Consultation

DCC Review Phase 2: Governance and Centralised Registration Service arrangements

Publication date:	21/05/2024
Response deadline:	16/07/2024
Contact:	Jakub Komarek
Team:	DCC Oversight and Regulatory Review (Retail Systems and Processes)
Telephone:	020 7901 7000
Email:	DCCregulation@ofgem.gov.uk

We are consulting on the future arrangements for the governance of the Data Communications Company (DCC) and the Centralised Registration Service. We would like to invite views from people and organisations with an interest in smart metering. We particularly welcome responses from DCC customers, including energy suppliers, distribution network operators, consumer groups and other current or potential future users of DCC network. We would also welcome responses from other stakeholders and the public.

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

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Executive Summary

The Data Communications Company (DCC) is responsible for establishing and operating a secure national communications network for smart metering in Great Britain. It currently operates under the Smart Meter Communication Licence,[1] awarded by the government in 2013 for an initial period of 12 years. We[2] are reviewing the regulatory arrangements to be put in place for DCC following the expiry of the current licence (due in 2025, subject to a possible extension).

In August 2022, we concluded the first, scoping phase of our review with a set of key features to form the basis of the design of the new regulatory model and drive our agreed principles.[3] This is the first consultation aimed at developing these key features into detailed policy proposals to underpin the new DCC Licence. In the first part of this consultation, we are seeking views on our proposals in relation to key feature #1 which stated that, under the Successor Licence, DCC's Board should be majority stakeholder or independent controlled and include consumer representation. In the second part, we invite views on the option to either retain the provision of the Centralised Registration Service (CRS) within the DCC Licence or transfer the obligation to the Retail Energy Code (REC) to be delivered by RECCo.

PART I: Future Governance Arrangements

DCC Board composition

To implement our first "key feature", we present and seek views on four possible models for the future composition of the DCC Board, drawing on our analysis of different arrangements that exist in the energy sector. Based on our analysis and for the reasons set out in further detail in **Chapter 2**, we are of the view that the frontrunner for the most appropriate model for the future board arrangement is currently an **independent majority** without *direct* representation from persons affiliated with DCC's service providers or customers.

Secondly, we are seeking stakeholder feedback on options to alter the independence requirements on Sufficiently Independent Directors in the new Licence, including

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[1] Hereafter referred to as "the DCC Licence" or "the Licence"
[2] References to the "Authority", "Ofgem", "we", and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work.
[3] Ofgem (2023), DCC review: Phase 1 Decision. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision. For details on principles, see Ofgem (2022), DCC review: Phase 1 Consultation, esp. p.26, table 2.1 www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

affording more discretion to the Board in deciding whether a person should be deemed Sufficient Independent.[4]

Thirdly, we seek views on our proposal that the independence requirements on Sufficiently Independent Directors should be extended to the Chair of the Board.

Finally, we invite views on our proposal not to prescribe the overall size of the Board or the number of possible executive members and shareholder representatives.

DCC Board appointment process and requirements

In **Chapter 3**, we seek views on the process and requirements involved in the appointments to the DCC Board. Our first proposal is for the new Licence to place a requirement on the Board to at all times to possess sufficient experience in certain core areas; to which end we have identified the following: GB energy market (supply and distribution), commercial contract management, data and communication technology, and consumer advocacy. As part of this, we propose that consumer voice be represented by a Sufficiently Independent Director with a proven consumer advocacy experience. Consumer focus may be further enhanced by a possible introduction of a consumer-focused objective (subject to a separate consultation).

Secondly, we are inviting views on options for Ofgem and stakeholder (customer) role in the Board appointment process. These include options for a review process of the Board appointments by Ofgem; and a stakeholder representation via the Nomination Committee, which could afford stakeholders direct input into the appointment process while protecting the autonomy of the Board and its members.

Finally, we seek views on whether the appointment of the first Chair should follow a distinct process, including a potential duty on DCC to consult with and seek view from Ofgem, on account of the importance of the Chair's position in appointing the remaining posts.

Incentivisation of DCC Board, executive leadership, and key staff

Through **Chapter 4,** we present and invite views on ways to assure the Board's decision-making and the right outcomes of the future governance. To that end, we consider different methods of incentivisation. First, we look towards limiting the terms of appointment as the best option to incentivise independent non-executive directors. We are seeking stakeholder input on our proposal to limit the initial term of appointment of

[4] The term "Sufficiently Independent Directors" has the meaning defined within the current Licence under Licence Condition (LC) 9.15, subject to our proposals in chapter 2 of this consultation.

non-executive board members to a maximum of 3 years, with the possibility to be reappointed twice, each reappointment with a 3-year limit.

Secondly, we seek stakeholder views on proposals for reputational incentives and enhanced regulatory requirements in the areas of system performance, customer engagement and contract management (covered by the existing Operational Performance Regime, or OPR); with the possibility of further incentives associated with an envisaged shift to an *ex-ante* cost control regime, targeting business planning and cost management. We also propose that the measurable outcomes of these reputational incentives be considered by the Renumeration Committee when setting targeted financial incentives on executive leadership and key staff.

Finally, we seek stakeholder views on our proposal to allow a qualified majority of DCC customers to issue a (non-binding) motion of 'no confidence' in DCC's management as a measure to enhance accountability to stakeholders.

Interim changes to governance

We previously estimated that a 12-36 month extension to the current licence would likely be needed to develop and implement the new Licence. We envisage that (subject to the outcome of this and our future consultations) certain changes may be implemented within this extension period. Through **Chapter 5** we are seeking stakeholders' opinions on the key changes we have identified. These may include working with DCC to appoint an independent Chair and a board member with consumer advocacy experience, increase stakeholders' engagement in board meetings and the appointment of an Ofgem observer in a suitable forum to oversee the business handover to the Successor Licensee. Our current view is that these interim changes can be implemented without Licence modifications. As such, we are proposing to focus on reaching an agreement with DCC in the first instance. However, we welcome views from DCC and other stakeholders and will consider these as part of our ongoing redesign of the regulatory framework and our future design of the new Licence. We also seek stakeholder views on possible retention of the current Sufficiently Independent Directors on the successor Board.

PART II: Centralised Registration Service Arrangements

We are seeking stakeholders' views on whether DCC should remain responsible for the provision of the Centralised Registration Service ("Switching"). We have already received some stakeholder feedback on this topic. Some stakeholders have suggested that the Retail Energy Code Company (RECCo) should assume responsibility for contracting with the service providers to deliver these services directly. Building on this feedback, we discuss two options for the provision of the Centralised Registration Service (CRS) and set out our assessment of them. Based on our analysis and for the reasons set out in further detail in **Chapter 6**, we are currently of the view that there may be sufficient reason to separate the provision of the Switching service from the Smart Meter Communication Licence and transfer the responsibility to the Retail Energy Code (REC) to be delivered by RECCo.

Next steps

This is the first consultation that will comprise our second 'detailed design' phase of the review. On the basis of stakeholder responses we will make decisions on the future DCC Board composition, the method of appointment, including the role of stakeholders and the Authority in the process, the appropriate method for the Board's incentivisation, and the way forward for the Centralised Registration Service arrangements. Following this consultation, in the coming months, we plan to publish two further consultations. One will focus on changes to the determination of DCC's Allowed Revenue, setting out our proposals for *ex-ante* cost control arrangements under the Successor Licence, and the changes that will come into effect in the extension period of the current Licence. The other consultation will cover future role of DCC, including the scope of its Authorised Business, revised objectives, rules for DCC's operating model, and how change in DCC role could be managed as and when the need arises.

1. Introduction

What are we consulting on?

1.1 This policy consultation is part of our ongoing review of the regulatory arrangements for the Data Communication Company (DCC) to be put in place following the expiry of the current Licence. It covers two key areas:

(1) The future governance arrangements for DCC under the Successor Licence

(2) Who should be responsible for the delivery of the Centralised Registration Service

1.2 For the avoidance of doubt, DCC is the term used to refer to the holder of the Smart Meter Communication Licence ("the Licence"). It operates under the conditions of its Licence and is regulated by Ofgem. At present, Smart DCC Ltd is the legal entity that holds the Licence, following a competitive tender process that took place in 2013. Throughout this document, we refer more broadly to "DCC", meaning the holder of the Licence (in its generic sense) and the organisation currently carrying on the Authorised Business, and our references should be interpreted in accordance with the context to which they relate, whether that be the current licensee or the future DCC.

1.3 We are carrying out a review of the regulatory framework ahead of the expiry of the current Licence – due in 2025, subject to a possible extension in accordance with the 'Terms of the Grant' of the Licence.[5] In August 2023 we published a consultation response concluding the first, scoping phase of our work.[6] This consultation is the first of three that will form the second 'detail design' phase of the review. We are seeking stakeholders' views on:

- Future DCC's Board composition
- Board appointment process and requirements
- Incentivisation of DCC Board and executive
- Interim changes to governance
- Future of Centralised Registration Service

1.4 Below, we set out what each individual chapter of this consultation will cover.

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[5] Part 1 (Terms in respect of Grant), Section C
[6] Ofgem (2023), DCC review: Phase 1 Decision. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision

DCC Board composition

1.5 In our August 2023 consultation response, we set out our conclusions that the future DCC Board should consist of a majority of stakeholder/independent members. This chapter presents our analysis of four possible implementation models which we seek stakeholder views on. We have identified and present one option (Option 4 – Board majority comprising "Sufficiently Independent Directors")[7] as a current frontrunner and are interested in stakeholder views on our assessment and proposal.

1.6 We also present and seek views on options to either retain or amend existing Licence requirements on Sufficiently Independent Directors, including a proposal that these requirements should newly apply to the Chair. Finally, we are looking for views on whether to introduce any restrictions or requirements on the overall size of the Board or the number of possible executive members and shareholder representatives.

Questions

1. **What are your views on the presented options for the future DCC board composition? Do you agree with our analysis that Option 4 (majority independent model) is the most appropriate to take forward? Please state your reasoning.**
2. **What are your views on the current and proposed Licence requirements on Sufficiently Independent Directors? Do you agree that one or more of the current Licence-imposed Independence Requirements may be relaxed in favour of more discretion afforded to the Board?**
3. **Do you agree with our proposal that the Chair of the future DCC board should meet the requirements on 'Sufficiently Independent Directors' without exception?**
4. **What are your views on our analysis and proposal not to introduce additional requirements or restrictions on the size of the future Board and on the number of executive members and shareholder representatives?**

[7] Where we use the term "Sufficiently Independent Director(s)" throughout this document, we mean as currently defined within the current Licence (LC 9, Part E), subject to our proposals set out in chapter 2, section B.

Board appointment process and requirements

1.7 In this chapter we outline and seek stakeholder views on our analysis and proposals for how the future DCC Board and Chair could be appointed, including the possible role of DCC stakeholders and Ofgem in the process. We also discuss proposals for requirements on specific areas of expertise on the Board and how consumers could be best represented.

Questions

5. Do you agree with a possible requirement on the Board to possess expertise in certain core areas? Do you agree with the areas we have identified? What are your views on the implementation options?

