that customer expectations have increased, particularly now that there are fewer energy suppliers in operation, compared to RY21/22 and before. They also highlighted that most industry forums are now held online, meaning less time and expenses are spent on organising and travel. They highlighted that a number of DCC staff attend industry forums without contributing and questioned the economy and efficiency with which DCC's resources are used
- Given that the 'Increase in Customer Service Expectations' ground was raised partly in relation to the costs associated with DCC's Quarterly Finance Forum (QFF), one respondent raised their criticisms of the QFF. They argued that it does not provide a suitable mechanism to effectively scrutinise DCC's costs, assumptions, or strategic decision making; nor did they consider the QFF to offer value for money
- DCC maintained its view that customer expectations have increased, stating both its customer base and its activities are now different and more complex than envisaged at the time of its Licence application, and for which it was originally funded. It argued that disallowing the 'Increase in Customer Service Expectations' ground was akin to asking DCC to run its services at a cost

5.3 Respondents made the following comments on other areas of our proposed disallowances:

- Regarding our proposal to disallow the 'Change to DCC's Supply Chain Structure - Increase in Commercial Activity' sub-ground, one respondent stated that a supply chain structure is a standard corporate governance mechanism and agreed with Ofgem that effective supplier and contract management are reasonably anticipated functions for DCC
- Regarding our proposal to disallow unjustified margin on cost variances below the £150k threshold, one respondent agreed that DCC should not benefit from a BMA for positive cost variances where it does not provide appropriate supporting evidence. DCC, however, argued that disallowing margin on such costs is "incomprehensible" given that they have otherwise been approved as part of the price control process

5.4 DCC also raised some broader criticisms of the BMA application process in their response to our proposals:

- It considers the BMA application process "extremely onerous" and stated Ofgem's baseline – against which DCC must justify its expenditure to earn a BMA – is significantly below its own business plan forecast, leading to DCC having to justify ongoing spend on hundreds of members of staff and procurements
- Related to the above point, DCC argued that the BMA process is no longer fit for purpose, given that its activities are "dramatically different to those assumed at Licence award" which leads to a structural bias against DCC in applying for margin.
- There is a perverse incentive to apply for a BMA on small amounts of expenditure to avoid having margin for this expenditure disallowed in future, on the basis of missing the application window for it

Reasons for our decision

5.5 Having considered all consultation responses, we are proceeding with our consultation position to reduce DCC's BMA application by £13.057m, therefore amending the application to an adjustment of £10.966m. Below, we detail our reasons for each area of margin reduction.

Rejection of the 'Increase in Customer Service Expectations' ground.

5.6 In our November 2023 consultation, we outlined our views on why we did not consider the 'Increase in Customer Service Expectations' ground raised by DCC to have met the LC criteria for a BMA.[64] Primarily, we did not consider DCC to have demonstrated a material increase in volume and/or complexity in its activities. DCC has not provided any further evidence in its consultation response to demonstrate these criteria. While DCC showed an increase in the volume of activity from 'Other Users' in its price control submission, it did not, at the time, demonstrate that such an increase in volume was unexpected, or that it led to material pressures on its systems. DCC did not provide any further evidence to this end in its consultation response.

5.7 Moreover, DCC would have had to demonstrate that such an increase in complexity and/or volume arose within the Regulatory Year the ground was applied for. In its price control submission, DCC referred to its customers

[64] See paragraph 6.28 of our RY22/23 Price Control consultation. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202223

becoming more ambitious "with each passing year." The Licence[65] requires DCC to apply for grounds in the Regulatory Year they were first identified.

5.8 Lastly, given that the ground was raised in relation to an increase in costs associated within DCC's Customer Engagement team – which manages DCC's input to industry forums and DCC's own QFF – we are concerned by the criticisms raised by other respondents around DCC's attendance at industry forums and the perceived lack of value for money provided by the QFF. These criticisms imply that cost increases in this team have been, to some extent, inefficiently incurred. We will continue to monitor costs incurred in this area.

5.9 We are therefore proceeding with the rejection of DCC's BMA application under the 'Increase in Customer Service Expectations' ground. This amounts to a reduction of **£1.352m** across RY22/23, RY23/24, and RY24/25.

Rejection of unjustified margin on costs below £150k

5.10 With regards to our rejection of unjustified margin on costs below £150k, we would remind DCC that the £150k materiality threshold on the justification of costs as part of the price control process is in place for the benefit of both DCC and Ofgem to help streamline the price control assessment process. There is no equivalent automatic provision of margin in the BMA process for costs below a certain threshold. Should DCC wish to earn margin on any of its activities, it must provide appropriate justification, either in its Internal Costs submission or BMA submission.

5.11 Upon receipt of DCC's RY22/23 Price Control submission, we informed DCC that we would expect all activities for which it is applying for margin to be properly justified. DCC has not provided any further justification for any of these activities in its consultation response and therefore we will proceed with our reduction of DCC's BMA application by **£1.570m** across RY22/23, RY23/24, and RY24/25. However, as stated in our consultation, DCC is able to re-apply for margin on these activities in future years.

Other areas of rejection

5.12 We will also be proceeding with our rejection of activities under the sub-grounds 'Other Activities' and 'Other Accommodation' within the 'Facilitating Additional Relevant Service Capability' ground aside from activities performed to manage

[65] LC36: Determination of the Licensee's Allowed Revenue, Appendix 2, A6 (Adjustment mechanism for the BM term).

capacity on the network' for the reasons outlined in our consultation.[66][67] DCC did not provide any further evidence for how these activities relate to the 'increase in complexity' criterion for a BMA. This amounts to a reduction of **£0.350m** over RY22/23, RY23/24, and RY24/25.

5.13 Lastly, DCC provided no further evidence or justification for the following activities included under different grounds that we identified as improperly justified for a BMA in our consultation: Commercial Transformation ('Change to DCC's Supply Chain Structure - Increase in Commercial Activity' ground; 'Conference, forums, events' ('Support - Resourcing Planning and Management' ground); 'DCC culture project' ('Support - Resourcing Planning and Management' ground); and MSA (Support - Resourcing Planning and Management' ground). We are therefore proceeding with rejection of the BMA associated with these four activities, amounting to a reduction of **£0.240m** over RY22/23, RY23/24, and RY24/25.

5.14 The BM reductions outlined above total **£3.512m.**[68] In addition to this, we have decided to reduce DCC's BMA by **£9.515m** to reflect the margin associated with DCC's Internal Costs that have been determined Unacceptable Costs.[69] This is a decrease of £0.303m in margin reduction compared to our consultation proposal. The total reduction to DCC's BMA application is therefore £13.055m, leaving £10.966m awarded to DCC.

Q19: External Cost Gain Share

Proposal at consultation*: reduce the Relevant Adjustment to the ECGS term by £0.051m to reflect the portion of ECGS that stemmed from a temporary increase in comms hub unit prices, therefore amending DCC's application to an adjustment of £5.156m between RY22/23 and RY25/26.*

Decision: *no change from consultation.*

[66] See paragraphs 6.34-6.38 of our consultation.
[67] Please note, with regards to this rejection, our consultation only refers to activities within the 'Other Activities' sub-ground in error. This does not affect the value of any proposals.
[68] Please note, this figure is incorrectly referred to as £3.744m in the executive summary of the Performance Incentives chapter of our consultation. However, the correct figure of £3.719m is used later in the chapter.
[69] Details of our Internal Costs disallowances and any changes from our consultation positions can be found in chapter 4 of this document.

Context

5.15 The formula for DCC's Allowed Revenue includes an ECGS term, which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the Fundamental Service Provider (FSP) contracts as detailed in Condition 39 of the Smart Meter Communication Licence.[70] This is so that DCC has an incentive to seek and achieve cost savings in the FSP contracts. This term is zero unless DCC applies for a Relevant Adjustment to this term.

Respondents' views

5.16 Six respondents agreed with our proposal, including DCC. Five did not offer a response to the question, and no respondents disagreed.

5.17 Two respondents, in agreement with our proposal, expressed the view that DCC has become too reliant on interest rate/refinancing savings to secure ECGS, and that it should be actively exploring opportunities to realise cost savings in other areas. One highlighted that the upcoming re-procurement of the next Licensee presents an opportunity for Ofgem to strengthen expectations and obligations around the ECGS mechanism.

Reasons for our decision

5.18 Having reviewed the responses, we have decided to proceed with our consultation position.

5.19 Regarding our reduction of the ECGS term by £0.051m to reflect the portion stemming from a temporary increase in comms hub unit prices, we reiterate that the purpose of ECGS is to reflect cost reductions that DCC helped to achieve. Awarding this portion of ECGS would go against this intended purpose.

5.20 As per the case with the DCC's RY21/22 ECGS application, we highlight that, this year's application was equally inflated by increased comms hub costs. Our view remains that this element of DCC's ECGS applications should be rejected.

[70] Smart Meter Communication Licence available at: www.ofgem.gov.uk/energy-policy-and-regulation/industry-licensing/licences-and-licence-conditions

6. Switching Programme

This section covers our assessment of DCC's costs associated with the Switching Programme in RY22/23 and the forecasts to the end of the Licence period.