6. Do you agree with our proposal to represent consumer voice via a requirement on the appointment of a Sufficiently Independent Director with consumer advocacy experience?

7. What are your views on Ofgem's role in the Board appointment process? Do you agree with our proposal that the Authority could have a role in the appointment process of non-executive directors? Which option would provide the most appropriate and effective accountability framework, and why?

8. What are your views on the role of DCC customers and other stakeholders in the Board appointment process? Do you agree with our proposal to provide representation for DCC customers on the Nomination Committee? What should be the role of an industry representative in such an arrangement?

9. What are your views on our proposals for an additional requirement on the Chair's experience and Ofgem's role in the initial appointment of the Chair? In what other way should the appointment process for the Chair be different to that of other DCC Board members?

Incentivisation of DCC Board and executive

1.8 In this chapter we invite views on our proposals relating to placing additional incentives on DCC and its leadership under a not-for-profit arrangement in the absence of a margin that can be put at risk. Firstly, we consider options to alter the Licence restrictions on the term of appointment of non-executive board members. We then discuss introduction of possible reputational incentives (by adapting existing incentives under the Operational Performance Regime and introducing possible new incentives associated with the envisaged shift towards *ex-ante* cost control regime), and the way in which these incentives could be linked to senior leadership and staff performance through renumeration. Finally, we set out an option for a customer-led non-binding motion of "no confidence", the objective of this power, and the requirements for, and consequences of, such a motion.

Questions

10. What are your views on changes to the term of appointment of non-executive directors? Do you agree with our proposals to limit the initial term of appointment for non-executive directors to 3 years, and to allow for up to two reappointments with the total term limited to a maximum of 9 years?

11. What are your views on the identified reputational incentives and associated enhanced regulatory requirements? How effective do you believe these incentives can be?

12. What are your views on direct financial incentivisation of executive leadership and key staff? What would make those incentives effective? Please consider their interlink with the reputational incentives.

13. What are your views on the proposal to grant stakeholders the power to issue a (non-binding) motion of "no confidence", its objective and requirements? If implemented, what should be the methodology for determining a qualified majority and distribution of votes among stakeholders?

Interim changes to governance

1.9 In this chapter we discuss the changes that we hope to bring in during the extension period of the Licence via mutual agreement with DCC. We are seeking stakeholder feedback on proposed changes and their views on the prioritisation of these changes.

Questions

14. Do you agree with the identified priority areas of interim changes? Are there other governance changes that should be implemented in the Licence extension period?

15. What are your views on the possible retention of current Sufficiently Independent Directors on the Board of DCC2? What provisions may need to apply to facilitate this?

Centralised Registration Service (CRS)

1.10 Pursuant to stakeholder feedback in relation to the continued provision of the CRS through the DCC Licence, in this chapter we are seeking stakeholders' views on whether DCC should remain responsible for the provision of the CRS. We present two options – retention under the DCC Licence (Option 1) or transfer the obligations to deliver this service to the Retail Energy Code (Option 2 – *currently preferred*).

Question

16. Do you agree with our proposal that it would be appropriate to remove provision of the Centralised Registration Service (CRS) from the DCC Licence and transfer the obligation to the Retail Energy Code (REC) to be delivered by RECCo?

17. What are your views on the considerations we have identified under option 1?

Context and related publications

1.11 Work on the DCC review commenced in February 2021 with our call for evidence in the form of a published open letter.[8] Through this open letter we sought early stakeholder views to inform our approach towards, and the scope of, the review.

1.12 In April 2021, we held a series of structured bilateral engagements to help contextualise the evidence.

1.13 In June 2021, we hosted a stakeholder workshop where we invited views on our understanding of the range of issues identified through the call for evidence, tested our proposed principles, and explored the extent of changes needed to deliver our principles and if these can be achieved via changes to the Licence.

[8] Ofgem (2021), Call for evidence: Review of the DCC licence arrangements. www.ofgem.gov.uk/call-for-input/call-evidence-review-dcc-licence-arrangements

1.14 Our autumn 2022 consultation concluded the first, 'scoping' phase of the DCC review.[9] We published our phase 1 consultation response in August 2023[10] in which we decided to adopt a set of key features to form the basis of the new regulatory model:

1. The company Board should be majority stakeholder or independent controlled and include consumer representation
2. The Core Mandatory Business should be conducted on a not-for-profit basis
3. Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process.

In addition, we concluded we would retain the following features of the current model:

4. The operational model will remain primarily outsourced with key contracts procured competitively on the market (decisions made by the Board subject to Licence limitations)
5. DCC's Core Mandatory Business will remain funded by charges on users

1.15 We also said we would follow the existing procedure for granting the next Licence to a new licence-holder ('Successor Licensee'); we envisage following the existing requirements to implement the new framework via an open, competitive tender process run by Ofgem.[11]

1.16 In November 2023 and February 2024, we hosted further stakeholder workshops to test our emerging proposals on the detailed policy design in relation to DCC's governance, cost control and future role.

1.17 We set out in our 2024-25 Forward Work Programme that we will prepare governance for the not-for-profit successor to [the current] DCC, with milestones including this consultation, approval of DCC's revised Business Handover Plan,[12]

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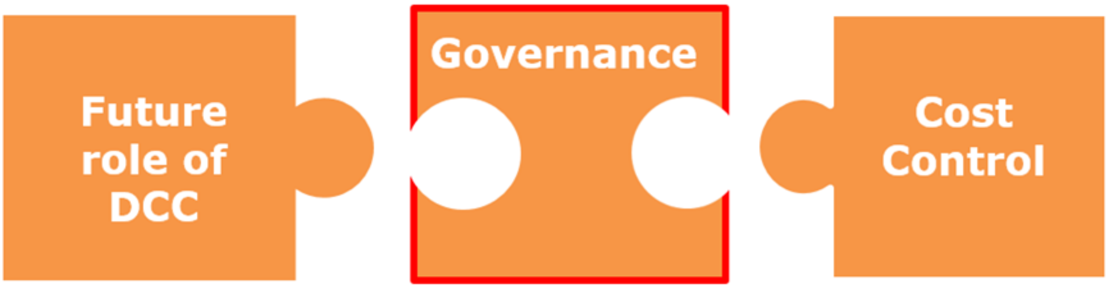
[9] Ofgem (2022), DCC review: Phase 1 Consultation. www.ofgem.gov.uk/consultation/dcc-review-phase-1-consultation
[10] Ofgem (2024), DCC review: Phase 1 Decision. www.ofgem.gov.uk/decision/dcc-review-phase-1-decision
[11] In line with the Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012. www.legislation.gov.uk/uksi/2012/2414/contents/made
[12] Under LC 43 (Arrangements for the handover of business)

and publication of further consultations on future DCC price control arrangements and future role of DCC.[13]

Links and considerations

1.18 This is the first of three policy consultations that we expect to form part of the second (detailed design) phase of the DCC review programme. These three consultations (and our decision in response to these) should be taken as a whole. Below we have sought to set out the envisaged key tenets of our evolving proposals to provide further context of the role of stakeholders in the new framework.

Figure 1.1: The three policy workstreams of Phase 2 (Detailed design) of the DCC review



1.19 Our consultation on the "future role of DCC" is expected to cover the following topics: scope of DCC's future Mandatory Business, scope and rules for any non-mandatory business, future Licence objectives, the operational model and wider strategy-setting. Within these, we will consult on options for enhanced customer role including through: governance process for changes in the scope of DCC's Core Mandatory Business and requirements, process for agreeing provision of any additional services subject to customer consultation, and how our "customer-centric and consumer-conscious" principle should be reflected in DCC's objectives and decision-making, among others.

1.20 Our consultation on the future method for determination of DCC's Allowed Revenue ("cost control") will seek views on the envisaged shift towards *ex-ante* regime for DCC's price control, and its possible implementation in any Licence extension period. This will include proposals for strengthened customer and

[13] Ofgem (2024), 2024/25 Forward Work Programme, objective 13.2. www.ofgem.gov.uk/publications/decision-consultation-ofgems-forward-work-programme-202425

consumer representation, including the possibility for the introduction of a new formal customer challenge group as part of business planning and cost approval process.

1.21 In addition, our ongoing work has linkages with several live programmes, among these the Energy Code Reform project, a joint Ofgem-DESNZ initiative aiming to reform the governance of the industry codes, to establish a codes framework that is forward-looking, agile, and able to facilitate the transition to Net Zero.[14] The changes, enabled by the passage of the Energy Act 2023, will impact the governance of the Smart Energy Code (SEC) and the Retail Energy Code (REC), with implication for the operations of DCC2 and therefore this review. We will continue to seek alignment on our proposals and timing of implementation alongside this project.

1.22 By the expected endpoint of the smart meter rollout, the vast majority of smart meters will have been installed; in this context we anticipate changes in DESNZ's role in the Smart Meter Implementation Programme (SMIP). This includes a planned change in DESNZ's continued role in driving and assuring DCC programmes and operations. This change will have implications for any transition period and is a key consideration for putting in place enduring governance and oversight arrangements under a new framework. As this consultation focuses on the governance of DCC at the organisational level, we will consider changes to wider governance, for example in the context of strategy-setting, in our upcoming consultation on the future role of DCC.

[14] Ofgem (2024) Energy code reform: implementation consultation. www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation
Ofgem, DESNZ (2024), Energy code reform: code manager licensing and secondary legislation. www.gov.uk/government/consultations/energy-code-reform-code-manager-licensing-and-secondary-legislation

Consultation stages

1.23 This consultation will open on 21 May 2024 and will close on 16 July 2024. Following our review of stakeholder representation, we expect to make our decision later in summer 2024, subject to internal governance.

Table 1.1: Consultation stages

Stage 1	Stage 2	Stage 3	Stage 4
Consultation open	Consultation closes (awaiting decision). Deadline for responses	Responses reviewed and published	Consultation decision
21/05/2024	16/07/2024	summer 2024	Expected in late summer 2024

How to respond

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

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

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

Your response, data and confidentiality

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

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

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

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

General feedback

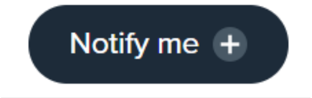
We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

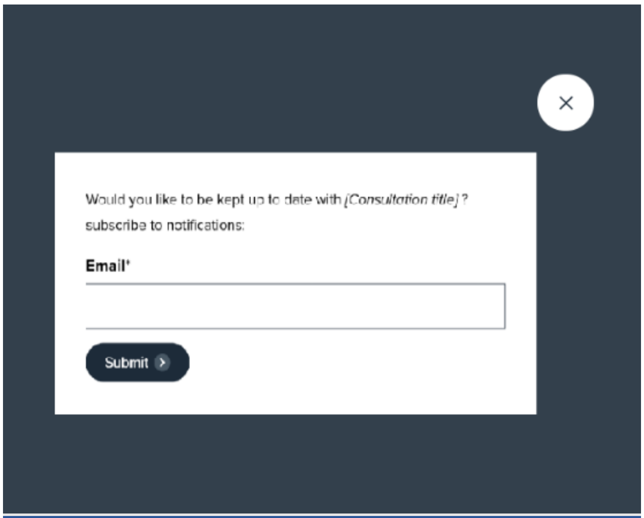
1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6.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

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

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations





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

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

2. DCC Board composition

Section summary

We present and seek views on four possible models for the future composition of the DCC board, drawing on our analysis of different arrangements that exist in the energy sector. Based on our analysis and for the reasons set out in further detail in this chapter, we are of the view that the frontrunner for the most appropriate model for the future board arrangement is currently an independent majority without *direct* representation from persons affiliated with DCC's service providers or customers. Secondly, we are seeking stakeholder feedback on options to alter the independence requirements on Sufficiently Independent Directors in the new Licence, including affording more discretion to the Board in deciding whether a person should be deemed Sufficient Independent. Thirdly, we seek views on our proposal that the independence requirements on Sufficiently Independent Durectors should be extended to the Chair of the Board. Finally, we invite views on our proposal not to prescribe the overall size of the Board or the number of possible executive members and shareholder representatives.