It also sets out our view on the three incentive frameworks relevant to Switching, including the fifth and final delivery milestone of the Design, Build and Test (DBT) phase incentivisation framework: Delivery Milestone 5 (DM5).

In our November RY22/23 consultation, we proposed to disallow DCC's forecast costs of £44.514m (£13.432m of Internal costs and £31.082m of External costs) for RY23/24 onwards as DCC did not provide any justifications for these costs.

This year, all DM5 was achieved. We proposed that DCC should retain all margin associated with this milestone. We also awarded DCC 17.25% of all lost margin under the DBT phase, equating to £0.099m (from a total lost margin of £0.576m) of the Discretionary Recovery Mechanism (DRM) and an upward adjustment of £0.105m under the Discretionary Data Reward (DDR) based on DCC's performance in improving data quality.

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

Questions from the consultation

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

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

Q20 Switching Costs

Proposal at consultation*: disallow all forecast costs for RY23/24 to the end of the Licence period, £44.514m.*

Decision*: remains unchanged from the consultation proposal.*

Context

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

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

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

Respondents' views

6.4 Five respondents explicitly agreed with our proposal for DCC to lose all forecast costs related to the Switching Programme due to a lack of justification for these costs. The remaining six respondents did not have a view.

6.5 One respondent noted this is another area where DCC have not successfully provided enough evidence or sufficient justification for its forecast costs associated with Switching.

6.6 Another respondent stated that switching activities should be separate from DCC's smart-related core mandatory business.

6.7 DCC were pleased that we are not proposing to disallow any of its costs incurred in RY22/23. However, DCC posed concern that we propose to disallow the entirety of the forecast costs associated with the Switching Programme for RY23/24, RY24/25, and RY25/26.

Reasons for our decision

6.8 We have reviewed all responses that were received. No further evidence to justify the Switching forecast costs were provided by DCC. As a result, we will maintain our consultation position.

6.9 We reiterate that as the Business Plan for the Switching Programme was not competitively tendered, and therefore cannot be considered innately economic and efficient, DCC must justify all costs to the end of the Licence Period.

Q21 Switching Performance

***Proposal at consultation**: allow DCC to retain all margin associated with DM5 which equates to 15%. Award DCC the Discretionary Recovery Mechanism (DRM) and the Discretionary Data Reward (DDR).*

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

Context

6.10 We published our decision on an updated incentive regime for DCC's role in the Design, Build and Test (DBT) Phase of the Programme in May 2019.[71] To note, this is a separate regime from the OPR and BMPPAS (discussed in chapter 5).

6.11 The first of the delivery milestones under the DBT Phase occurred in RY19/20. Delivery Milestone 1 (DM1) required DCC to develop the Centralised Switching Service (CSS) interface specifications and the CSS Integration Approach (CSSIA). Due to the extent of the delays with DM1, DCC lost all associated margin. The second and third of the delivery milestones occurred l in RY20/21. Delivery Milestone 2 (DM2) required DCC to successfully complete the initial pre-integration testing of the CSS. Delivery Milestone 3 (DM3) represented the successful completion of the planning and preparation activities for System Integration Testing (SIT). Delivery Milestone 4 (DM4) required DCC to complete the Programme-led End to End Testing. The purpose of Delivery Milestone 5 (DM5) was to confirm that all elements of the transition to live services were complete. Achievement of DM5 was confirmed by the Delivery Group on 30 June 2022.

6.12 All margin on Internal Costs relating to the successful delivery of the DBT phase is at risk against the DBT milestones, with 30% against DM1, 20% at risk against DM2, 25% against DM3, 10% against DM4 and 15% against DM5. The final values that this represents in terms of margin retained has now been finalised and stands at £2.74m as all delivery milestones under the DBT phase have been assessed.

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

Respondents' views

6.14 Six respondents including DCC supported our proposal for DCC to retain all margin at risk against DM5 as the milestone was achieved.

6.15 DCC welcomes our recognition that the final delivery milestone for the Switching Programme was achieved in full and our decision to award additional switching margin through the DDR and DRM.

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[71] Ofgem (2019), Decision on margin and incentives for DCC's role within the Design, Build and Test Phase of the Switching Programme. www.ofgem.gov.uk/publications/decision-margin-and-incentives-dccs-role-within-design-build-and-test-phase-switching-programme

Reasons for our decision

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

7. Proposals to amend future Baseline Margin and Shared Services Charges

Section summary

This section summarises our position on the proposals to adjust DCC's Baseline Margin (BM) level from 15% to a value in the range of 7-9%; a lowering of the existing Shared Services Charge (SSC) from 9.5% to 4.5%; and our proposal for services provided to DCC by Capita to no longer attract any additional baseline margin.

We have reviewed all responses and accept the view that our proposal for services, provided to DCC by Capita, to no longer attract any additional baseline margin, could potentially constitute an unjust distortion of competition and an imposition of an arbitrary competitive disadvantage on Capita against its rivals. We have decided not to implement this proposal on those grounds but will instead impose additional reporting requirements on DCC for where services are being procured from Capita.

We will be seeking further evidence from DCC and Capita to inform our decisions on the adjustment of DCC's BM levels as well as our proposal to lower the SSC. We expect to publish our decision on these areas in due course.

Questions from the consultation

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?

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?

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?

Q24 Removal of additional Baseline Margin on services provided to DCC by Capita

Proposal at consultation*: to disapply any additional BM through the adjustment process from 01 April 2024 onwards, for any services provided to DCC by Capita, whether through a services contract or through the SSC arrangements.*

Decision: *we will not proceed with our proposal to remove additional baseline margin for any services provided to DCC by Capita.*

Respondents' views

7.1 All respondents, except DCC and Capita, agreed with our consultation position.

7.2 DCC expressed disappointment that Ofgem had chosen to propose fundamental policy changes in these areas. DCC's shareholder, Capita, explained that the proposal to remove any Baseline Margin to services provided by Capita would constitute an unjust distortion of competition and an imposition of an arbitrary competitive disadvantage on Capita against its rivals. For example, if Capita were to submit the lowest bid, then DCC might still be inclined to select the next best bid as this would be a better outcome (in terms of baseline margin) for DCC. As such, this might result in an outcome that represents a service with higher prices.

Reasons for our decision

7.3 We have reviewed all responses and accept the view that our proposal for services, provided to DCC by Capita, to no longer attract any additional baseline margin, could potentially constitute an unjust distortion of competition and an imposition of an arbitrary competitive disadvantage on Capita against its rivals. We have decided not to implement this proposal on those grounds but will instead impose additional reporting requirements on DCC for where services are being procured from Capita. We will further engage with DCC on agreeing the reporting template for additional reporting requirements and expect DCC to submit these to us from the RY23/24 Price Control submission onwards.

7.4 We will also be seeking further evidence from DCC and Capita to determine the appropriate levels of BM and SSC (consultation questions 22 and 23). We expect to publish our decision on these areas in Spring 2024.

Appendices

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Appendix 1 – Determination of Allowed Revenue (AR)

Regulatory Year	2022/23	2023/24	2024/25	2025/26
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 (excludes any performance adjustments)	**561.029**	**585.608**	**675.751**	**540.938**
Cost Disallowances				
External Cost Disallowances				
S1_DCOa	2.443	0.000	0.937	0.937
S1_DCOc	0.000	0.000	1.037	1.037
Service stabilisation	0.714	0.000	0.000	0.000
CH&N_DM	0.402	0.816	0.392	1.063
CH&N_CI	0.155	0.357	0.198	0.000
DSP – forecast costs	0.000	11.834	4.245	11.086
CSP-C – forecast costs	0.000	1.333	1.920	0.000
CSP-S – forecast costs	0.000	0.055	0.441	0.000
CRS forecast external costs (Switching)	0.000	10.743	9.849	10.490
Total External Costs disallowances	***3.714***	***25.138***	***19.019***	***24.613***

Internal Cost Disallowances				
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	0.789	0.000	0.000	0.000
Corporate Management - Payroll - lack of evidence/ justification	0.090	0.200	0.250	0.000
Design and Assurance - Payroll - lack of evidence/ justification	0.000	1.965	4.370	0.000
ES & IS - Planning/Outsourcing of services	3.337	0.312	0.000	0.000
ES & IS - Procurement (NCP)	0.352	0.000	0.000	0.000
Security - Payroll - lack of evidence/ justification	0.089	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
Service Desk contract	0.050	0.538	0.538	0.000
Shared Service Charge	0.917	2.019	2.406	8.006
Total Internal costs disallowances	***11.212***	***26.929***	***31.458***	***102.184***
Total cost disallowances	**14.926**	**52.067**	**50.477**	**126.797**
Performance Adjustment Reductions				
OPR	**-0.870**	**0.000**	**0.000**	**0.000**
BMPPA - SMETS1	**-6.955**	**-1.224**	**0.002**	**0.000**
CRS performance adjustment due to disallowances	**0.000**	**0.000**	**0.000**	**0.000**
AR excluding BM and ECGS adjustments	***538.278***	***532.317***	***625.275***	***414.141***
Baseline Margin and ECGS adjustments				
BM adjustment (22/23 prices)	0.000	0.000	5.303	5.663
ECGS adjustment	0.000	0.000	5.156	0.000
AR with BM and ECGS adjustments	**538.278**	**532.317**	**635.735**	**419.804**