Questions

1. **What are your views on the presented options for the future DCC board composition? Do you agree with our analysis that Option 4 (majority independent model) is the most appropriate to take forward? Please state your reasoning.**
2. **What are your views on the current and proposed Licence requirements on Sufficiently Independent Directors? Do you agree that one or more of the current Licence-imposed Independence Requirements may be relaxed in favour of more discretion afforded to the Board?**
3. **Do you agree with our proposal that the Chair of the future DCC board should meet the requirements on 'Sufficiently Independent Directors' without exception?**
4. **What are your views on our analysis and proposal not to introduce additional requirements or restrictions on the size of the future Board and on the number of executive members and shareholder representatives?**

Background

2.1 In our August 2023 consultation response, we concluded that one of the key features of the new regulatory model would be that the future DCC Board should be majority independent/stakeholder-controlled[15] (with consumer representation).[16] We set out 3 possible arrangements to meet this model:

- Stakeholder majority
- Stakeholder plurality
- Independent majority

2.2 We also envisaged that there would be at least one member on the Board from the parent organisation, one independent board member, and a consumer representative. We are now consulting on the details of this composition.

A. Board composition considerations

Q1 What are your views on the presented options for the future DCC board composition? Do you agree with our analysis that Option 4 (majority independent model) is the most appropriate to take forward? Please state your reasoning.

2.3 In reviewing the options for the Board composition, we have considered:

- Other licences that Ofgem grants and Ofgem's role within the governance of the licensees
- Central Service Delivery Bodies (CSDB) (for a summary of the CSDBs board composition and stakeholder and Ofgem role, please see Appendix 1),
- Principles and recommendations of the UK Corporate Governance Code (2018 and 2024)
- Input from internal and external stakeholders, including an academic panel and legal advice

2.4 We presented our initial considerations at a workshop on 22 November 2023. We have analysed the three positions identified in our August 2023 consultation response, as well as an alternative arrangement similar to that in place for the Alt-HAN Co, from a policy, regulatory and legal perspective.

2.5 Although we have considered the existing governance arrangements for other CSDB for comparison, it is important to note key differences between DCC and

[15] By 'stakeholder-controlled' Board, we mean a board composed of the representatives of DCC customers (with a potential consumer representation)
[16] Ofgem (2023), DCC review: Phase 1 Decision, 2.45. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision

those organisations. DCC was set up to design, build, test, operate, and maintain the communication infrastructure for smart metering. DCC delivers this role against the objectives and obligations set out in its Licence and the requirements in relevant codes (SEC, REC); however, DCC is not an industry code administrator or a body representing parties to the code(s). This means that not all lessons learnt from the governance of industry panels or administrators can directly apply in this case.

2.6 Below we in turn discuss each of the four options, their perceived benefits, risks and challenges, and our analysis. We have identified one option (Option 4 – Board majority comprising "Sufficiently Independent Directors") as a current frontrunner. However, we invite views on all options we have analysed and presented and want to hear whether stakeholders agree with our proposal.

Option 1: Stakeholder majority board

2.7 The first option we considered is a stakeholder majority model, meaning a board which is controlled by a majority of representatives from DCC customers (with a minority of independent directors, shareholder representatives and executive board members). This option had received support from many stakeholders in response to our Phase 1 consultation.[17] We have considered two possible arrangements for this model:

2.8 Under **Arrangement A** DCC customers would vote on their representatives to the Board using a constituency model. Within the existing CSDB the most direct comparison is the Smart Energy Code (SEC) panel and board. The SEC(Co) board includes representatives from Large Supplier Parties, Small Supplier Parties, Electricity Network Parties, Gas Network Parties, Other SEC Parties and DCC.[18] To represent different groups of stakeholders fairly and to balance the interests of different groups, while preventing domination by a handful of large users, DCC board constituted in this way could adopt voting using similar constituencies.

2.9 **Arrangement B** would remove categorisation of DCC customers with parties nominating candidates as a whole. The nominated candidates would be reviewed by the Board's Nomination Committee which would select a shortlist. DCC

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[17] Ofgem (2022), DCC review: Phase 1 Consultation. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation. See published non-confidential stakeholder responses.

[18] The SECCo Board membership is almost identical to the SEC Panel membership: each SEC Panel member is appointed as a SECCo Director except for DESNZ and Ofgem representatives, and the SEC Panel Chair is also appointed as the SECCo Chair. Current membership of SECCo board can be found here: https://smartenergycodecompany.co.uk/secco-board/

stakeholders would then vote to approve that candidate(s). There are a number of ways to allocate votes under this option and we discuss how voting could be allocated to stakeholders in chapter 4, section D (see paragraphs 4.41-4.45). This arrangement would allow for more nuanced balancing of interests of individual parties. The most direct comparison within CSDBs for this arrangement would be BSC and Elexon.[19]

Rationale and perceived advantages

2.10 A stakeholder-led model would create a **direct line of accountability** from DCC to its customers. Allowing the majority of the board to be drawn from DCC customers could be expected to directly align decision-making to customer needs. This could in turn ensure consistent focus on the delivery of core service and operation for the benefit of customers and, ultimately, consumers.

2.11 A stakeholder-controlled board may also be more likely to improve **transparency in decision-making,** including around the procurement and management of key contracts, and afford industry, through their representatives, more control over expenditure.

2.12 Meanwhile, the presence of independent directors and any shareholder representatives would provide a balance of views and potentially offer access to a wider range of experience and skills.

Risks and disadvantages

2.13 **Conflicts of interest**: All board members (who are also directors of the company) are bound by the duties and responsibilities imposed upon them by law. These include the statutory (general) duties set out in the Companies Act 2006.[20] Whilst directors could be drawn from amongst DCC customers, their statutory duties would preclude them from acting as representatives of their organisations, or indeed, by being guided by interests other than those of the organisation to whose board they are appointed, *ie* DCC. Any industry-appointed directors would face potentially irresolvable conflicts of interests, compelled to either act on behalf of industry stakeholders but at risk of breaching their legal duties, or act independently but risk undermining the expectations placed upon them by stakeholders during their appointment. This risk is less pronounced in

[19] Details on Elexon's governance and voting share can be found here: www.elexon.com/governance/voting-share/

[20] Companies Act 2006, Part 10. www.legislation.gov.uk/ukpga/2006/46/part/10

the governance arrangements of industry codes (boards and panels), as those bodies have been created to represent the interests of industry parties.

2.14 **Imbalance in incentives to manage costs**: A majority industry-led model could have weak incentives to control common costs which are socialised among parties (and passed to consumers). Conversely, a strong desire by the funding parties towards cost minimisation could impact quality of service and/or lead to lack of long-term investment.

2.15 **Inefficient governance**: Governance by a diverse group of industry stakeholders may be impractical due to differing opinions and priorities of different stakeholder groups. This risk would be particularly pronounced under Arrangement 1 (constituency model) due to it requiring a larger board to accommodate various constituencies. This difference in views between stakeholder representatives may result in operational constraints, slow decision-making, and loss of strategic vision. If Arrangement #2 was chosen, the voting method would need to be carefully considered as it carries the risk of a small group of stakeholders potentially exercising unduly large influence on the board.

2.16 **Information confidentiality**: While a stakeholder-led board could be expected to provide transparency of the decision-making processes, board members would still be guided by their statutory duties as directors. Any disclosure of information outside of board discussions would continue be restrained by confidentiality principles, curtailing the ability of industry to have full visibility of all commercial information which it may desire. Conversely, pressure on transparency could lead to the release of information that should remain confidential.

2.17 **Skills shortage**: Representatives drawn from among DCC customers would be expected to possess significant energy sector experience. However, given the nature of DCC's role, the range of skills required on DCC board is boarder. There is a risk of potential skills shortages as the range of experience that industry stakeholders could draw on (when nominating their representatives) is smaller than that of independent directors, who may be recruited from outside the sector.

Our conclusion

2.18 A stakeholder-led model could in theory best meet our principle #2,[21] requiring the future regulatory model to be customer centric and consumer conscious in its

[21] For details, see: Ofgem (2022), DCC review: Phase 1 Consultation, chapter 2, table 2.1. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

design. However, the inherent risk of conflicts of interests renders this option challenging to implement in practice. We also do not view this arrangement as fully meeting our principle #3 in relation to governance, in that it may not grant DCC sufficient level of operational independence. As noted above, DCC is different to other CSDBs in that it is guided first and foremost by its Licence obligations. This can at times mean balancing decisions which do not directly align to the expectations of one or more industry parties. **For these reasons, we do not currently consider this option to be the most appropriate**.

2.19 Nonetheless, we recognise the strong support for this model and direct representation among many industry stakeholders and we remain committed to driving accountability and enhancing the role of DCC customers. We believe that this can still be served in the governance arrangements *indirectly,* including through the Board appointment *process*, DCC executive and staff incentivisation (where customer outcomes are linked to renumeration), and the possibility for stakeholders to pass (non-binding) motions of no confidence, all of which are discussed in subsequent chapters 3 & 4.

Option 2: Stakeholder (or independent) plurality board

2.20 The second configuration under consideration is a stakeholder/independent plurality position. Under this arrangement, there would be no overall control of the DCC board with customer representatives (or independent directors) holding the plurality of votes. We are not aware of any direct sector comparator as no existing board has this arrangement mandated within their code or licence. However, the current board arrangement of Elexon could be considered a functioning example of this model.[22]

2.21 The BSC limits the number of Elexon employees who can sit on the board and mandates a minimum number of stakeholder and independent board members.[23] Additional members can be added which could change the balance in favour of an independent or stakeholder majority position.

Rationale and perceived advantages

2.22 This option has the potential to **balance stakeholder and independent representation**. It could still provide the benefits of a stakeholder-led board by

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[22] The current membership of Elexon's board can be found here: www.elexon.com/governance/elexon-board/
[23] BSC, Section C, 4.1 (Appointment of Board of Directors and Chair). https://bscdocs.elexon.co.uk/bsc/bsc-consolidated

more closely, if not directly, **aligning decision-making to customer needs**, **enhancing transparency** and **refocussing delivery to core service** and for the benefit of stakeholders and consumers.

2.23 The inclusion of more independent directors, drawn from a more diverse pool of talent, including outside the sector, could mitigate against the risk of skills shortages. This arrangement might also reduce the likelihood of conflicts, both conflicts of interest, and conflicts between industry-nominated members, when compared to a stakeholder-majority board, and encourage seeking of consensus.

Risks and disadvantages

2.24 **Conflicts of interests and ineffective governance**: The presence of direct industry representatives would continue to pose a significant risk of conflicts of interests, as highlighted in option 1 above. Even where not in the position of a working majority, industry-appointed directors would still be bound by their director duties, which would undermine their ability to act on behalf of DCC customers or be guided by their interests. The absence of a clear majority, although theoretically encouraging building of consensus between industry representatives and other board members, may in practice lead to slow decision-making. This risk may be more pronounced in DCC compared to Elexon due to the comparatively complex nature of DCC's business.

2.25 **Compliance**: As previously noted, we did not find a direct comparison for this model. Were this option selected, its implementation would require highly prescriptive set of licence requirements to maintain the balance with no overall majority. An overly prescriptive approach could easily put DCC in non-compliance, for example if a board member left, tipping the plurality into a majority for one set of directors. Conversely, a more flexible approach could result in a stakeholder or independent majority undermining the policy intent.

Our conclusion

2.26 This option could provide many of the same benefits as option 1 by allowing stakeholder inclusion on the board, while partially mitigating against some of its risks by the inclusion of independent directors. It has proved capable of functioning efficiently in the case of Elexon, even as a non-mandated set-up.

2.27 However, this arrangement would likely suffer from the same challenges in effective implementation as Option 1 due to the continued risk of conflicts of interests faced by industry-appointed members. In addition, a potentially overly prescriptive design would be needed to implement this option to protect the balance of votes on the Board. **For these reasons, we do not currently consider this option to be the most appropriate**.

Option 3 Alt-Han model

2.28 Following the model in place for the Alt-Han Co, this option would split the board powers between a shareholder-controlled board and an industry forum representing DCC stakeholders. The industry forum would function as a decision-making body, for example on questions of service delivery, prioritisation and associated costs, while the shareholder-controlled board would oversee implementation, the internal organisational management and compliance with the Licence.

2.29 The industry forum would consist of DCC customers, with different options for their selection including all funding parties (parties that pay user charges), or all parties who utilise the DCC network. Voting within the forum could be conducted in various ways. Under the Alt-HAN arrangements, voting rights are allocated in proportion to the number of meters that individual parties operate or by the funds they contribute to Alt-HAN, subject to a cap.[24]

Rationale and perceived advantages

2.30 This option would preserve shareholder position on the board, giving the shareholder control over key decisions, for example in corporate matters or in ensuring regulatory compliance, while **allowing for direct stakeholder representation** via the decision-making forum.

2.31 While a board is operationally limited in size, the forum could allow for a more **direct and diverse representation of different stakeholders**, including smaller parties.

Risks and disadvantages

2.32 **Ineffective governance**: This arrangement has a proven record in overseeing a well-defined area of Alt-HAN, which is more limited in scope compared to DCC. While enabling more diverse representation of different parties, the forum may not produce effective decision-making for DCC. Differences in views among members of the forum may result in operational constraints, slow decision-making, and loss of strategic vision. Expectation to participate in the forum may

[24] Smart Energy Code, Section Z (Alt HAN Arrangements), accessible at: smartenergycodecompany.co.uk/the-smart-energy-code-2/

also place significant resource burden on DCC stakeholders, particularly smaller parties.

2.33 **Division of responsibilities**: For this model to work effectively in the context of DCC, areas of responsibility which would fall within the scope of this forum would have to be identified. Careful thought would be needed on how responsibility could be shared between the forum and the DCC board and where decision-making powers would lie. While the Licensee is ultimately responsible for regulatory compliance, there is a risk that the design could effectively remove the shareholder from key questions and limit its powers and accountability for implementation against Licence requirements. It may also be difficult to delegate certain decision-making powers to a sizeable industry forum, particularly in matters of commercial confidentiality.

2.34 **Duplication of responsibilities:** This option could result in duplicating functions between the Board, the forum and the SEC Panel and the future SEC code manager with the risk of a misalignment with code governance reforms. This option could therefore take a significant time to design and implement.

Our conclusion

2.35 This option would allow the DCC shareholder to retain a control of the Board while giving DCC stakeholder significant control of DCC strategy and operations via the stakeholder forum. However, due to a possible duplication of duties and the difficulty in defining the roles and shared responsibility, this arrangement would be very complex to implement, with uncertain benefits arising from the final design. Moreover, the risk of limitations of DCC's operational independence may outweigh the benefits of greater industry control. **For these reasons, we currently do not consider this option to be the most appropriate.**

Option 4: Majority independent board

2.36 Our fourth option is a majority independent board. Such a board would consist of at minimum 50%+1 "Sufficiently Independent Directors". (We discuss the definition of "Sufficiently Independent Directors" and requirements on independence further below in section B of this chapter.[25])

[25] Chapter 2, Section B, 2.49-2.60

Rationale and perceived advantages

2.37 Independent directors would be **well placed to take decisions that best deliver DCC's objectives and obligations**, as set out in its Licence and the relevant code(s), **without encountering those conflicts of interests** arising from direct industry appointments. An independent majority would provide **operational independence** from both the customer base and the shareholder, thus mitigating against the risk of undue influence by any vested interests. For the same reason, it may also be less prone to internal conflicts potentially present in other models which could frustrate effective and agile decision-making.

2.38 This option could also deliver the **widest range of skills, experience and expertise** by drawing on the largest pool of talent.

2.39 Finally, it would also **align to best practice**. Under the conditions of the current Licence, the Licensee must (unless and to the extent that the Authority otherwise consents), comply with the main principles of the UK Corporate Governance Code ("the Code") that has effect pursuant to the listing rules of the Financial Conduct Authority.[26] To achieve the principles set out under the Code, the Code recommends that at least 50% of the board, excluding the chair, should comprise non-executive directors whom the board considers to be independent.[27] When looking at industry practice, the Retail Energy Code (REC), which is the most recently formed CSDB, also has a fully independent board.

Risks and disadvantages

2.40 **Lack of relevant industry experience**: Compared to industry-led models, an independent majority board may be at risk of lacking recent relevant sector experience. The requirements on independence, notably the time limitation on the "material business relationship" between the candidate and the Licensee, may disqualify industry experts with current experience. We discuss this risk and ways in which it can be mitigated in paragraphs 2.54-2.60 below.

2.41 **Retention**: Independent directors, by their nature, are not tied to the company as strongly as shareholder representatives or members of the executive leadership. This may create a risk that independent experts may be hard to attract and retain.

[26] LC 7.3
[27] FRC (2018), UK Corporate Governance Code, Section 2.11. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/

2.42 **Incentivisation**: Independent directors have less stake in the organisation as they are typically only renumerated via director's fees and expenses and may be precluded from holding shares or participate in any performance-related pay scheme. This makes it inherently more challenging to effectively incentivise them.

Our conclusion

2.43 **Out of the four presented options the majority independent model is our current preferred option to adopt in the Successor Licence**. While we recognise that all options have their merits and proven record in other organisations, in our view the independent model is most suitable in context of DCC's position as a licensed entity, the nature of its business, and the overall shift towards a purpose-driven not-for-profit organisation.[28]

2.44 The model would allow the Board to access and recruit from the widest range of knowledge and expertise. It would preserve DCC's operational independence and could be expected to foster the most objective decision-making processes to fulfil the organisation's objectives. (We will consult on a revised set of objectives as part of our upcoming consultation on future role of DCC, expected in summer 2024.)

2.45 While we recognise potential risks around director retention, incentivisation and industry experience, we consider that on balance these risks can be more easily mitigated compared to the risks of conflicts of interests which arise in other models. We discuss these in further detail in the following chapters.

2.46 This option would also bring DCC in line with the recommendations of the UK Corporate Governance Code which advises that "at least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent".[29] It follows our recent positions on the governance arrangements for the REC, which is the most recently set up CSBD with a fully independent board, as well as the National Energy System Operator whose draft licence

[28] Ofgem (2023), DCC review: Phase 1 Decision, key feature 2, see chapter 2. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision
[29] FRC (2024), UK Corporate Governance Code, Section 2, paragraph 11. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/

proposes that at least half of non-executive directors are Sufficiently Independent Directors.[30]

2.47 We believe that an independent majority board would still be able to deliver to customer needs and ensure that DCC's activities are based on DCC's customers' evolving expectations in line with our principle #2 (to be customer centric and consumer conscious).[31] Any form of direct industry representation would be challenging from a regulatory and legal standpoint due to the significant risks of conflicts of interests that could arise. Instead, we propose to drive accountability and customer (and consumer) voice indirectly via requirements on Board appointments and other governance arrangements covered in chapters 3 & 4. The proposal is complemented by our parallel reforms to DCC's cost control and future evolution of the role of DCC which will aim to strengthen the role of DCC customers and consumer representatives. Taken together, our proposals will enable DCC customers to engage with and shape DCC's activities in a meaningful way that is not unduly burdensome to either DCC or its customers, and without creating unreasonable expectations on the organisation or individuals.

2.48 **We therefore propose that the Successor Licence require the Licensee to ensure that at any time the majority of the persons appointed as its directors must be considered to be Sufficiently Independent Directors**. Below we discuss options for requirements on Sufficiently Independent Directors and the manner in which these requirements should apply.

B. Requirements on Sufficiently Independent Directors

Q2 What are your views on the current and proposed Licence requirements on Sufficiently Independent Directors? Do you agree that one or more of the current Licence-imposed Independence Requirements may be relaxed in favour of more discretion afforded to the Board?

Background

2.49 The current Licence requires that "at least two of the persons at any time appointed as the Licensee's directors must persons who are sufficiently

[30] Ofgem, DESNZ (2024) National Energy System Operator licences and other impacted licences; Annex E: Electricity System Operator licence conditions, condition B1.7. Available at: www.gov.uk/government/consultations/national-energy-system-operator-neso-licences-and-other-impacted-licences-statutory-consultation

[31] Ofgem (2022), DCC review: Phase 1 Consultation, chapter 2, table 2.1, p.26. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

independent".[32] As set out in section A above, we propose to increase this requirement to a majority.

2.50 The current Licence[33] defines Sufficiently Independent Directors as natural persons who:

(a) Have the skills, knowledge, experience, and personal qualities that are necessary for them to perform effectively as non-executive directors of the Licensee

(b) Are not required to perform any executive duties within the Authorised Business of the Licensee

(c) Satisfy the requirements in respect of independence ("Independence Requirements")

2.51 Under the Independence Requirements imposed by the current Licence,[34] Sufficiently Independent Directors:

- Except where and to the extent that the Authority otherwise consents, must not be and must not at any time during the 12 months preceding their appointment have been: (a) a director or an employee of the Licensee; or (b) a director or an employee of any Affiliate or Related Undertaking of the Licensee ("First Independence Requirement")
- Must not have, and must not at any time during the 12 months preceding his appointment have had, any material business relationship with the Licensee or any Affiliate or Related Undertaking of the Licensee ("Second Independence Requirement")
- Must at no time during their service hold any remit to represent the interests of: (a) any particular shareholder or group of shareholders of the Licensee; or (b) any Affiliate or Related Undertaking of the Licensee ("Third Independence Requirement")
- Must not receive any remuneration from the Licensee or any Affiliate or Related Undertaking of the Licensee apart from a director's fee and reasonable expenses ("Fourth Independence Requirement")

[32] LC 9.14
[33] LC 9.15
[34] LC 9.16-19

2.52 In addition, all directors, including Sufficiently Independent Directors, are prohibited from becoming a director or an employee of, and from holding shares, securities or other financial rights, in DCC's customers or External Service Providers.[35]

2.53 These requirements are broadly in line with the current guidance provided by the UK Corporate Governance Code.[36] The only exception applies to the time limits imposed under the First and Second Independence Requirements. The Code identifies circumstances which are "likely to impair or could appear to impair" a non-executive director's independence which include: an employment by the company or group in the last **five** years, and a material business relationship with the company within the last **three** years. (These limitations stand at 12 months in the current Licence.)

Our analysis and proposal

2.54 We consider the existing requirements to be generally fit for purpose to support our proposal and safeguard the integrity of the future Board. Nonetheless, we are interested in views on the application of these requirements, especially the First and Second Independence Requirements and the balance between protection of the Board's independence and the risk that a strict application of these requirements may unduly disqualify experts with strong sector knowledge from becoming directors, leading to a potential lack of recent industry experience on the Board. We have considered the following three options.

2.55 **Option 1**: **Maintain the existing 12-month restriction in the First and Second Independence Requirements**. We are not aware of any adverse impact this restriction has had to date. We are inviting views on whether this continued arrangement may negatively impair the organisation's access to sector expertise in the appointment of its directors; in particular, if the proportion of directors to whom this condition would apply increases to a majority of the board, as per our analysis in paragraphs 2.43-2.48 above.

2.56 **Option 2**: **Increase the restrictions in line with the UK Corporate Governance Code recommendations to 5 and 3 years for the First and Second Independence requirements, respectively**. This stricter arrangement

[35] LC 9.8
[36] FRC (2018), UK corporate governance code, Section 2, paragraph 10. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code

has been in place for example in the licence of the electricity System Operator of Northern Ireland (SONI). The SONI licence establishes a majority independent board for the System Operator and imposes restrictions on independent directors of 5 years, both in the case of former employee and persons who had previous material business relation with the licensee or an associated company.[37] Increasing this requirement for DCC would bring more assurance for the Board's independence and, while it might in turn increase the risk of appointed independent members lacking relevant industry experience, we are not aware of this risk materialising in the case of SONI.

2.57 **Option 3: Remove some (or all) regulatory restrictions from the Licence; allow the Board to exercise its own judgement in relation to the appointment of Sufficiently Independent Directors.** As set out in the UK Corporate Governance Code,[38] where any of the relevant circumstances "likely to impair" a non-executive director's independence applies, the Board may still consider that non-executive director is independent, as long as a clear explanation is provided that is to the Board's satisfaction. Under this option, the Second, and potentially other, Independence Requirements could be reframed as recommendations at the discretion of the Board. Prior to the appointment, the Board would be required to:

- Inform the Authority if one or more of the requirements were not met in the appointment or reappointment of a Sufficiently Independent Director
- Seek the Authority's view by explaining to the Authority why the appointee is still considered to be independent
- Have regard to the Authority's view when deciding whether to make the appointment

2.58 Ofgem would review relevant information provided by DCC in respect of its intended appointment and inform DCC if it was not satisfied with the Board's explanation or considered any arising conflicts to be sufficiently significant so as to compromise the integrity and independence of the Board as a whole. Subject to our proposals in relation to Ofgem's role in the Board appointment process

[37] UREGNI (2023), SONI transmission system operator licence, Condition 42 17(c) amended version available at: www.uregni.gov.uk/publications/notice-proposed-modifications-condition-42-soni-tso-licence
[38] FRC (2024), UK Corporate Governance Code Section 2, paragraph 10. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/

(chapter 3, section C of this consultation), Ofgem's review may also consider additional criteria for the appointment to ensure the appointee is fit and proper to perform their role.

2.59 We consider that with the safeguard in the form of Ofgem's review, this degree of flexibility in the appointment process could allow more industry experience on the Board, striking the right balance between expertise and independence. **Consequently, and for those reasons, our current view is that this option would be the most appropriate**, subject to further governance from both DCC stakeholders and Ofgem detailed in chapter 3.

2.60 We seek stakeholder views on these options. With regard to option 3, we are particularly interested in views on whether the time restrictions in relation to the Independence Requirements, if relaxed, to give more discretion to the Board, should follow the UK Corporate Governance Code recommendations and be set at 3-5 years,[39] or remain in line with limitations currently imposed by the Licence (12 months).[40] We would also like to hear views on whether this relaxation should be extended to more or all Independence Requirements.

C. Independence Requirements on the Chair

Q3 Do you agree with our proposal that the Chair of the future DCC board should meet the requirements on 'Sufficiently Independent Directors' without exception?

2.61 The Licence presently does not prohibit the appointment of a shareholder representative to the position of the Chair of the Board. In line with our proposal to shift to a majority independent board, **we propose that the Chair would be required to satisfy all of the Independence Requirements on Sufficiently Independent Directors and that these would apply without exception.**

2.62 This change would align DCC to the UK Corporate Governance Code recommendation that a chairperson should be independent when assessed against circumstances that may impair its independence. These are closely aligned to our proposed Independence Requirements outlined in section B above.[41]

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[39] Ibid
[40] Under LC 9.16-17
[41] FRC (2024), UK corporate governance code, Section 2, paragraph 9. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/

2.63 We recognise that this proposal may be a less attractive proposition for potential applicants for the Successor Licence. Nevertheless, we consider that, on balance, this change is needed to ensure the overall independence of the Board, given the Chair's role in leading board discussion, involvement in the appointment of other directors, and the potential to have a casting vote in the event of a tie on the board (subject to rules within the Articles of Association).

D. Board size & Executive and shareholder representatives on the Board

Q4 What are your views on our analysis and proposal not to introduce additional requirements or restrictions on the size of the future Board and on the number of executive members and shareholder representatives?

2.64 The current DCC board has 7 members while the average board size among CSDBs is 8. The Licence at present does not contain a restriction on the size of the Board, nor a limitation on the number of executive directors or the number of shareholder representatives. **We do not propose to introduce additional restrictions or requirements in these areas.**

2.65 In our analysis, it is not atypical for CSDBs to have minimum requirements on the size of their board with the flexibility to increase the size if there is the need to do so. CSDBs with boards whose composition is prescribed tend to have larger boards. This is often to accommodate representation of different stakeholder constituencies – for instance in the case of the SEC. We recognise the need for diversity on the board, both in terms of views and expertise. However, this should be balanced against the board's ability to be decisive and agile. Research has shown that that large boards in particular can suffer from slow decision-making.[42] To allow DCC operational flexibility, our current view is that the most suitable option would be to leave the size of the board at the DCC's discretion and not prescribe its size through the Licence. We think this would be suitable for a majority independent model which would not require reserved seats for third party representatives. If a model with direct customer representation was selected, accommodation of different stakeholders (for instances through constituencies) may be needed as a Licence requirement.

[42] David Walker (2009), A Review of Corporate Governance in UK Banks and other Financial Industry Entities. https://corpgov.law.harvard.edu/2009/12/26/a-review-of-corporate-governance-in-uk-banks-and-other-financial-industry-entities/

2.66 Further to our proposals in chapter 3, section B on experience, we would expect that the need to ensure the Board possesses sufficient skills and expertise, together with our proposal for an independent majority, would provide for an appropriate combination of executive and non-executive directors, such that no one individual or small group of individuals dominates the Board's decision-making. Similarly, for those reasons, we do not currently view the Board being *too* small as a risk.

2.67 Arguably, a restriction on the number of shareholder representatives or executive members on the Board could allow a larger portion of the Board to be independent. However, in practice, the shareholder may wish to retain as much presence on the Board as possible. Therefore, limiting the number of shareholder and executive board members could have the effect of reducing the overall number of members, thus potentially limiting the Board's diversity and restricting its expertise to any minimum requirements. We do not propose to limit either the number of executive members or the number of shareholder representatives on the Board. As discussed in section A of this chapter, we envisage that the requirements on the overall control of the Board (eg majority Sufficiently Independent under our currently preferred option) would be enshrined in the Licence. Together with independence requirements on Sufficiently Independent Directors, this should be sufficient to safeguard the integrity of the Board.

2.68 Finally, current regulations require the new DCC Licence to be competitively procured and limiting the board size, the number of shareholder representatives, or executive members on the board could be viewed as unnecessarily restrictive. We are interested in stakeholder views on this point.

3. Board appointment process and requirements

Section summary

We seek views on the process and requirements involved in the appointments to the DCC board. Our first proposal is for the new Licence to place a requirement on the Board to at all times possess sufficient experience in certain core areas; to which end we have identified the following: GB energy market (supply and distribution), commercial contract management, data and communication technology, and consumer advocacy. As part of this, we propose that consumer voice be represented by a Sufficiently Independent Director with a proven consumer advocacy experience. Consumer focus may be further enhanced by a possible introduction of a consumer-focused objective (subject to a separate consultation). Secondly, we are inviting views on options for Ofgem and stakeholder (customer) role in the Board appointment process. These include options for a review process of the Board appointments by Ofgem; and a stakeholder representation via the Nomination Committee, which could afford stakeholders direct input into the appointment process while protecting the autonomy of the Board and its members. Finally, we seek views on whether the appointment of the first Chair should follow a distinct process, including a potential duty on DCC to consult with Ofgem, on account of the importance of the Chair's position in appointing the remaining posts.

5. **Do you agree with a possible requirement on the Board to possess expertise in certain core areas? Do you agree with the areas we have identified? What are your views on the implementation options?**
6. **Do you agree with our proposal to represent consumer voice via a requirement on the appointment of a Sufficiently Independent Director with consumer advocacy experience?**
7. **What are your views on Ofgem's role in the Board appointment process? Do you agree with our proposal that the Authority could have a role in the appointment process of non-executive directors? Which option would provide the most appropriate and effective accountability framework, and why?**
8. **What are your views on the role of DCC customers and other stakeholders in the Board appointment process? Do you agree with our proposal to provide representation for DCC customers on the Nomination Committee? What should be the role of an industry representative in such an arrangement?**

> **9. What are your views on our proposals for an additional requirement on the Chair's experience and Ofgem's role in the initial appointment of the Chair? In what other way should the appointment process for the Chair be different to that of other DCC Board members?**

Background

3.1 The appointment process to DCC board is currently led by its Nomination Committee.[43] The Nomination Committee is responsible for reviewing the structure, size and composition of the board and its committees, ensuring they have the right balance of skills, experience, knowledge, and diversity, including that of gender, cognitive and personal strengths, needed to carry out its duties. The committee also leads the process for appointment of senior management (Executive Committee) positions, considers and formulates succession plans and oversees the development of a succession pipeline of candidates in the context of DCC's strategic plans, its leadership needs and ensuring the company's continued ability to compete effectively in a marketplace.[44]

3.2 DCC customers and consumer representatives do not have a route to input into the structure, governance or appointment process to the DDC board. Ofgem oversees DCC's compliance with the Licence; the governance and independence requirements are set out in Licence Conditions 7 and 9.

3.3 In this chapter we set out our analysis and proposals for changes to the appointment process under the Successor Licence.

A. Method of selection of Board members

3.4 We assume that the future Board would establish a nomination committee, and that the nomination committee would continue to oversee, review and recommend Board appointments. The nomination committee would be responsible for:

- Determining the skill sets, capabilities and areas of specialism required for each Board appointment, ensuring to reflect the interests of different classes of customers and consumers and to enable the Board to deliver its strategy and business plan in line with licence requirements

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[43] DCC (2023), Annual Report, p.63. www.smartdcc.co.uk/media/wk4d52yw/annual-report-2023.pdf
[44] Ibid

- Determining the level of remuneration for the role
- Leading the process for Board appointments, including the selection and evaluation of candidates
- Making recommendations on Board appointments
- Seeking a view from the Authority prior to appointment of directors (subject to proposals set out in section C of this chapter)

B. Requirements on relevant experience

Q5 Do you agree with a possible requirement on the Board to possess expertise in certain core areas? Do you agree with the areas we have identified? What are your views on the implementation options?

3.5 We recognise that DCC board would benefit from a broad range of skills and expertise, reflecting the roles DCC performs, the breadth of its customer base, and the impact its service has on energy consumers. The Licence already requires that all Sufficiently Independent Directors "*have the skills, knowledge, experience and personal qualities that are necessary for them to perform effectively as non-executive directors of the Licensee*".[45] However, the exact mixture of the skills, experience and qualities represented on the Board is at the discretion of the Board (and the Nomination Committee).

3.6 To ensure that the future Board, especially if operating under an independent majority, is able to perform its role effectively, **we propose that the Licence places an explicit requirement on the Board to at all times possess sufficient experience in the following core areas:**

- **GB energy market (supply and distribution)**
- **Commercial contract management**
- **Data and communication technology**
- **Consumer advocacy**

3.7 We have considered two ways for implementation. The Licensee may either be required to appoint individuals identified against each of the core area of expertise (option 1); or the requirement would apply to the Board as a whole (option 2).

[45] LC 9.15(a)

3.8 Having an appointed expert in each area would help DCC demonstrate compliance and provide assurance and transparency around the Board's capacity. During the appointment of the initial Board, DCC would likely need to identify individuals with requisite experience for each of these core areas. However, over time, a Board member's resignation or a vacancy may put DCC in non-compliance and DCC might require a larger representation to mitigate against that risk.

3.9 Option 2 moves the requirement from individual to the Board level. This arrangement would provide the Licensee with more flexibility but demonstrating compliance may be more difficult placing DCC at risk of reliance on one or two strong individuals providing the Board with expertise in more than one of the core areas.

3.10 On balance, **we currently view option 2 as more appropriate**, affording the Licensee more flexibility to construct its Board. Nonetheless, we are minded to take a different approach for consumer advocacy, which is a distinct area of expertise. We discuss the details of this proposal below.

Consumer representation

Q6 Do you agree with our proposal to represent consumer voice via a requirement on the appointment of a Sufficiently Independent Director with consumer advocacy experience?

3.11 In our conclusion of Phase 1 of the review, we said that the future DCC Board should include consumer representation. To that end we have identified the following options:

- Option 1: A board member acting as a direct consumer representative
- Option 2: A board member with consumer advocacy experience
- Option 3: A consumer-facing objective included in DCC's Licence to guide the Board's decision-making process

3.12 As discussed in chapter 3, all Board members who are also directors are bound by director duties under the Companies Act 2006. This would include any consumer representative in the position of a non-executive director. As such, the extent to which such a person could act on behalf, or in the interest of, any other party would be circumscribed. In our view, a direct consumer representative would be likely to face similar risk of conflicts of interest as any industry representative, particularly if employed by a consumer group. However, we recognise the strength of support for representation of the consumer voice on the Board. For that reason, **our preferred option would be Option 2, placing in the Successor Licence a requirement that the Board must at all times have a Sufficiently Independent Director with proven consumer advocacy experience**. While the option for collective board experience is our preferred option for other core areas of expertise, in our view consumer advocacy is sufficiently distinct to warrant a dedicated individual. With a consumer advocacy expert, we believe that the Board would be able to sufficiently consider the impact of its decisions on end-consumers without the risk of a conflict of interest.

3.13 We will further consider the inclusion of a consumer-facing objective and consult in due course alongside our other proposals for a revised set of DCC's objectives.

C. The role of Ofgem and DCC customers in the Board appointment process

Q7 What are your views on Ofgem's role in the Board appointment process? Do you agree with our proposal that the Authority could have a role in the appointment process of non-executive directors? Which option would provide the most appropriate and effective accountability framework, and why?

Q8 What are your views on the role of DCC customers and other stakeholders in the Board appointment process? Do you agree with our proposal to provide representation for DCC customers on the Nomination Committee? What should be the role of an industry representative in such an arrangement?

Role of Ofgem

3.14 Ofgem's role is to oversee DCC's compliance with the Licence. To ensure that the Board, particularly if majority independent, operates within an effective accountability framework, in line with our principle #3, **we propose that Ofgem could have a role in the Board appointment process**. We have identified and seek views on two options through which this could be achieved.

Option 1: The Authority's right of review

3.15 DCC must currently notify Ofgem of the names of its Sufficiently Independent Directors within 14 days of each appointment (or reappointment).[46] Under Option 1, we propose that **the Licensee could be required to notify the Authority of its intended appointment within a minimum set period *preceding* the**

[46] LC 9.21

appointment date. This would provide time for Ofgem to consider if it wished to initiate a review of the appointment and, if so, assess (based on additional information it may require) if the appointment satisfied relevant Licence requirements, including:

- Prohibition on all directors (for the avoidance of doubt, this includes any shareholder nominated directors) from being a director or an employee of, and from holding shares, securities, or other financial rights, in DCC's customers or External Service Providers
- Requirements on Sufficiently Independent Directors (see paragraphs 2.50-2.52)[47]
- Any additional requirements on the skills, knowledge and experience of the Board (see paragraphs 3.5-3.10)

3.16 The Licensee would be expected to have due regard to the Authority's view when deciding on making the appointment.

3.17 This option would provide Ofgem with an increased level of oversight of DCC's compliance, while maintaining DCC's operational independence.

Option 2: The Licensee's duty to seek approval

3.18 Alternatively, **the Licensee could be required to** not only notify but **seek a view from the Authority** prior to the appointment of any director. This would include a requirement to share such information so as to allow the Authority to carry out its review. Ofgem would consider whether the appointment satisfied relevant Licence requirements (as discussed above). Additionally, it could also take into account wider suitability criteria to assess whether the person to be appointed was 'fit and proper' to perform its duties. An 'Ongoing fit and proper requirement' already exists in Supply Licences that Ofgem grants[48] and could be adapted and included in the Successor DCC Licence.

3.19 Under this option, at the conclusion of its review, the Authority would issue DCC with a notice stating its conclusions in respect of the proposed appointment. DCC would be required to have due regard to Ofgem's view when deciding whether to proceed with the appointment. For the avoidance of doubt, we do not propose

[47] For the avoidance of doubt, this includes the four Independence Requirements, as well as a general requirement on "having the skills, knowledge, experience, and personal qualities that are necessary for them to perform effectively as non-executive directors of the Licensee".
[48] Electricity/Gas Supply Standard Licence Conditions, SLC 4C. Accessible at: www.ofgem.gov.uk/licences-and-licence-conditions

that Ofgem would authorise appointments in this manner; the onus would remain on DCC to ensure it remained compliant with its Licence. Nonetheless, this option would create a stronger, more formal process for oversight of DCC's Board appointment process.

3.20 We would like to hear stakeholders' views on whether they agree that a role for Ofgem in the appointment process would be appropriate (and if not, the reasons why), particularly if a majority independent model is selected, and if so, their further views on our proposed options.

Role of DCC customers and other stakeholders

3.21 As set out in chapter 2, in our view, direct stakeholder representation on the Board would carry a risk of conflicts of interest. In addition to requiring sector experience on the Board, we have further considered options for stakeholder involvement in the appointment process of the Board members and have considered the following three possible options:

- Option 1: Stakeholder involvement within the Nomination Committee
- Option 2: Consultation with stakeholders prior to a board member appointment allowing stakeholders to notify Ofgem of any concerns
- Option 3: A stakeholder vote to ratify the appointment of non-executive directors

Option 1: Stakeholder involvement within the Nomination Committee

3.22 The Nomination Committee, responsible for director appointments, is not prohibited from inviting persons outside the Board itself to assist in the process, for example at an interview stage. Subject to the terms of the Articles of Association, this could be an industry representative, such as a SEC Panel member.

3.23 This option would allow a direct stakeholder representation in the appointment process, allowing a stakeholder representative to test the suitability and calibre of the appointments, without giving rise to conflicts of interest or placing unreasonable expectations on the director to act in the interest of a party outside the organisation. However, it would be important to specify the manner in which stakeholders would be represented.

Option 2 Consultation with DCC stakeholders

3.24 Once a Board member has been selected, a formal public consultation would be required to be run by DCC, giving any interested parties the opportunity to respond and raise concerns or objections to the proposals. In response, subject to our proposals in section C above, Ofgem could carry out an assessment against Licence requirements. This option would give all stakeholders the opportunity to review the appointment and raise concerns formally. However, it is important to note that the Ofgem's review would be guided by the requirements set out within the Licence.

3.25 This option could place additional burden on both DCC and stakeholders. It would have to be implemented with a time restriction long enough to allow for sufficient feedback but not so long that it would impede on DCC's functions or result in a potential breach of Licence conditions with regards to Board composition and expertise. Furthermore, there may be a risk that potential Board members may be discouraged by this enhanced public scrutiny.

Option 3 Stakeholder vote to ratify appointments

3.26 Short of a direct representative on the Board, stakeholders could be granted the right to ratify the appointment of non-executive directors. This option would go furthest in maximising stakeholder influence, however, there are several important considerations and associated risks.

3.27 Firstly, an appropriate voting system would need to be designed and implemented for this option to function resulting in significant complexity in balancing the interest and influence of different stakeholders, with the risk of the process becoming dominated by a small number of large parties.

3.28 Secondly, although the review and voting by stakeholders would be expected to be guided by the Licence requirements, there is a risk that the process may in practice not be objective, leading to outcomes which reflect personal preferences. It may be more appropriate for the Authority to carry out this review.

3.29 Thirdly, there is a question of what appeal routes would be available to DCC if the process led to undesirable outcomes, for example limiting DCC's ability to operate or placing DCC in breach of Licence requirements by its inability to appoint directors.

3.30 Finally, the ratification process would not grant stakeholders influence over the Board governance. Once appointed, directors would be bound by their statutory duties, requiring them to exercise independent judgement. There is a risk that the ratification process could place unreasonable expectations on the directors to act on behalf of the parties ratifying their appointment, creating conflicts of interest.

Our proposal

3.31 **Of the three options considered, we are currently of the view that option 1 (stakeholder involvement within the Nomination Committee) would be the most appropriate,** as it would afford stakeholders direct input into the appointment process while protecting the autonomy of the Board and its members. In our view, the additional benefits of options 2 or 3 can be served by our proposals for Ofgem's review of appointments. The absence of a formal right to appeal or ratify appointment does not prevent any stakeholder from raising concerns directly with Ofgem without introducing undue risks.

D. Appointment of the Chair

Q9 What are your views on our proposals for an additional requirement on the Chair's experience and Ofgem's role in the initial appointment of the Chair? In what other way should the appointment process for the Chair be different to that of other DCC Board members?

3.32 We believe that the appointment of the Chair of the Board should be considered as a separate case to that of other Board members. In setting up the new Board, the Chair will be appointed first; we would then expect the Chair to have an important role in the appointment of the remaining Board members as the chair of the Nomination Committee. As previously discussed, the Chair also holds a special position by moderating decision-making and potentially holding the deciding vote in case of a tie.

3.33 Firstly, as per our previous proposal (paragraph 2.61), the Chair could be required to satisfy all requirements on Sufficiently Independent Directors. In addition, **we propose an additional requirement on the Chair to have a proven Board-level experience in an organisation of similar size and standing as DCC.**

3.34 Secondly, given the Chair's special role, **we propose that Ofgem should have a role in, at minimum, the initial appointment process**. We have considered the following two options:

- **Option 1: Consultation on appointment**

- **Option 2: Representation on the Nomination Committee**

3.35 Under option 1, Ofgem would not intervene in the selection process of the initial Chair but DCC would be required to consult on the appointment with Ofgem. Ofgem would review the proposed appointment against Licence requirements. In the event that the selection process produced more than one suitable candidate meeting all requirements, as part of its assessment, Ofgem could express a preferred candidate to appointed as the Chair. DCC would be required to have due regard to Ofgem's assessment in deciding on the appointment. This option would allow the selection process to run independently but provide greater reassurance to stakeholders that the best possible candidate is chosen.

3.36 Option 2 would give Ofgem a direct, active role in the selection process for the initial Chair through representation on the Nomination Committee. This may include a role in carrying out interviews of the candidates. However, this arrangement would effectively result in Ofgem having a dual role in both the selection and its subsequent review. Furthermore, as there is a lack of precedent for such an arrangement in other licensed entities, there are potential risks on both parties.

3.37 We consider that the most suitable choice would be option 1. We propose that Ofgem should be consulted on the appointment of at least the initial Chair of the Board but stay short of a direct role in the selection process. We believe this approach would provide additional assurance of the process without undue intervention by the regulator and are interested in whether stakeholders agree. We would also like to invite views on whether this process should be followed for the appointment of the initial Chair only or extended to subsequent appointments through either a bespoke process or adopting the same approach as for other non-executive directors (discussed in section C above).

3.38 Finally, we propose that stakeholder representation in the appointment be consistent with that detailed in the section above, that is for an industry representative to be involved within the process via the Nomination Committee.

4. Incentivisation of DCC board, executive leadership and key staff

Section summary

We present and invite views on ways to assure the right decision-making and outcomes of the future governance. To that end, we consider different methods of incentivisation. First, we look towards limiting the term of appointment as the best option to incentivise non-executive independent directors. We are seeking stakeholder input on our proposal to limit the initial term of appointment of non-executive board members to a maximum of 3 years, with the possibility to be reappointed twice, each reappointment with a 3-year limit. Secondly, we seek stakeholder views on proposals for reputational incentives and enhanced regulatory requirements in the areas of system performance, customer engagement and contract management (covered by the existing Operational Performance Regime, or OPR); with the possibility of further incentives associated with an envisaged shift to an ex-ante form of cost control, targeting business planning and cost management. We also propose that the measurable outcomes of these reputational incentives be considered by the Renumeration Committee when setting targeted financial incentives on executive leadership and key staff. Finally, we seek stakeholder views on our proposal to give stakeholders the ability to pass a (non-binding) motion of 'no confidence' in the DCC management, as a measure to enhance accountability to stakeholders.

Questions

10. What are your views on changes to the term of appointment of non-executive directors? Do you agree with our proposals to limit the initial term of appointment for non-executive directors to 3 years, and to allow for up to two reappointments with the total term limited to a maximum of 9 years?

11. What are your views on the identified reputational incentives and associated enhanced regulatory requirements? How effective do you believe these incentives can be?

12. What are your views on direct financial incentivisation of executive leadership and key staff? What would make those incentives effective? Please consider their interlink with the reputational incentives.

13. What are your views on the proposal to grant stakeholders the power to issue a (non-binding) motion of "no confidence", its objective and

requirements? If implemented, what should be the methodology for determining a qualified majority and distribution of votes among stakeholders?

Background

4.1 The existing regulatory model places three types of incentives on DCC and its leadership.

4.2 Firstly, financial incentives: All of DCC's Baseline Margin is put at risk against performance regimes, notably the Operational Performance Regime (OPR) incentivising DCC in the areas of system performance, contract management and customer engagement. DCC is also financially incentivised to manage its costs and drive efficiencies through the *ex-post* price control: Ofgem has the power to remove any costs which have not been incurred "economically and efficiently" from DCC's Allowed Revenue (a downside incentive); equally, subject to Ofgem's approval, DCC can apply for External Contract Gain Share (ECGS), allowing it to retain a portion of savings achieved on its major contracts (an upside incentive).

4.3 Secondly, reputational incentives: DCC is required to report on its performance against a set of measures under the SEC (including those not used for the OPR financial incentive). Poor performance on these metrics invites enhanced scrutiny from DCC customers, as well as Ofgem.

4.4 Thirdly, regulatory incentives: DCC must ensure that it remains compliant to the conditions of its Licence. Non-compliance may lead to enforcement action from Ofgem with possible sanctions up to a Licence revocation.

4.5 In a shareholder-led, for profit model, poor performance against financial, reputational or regulatory incentives would be expected to ultimately result in an intervention from the shareholder in the management to uplift performance. As explained in our August 2023 conclusion document, we recognise that, in a shift towards a not-for-profit model with the absence of margin that can be put at risk, the organisation and its shareholders may lack strong incentives in respect of cost efficiency or quality of service, and that additional assurance would be needed to complement changes to the governance.[49] In this chapter we discuss and seek

[49] Ofgem (2023), DCC review: Phase 1 Decision, paragraph 2.56. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision

views on possible ways in which the future DCC's Board and senior leadership could be incentivised in a not-for-profit model. These are:

- Term limits for non-executive directors with the opportunity for reappointment
- Reputational incentives
- Financial incentives on executive leadership and key staff tied to measurable outputs of the reputational incentives
- Enhanced accountability to customers through stakeholder power to pass a motion of "no confidence"

4.6 Table 4.1 below provides an overview of these incentives and their intended focus and application. However, it is important to note that the primary objective of these proposed incentive mechanisms is to provide **assurance or safeguards to complement the overall changes in the focus and governance of the organisation**. Moreover, subject to further consultation, costs will remain subject to (upfront) approval by Ofgem and enhanced input from stakeholders, and the guiding principles for the governance will be captured in a revised set of Licence objectives.

Table 4.1: Overview of proposed incentive mechanisms

Incentive type	Set by	Enforced by	Aimed at
Term limits	Ofgem via the Licence	Ofgem	Non-executive directors
Reputational incentives	Ofgem via the Licence DCC customers through the SEC	Nomination Committee when deciding on reappointment of directors	Board as a whole
Financial incentives	Renumeration Committee (on the basis of reputational incentives)	Renumeration Committee	Executive directors Key staff
No-confidence motion	DCC customers	Ofgem	Board as a whole

A. Term limits

Q10 What are your views on changes to the term of appointment of non-executive directors? Do you agree with our proposals to limit the initial term of

appointment for non-executive directors to 3 years, and to allow for up to two reappointments with the total term limited to a maximum of 9 years?

4.7 The first area of incentivisation focuses on the role of non-executive directors, specifically the Sufficiently Independent Directors. Subject to our proposal in chapter 2, section A, Sufficiently Independent Directors may form the majority of the future DCC's board. Under the current arrangements, independent directors are only allowed to receive a fee and reasonable expenses.[50] This is in line with standard industry practice.[51] We do not propose to relax this restriction as participation in the company's renumeration scheme(s) could imperil the non-executive members' independence. In our view the best way to incentivise non-executive directors is by setting the term of appointment such that it attracts, and retains, persons of good calibre but allows for retirement in case of poor performance.

4.8 Under the current Licence, a term of service for a Sufficiently Independent Director may not be longer than six years, but an individual may be reappointed once (and once only) provided that he or she continues to satisfy the Independence Requirements.[52] The Licence does not limit the term of appointment of other Board members, *eg* shareholder representatives.

4.9 We have considered if this initial term should be reduced and if there should be a maximum term limit to the appointments. A longer initial term can allow DCC to have a long corporate memory and better stagger its appointments; it also reduces Board turnover. However, in doing so, it limits the opportunity to review the Board's performance and refresh its membership.

4.10 Our first proposal, which we are seeking stakeholder views on, is therefore to **introduce shorter term of appointment of no more than three years**. This ties with DCC's current practice which is to appoint its non-executive directors for a period of no longer than three years.[53] This shorter term would also bring DCC Licence closer to industry practice (terms of one to three years are common

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[50] LC 9.19
[51] FRC, (2018), UK Corporate Governance, section 2, provision 10. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/
[52] LC 9.23
[53] DCC (2023), Annual Report, p.73. www.smartdcc.co.uk/media/wk4d52yw/annual-report-2023.pdf

among other CSDBs) and the UK Corporate Governance Code, which recommends annual re-appointments of non-executive directors.

4.11 Secondly, **we propose to retain the option for a reappointment but restrict this to a maximum of two reappointments, each with a three-year limit**, therefore capping the total term of non-executive directors at nine years. This upper limit also follows the recommendation under the UK Corporate Governance Code[54] and is in line with DCC's current practice.[55]

4.12 Finally, **we propose that these rules should apply to all non-executive members**, that is not only those appointed as Sufficiently Independent Directors. The rationale for this proposed expansion of term limits beyond independent non-executive members is to enable the removal of directors who may not be removed via the reappointment process and so may have unduly large influence on the Board.

B. Reputational incentives and enhanced regulatory obligations

Q11 What are your views on the identified reputational incentives and associated enhanced regulatory requirements? How effective do you believe these incentives can be?

4.13 Subject to further consultation on cost control arrangements, we propose that in the Successor Licence the link between existing margin-based incentives and DCC's Allowed Revenue is largely or completely removed. This is because a shift towards not-for-profit arrangements for, at minimum, DCC's Core Mandatory Business, in line with our conclusion of phase 1 of the review, will reduce or eliminate any margin capable of being put at risk.[56] (For the avoidance doubt, decision on whether any profit could be generated in other areas of DCC's Authorised Business, for example through any additional services provided on a commercial basis, will be subject to further consultation, including any limitations on the allowable profit thus realised.) Instead, we propose that existing performance incentives currently tied to DCC's Baseline Margin are restructured

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[54] FRC, (2018), UK Corporate Governance, section 2, provision 10. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/

[55] DCC (2023), Annual Report, p.73. "Independent Non-Executive Directors are appointed by letter of appointment for a period no longer than three years. An individual in this role can be re-appointed only once for a further period of no longer than six years." www.smartdcc.co.uk/media/wk4d52yw/annual-report-2023.pdf

[56] Ofgem (2023), DCC review: Phase 1 Decision, chapter 2. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision

to function as reputational incentives, and that a subset of measurable outcomes be linked to the financial compensation received by key personnel, DCC executives and relevant staff.

4.14 The first reputational incentive that we are seeking views on is adapting the existing Operational Performance Regime (OPR). At present, DCC's Baseline Margin is put at risk against the OPR across three measures:

- **System performance** – measures the reliability of DCC systems against targets set in the SEC. The assessment looks at whether DCC has or has not met relevant targets, of which an agreed subset is incentivised.
- **Customer engagement** – measures how well DCC engages with its customers, particularly how it informs its decisions by an understanding of its customers' needs. DCC is awarded a score which is based on qualitative submissions received from both DCC and the SEC Panel and determined by Ofgem, subject to consultation.
- **Contract Management** – measures the quality of DCC's contract management capability, processes and outcomes, using a modified version of the National Audit Office Contractual Relationships Framework (NAO Framework). DCC is awarded a score which is determined by Ofgem upon consultation with DCC and relevant stakeholders, on recommendation by an independent auditor.

4.15 A shift to not-for-profit service provision will not diminish the importance of the three areas subject to OPR. We therefore propose to retain the OPR as a Licence requirement, albeit with a removal of references to DCC's Allowed Revenue through a margin adjustment. Instead, we are focusing on possible enhancement of the reporting requirements and introduction of accompanying obligations. We discuss these considerations for each area in turn below.

OPR System performance

4.16 Data on system performance is key to monitoring and understanding the overall performance of the DCC network. We therefore envisage a continued reporting by DCC against SEC-based targets. DCC would remain bound by its Licence to comply with the SEC and would be expected to uplift any system underperformance. Oversight would continue to be provided by the SEC Panel and relevant subcommittees (and their successors following the implementation of the Energy Code Reform changes) with Ofgem's power to intervene. We would like to understand whether, and how, the reporting obligations may need to be enhanced to ensure transparency and accountability.

4.17 In addition to reporting to relevant parties under the SEC, **we propose that DCC would be obligated to publish, and keep up to date, data on its system performance on its website in an intelligible language and accessible format**. This would help establish a "single source of the truth" and serve as a reputational incentive on the organisation and its leadership. It is important to note that metrics would need to be easily understood by DCC customers and wider stakeholders to achieve the desired reputational effect on behaviour. We would like to hear from stakeholders which metrics would have the potential to be: (a) most reflective of the experience of DCC customers of the overall service; and (b) most easily communicated and understood. For example, the current metric on service availability may be a type of measure that could be easily understood by a wider set of stakeholders, including general public. Other metrics, such as Updating the Home Area Network device log,[57] may be less likely to be easily understood by consumers and wider industry and therefore could be less likely to provide a reputational incentive.

4.18 Finally, without financial incentives, some target levels could be increased to reflect optimal performance level and provide stretching targets for DCC to achieve. However, we recognise that for certain targets to be achievable, DCC must be able to reflect these in its contracts with External Service Providers. For the avoidance of doubt, we are currently not proposing to amend any targets as part of this review.

OPR Customer engagement

4.19 Strong and meaningful customer engagement under the Successor Licence will be key to delivering to our principle #2, *ie* ensuring that the future model is sufficiently customer centric. Customer engagement will continue to be crucial in informing DCC's decision-making – particularly if a majority independent governance model is adopted. We have considered two ways in which this metric could be applied:

- **Option 1 = maintain current focus on how DCC communicates and takes account of its customers' views** with the option for inclusion of

[57] The Device log means the electronic record on a device of the other devices that can receive data via the Home Area Network.

additional measures. These could include, for example, seeking input on the overarching quality of service, with the aim to reflect customer experience where system metrics may not be representative of the experience of a subset of users. The assessment could continue to consist of self-evaluation, assessment by the SEC Panel and an Ofgem determination and published score and findings. While the resulting engagement score would no longer result in a reduction in Baseline Margin, DCC could be obligated to act upon the feedback received through this exercise with oversight from Ofgem.

- **Option 2 = reform as a customer satisfaction survey** with a broader set of questions to measure stakeholder views of DCC's communication, engagement and performance as a whole. While this could result in DCC being scored on *perceived* performance with quantitative metrics available for system performance, it would provide DCC leadership with a true reflection of its customers' views and experience. There is a precedent for customer satisfaction surveys among CSDBs. For instance, Elexon's latest commissioned survey sought customer feedback in six areas: quality of service, giving [stakeholders] access to [Elexon's] experts, reliability of service, speed of service, being adaptable, and keeping costs to a minimum.[58] To ensure the integrity of the survey, it could be carried out, or assured, by an independent third party. As in option 1, DCC could be obligated to act upon the feedback with oversight from Ofgem.

4.20 **We are interested in stakeholder views on these options** and, in particular, the case for an introduction of a customer satisfaction survey, its intended benefits and potential design.

OPR Contract management

4.21 As over 70% of DCC's costs are External Costs, associated with DCC's contracts with External Service Providers, contract management is one of DCC's core capabilities. To ensure DCC continues to follow best practice, we propose to maintain the annual assessment by an independent auditor using the modified National Audit Office (NAO) Framework, with scope and terms of reference set out in the OPR Guidance.[59]

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[58] Elexon (2021), Customer feedback on Elexon's management. www.elexon.co.uk/about/about-elexon/customer-feedback-on-elexons-management-of-the-bsc/

[59] Ofgem (2024), Revised OPR Guidance March 2024. www.ofgem.gov.uk/publications/revised-opr-guidance-decision-march-2024 (subsidiary documents)

4.22 In addition to general assessment of DCC's contract management performance, the current Guidance provides for the auditor to give its "general recommendations on any areas of improvement found throughout the auditing process, which DCC can act upon".[60] In the absence of a margin-based incentive, **we propose to enhance this provision to a requirement on DCC to demonstrate to Ofgem how it will act upon the auditor's findings and recommendations.**

Business planning

4.23 The intended shift towards upfront cost approval and the removal of financial gain/loss under the proposed not-for-profit model increases the need for high-quality business plans. The current Licence already requires DCC to prepare and maintain an annual Development Plan.[61] However, this Development Plan does not include detailed information on costs, nor is it tied to DCC's Price Control submission. While the details of the future business planning and cost assessment processes will be subject to a dedicated consultation, we envisage that in an *ex-ante* cost control setting, DCC's business plan submission would be part of its forecast cost submission for the Authority's approval. Building on this assumption, as part of our considerations of wider incentives on the new Board, **we therefore wish to seek views on the introduction of a specific business planning incentive**. This incentive would take the form of an assessment of DCC's business plan carried out by Ofgem as part of the cost control process. The assessment would consider the plan's:

- Compliance against Licence requirements
- Quality against measures set out in Ofgem's guidance published in advance of the cost control process

4.24 The guidance document could explain the areas that Ofgem would measure, which could include:

- Any additional value beyond the minimum requirements that the business plan offers to DCC customers
- Any costs in the business plan deemed to be poorly justified, which would then be removed by Ofgem from the *ex-ante* allowance

[60] Ibid, paragraph 5.22.
[61] LC 14, Part A

4.25 Through this incentive, DCC could be encouraged to both identify and estimate the benefit of any additional value, to support our assessment. Conversely, poorly justified and removed costs (subject to Ofgem's decision on the cost control more generally) would serve a reputational function.

Cost management

4.26 Finally, in addition to a quality business plan, operating under an *ex-ante* regime will require continuous monitoring of spend to ensure DCC stays within its approved forecasts. To encourage DCC in this regard, DCC could be required to report on how its incurred costs compare with ("track against") its Allowed Revenue approved by Ofgem.

4.27 This could be carried out on a quarterly basis and aligned to how DCC currently informs its customers on charges. A duty to maintain a public account of operating within business plan forecasts could likewise provide a reputational incentive. **We seek stakeholder views on the need for, and design of, such a cost management incentive**. We will consult further on the details of future cost control in due course.

Table 4.2: Overview of possible revised incentives

Incentive	Current form	Current application (as of March 2024 decision)[62]	Proposed revised form	Proposed new obligation on DCC
OPR System performance	Reporting by DCC against set SEC-based targets	60% of DCC's Baseline Margin at risk against a subset of agreed metrics	Continued reporting	Performance against targets must be published and kept up to date on DCC's website in an intelligible language and accessible format
OPR Customer engagement	Ofgem-determined score based on qualitative assessment of DCC's performance by both DCC and SEC Panel	15% of DCC's Baseline Margin at risk against the customer engagement score	Option 1 = continued annual self-assessment and scoring by customers Option 2 = reformed into a broader customer satisfaction survey	Obligation to act upon the feedback received through either existing assessment (Option 1) or a new customer satisfaction survey (Option 2) Under option 2, obligation to commission the customer satisfaction report in set periods
OPR Contract management	Ofgem-determined scope based on the score awarded by an independent auditor operating under a modified NAO framework	25% of DCC's Baseline Margin at risk against the contract management score	Continued annual auditing	Obligation to act on the recommendations of the annual independent audit with oversight from Ofgem
Business Planning	N/A	N/A	Ofgem-published view of DCC's Business Plan against Licence requirements and quality measures set out in a guidance document	*(subject to further consultation on changes to the Price Control)* Obligation to produce a Business Plan as part of an ex-ante cost control submission
Cost management	N/A	N/A	Quarterly report tracking DCC's spend against approved forecast	*(subject to further consultation on changes to Price Control)* Obligation to report on cost management and maintain a public account of operating within business plan forecasts (subject to necessary redactions to protect commercial confidentiality where relevant)

[62] Ofgem (2024), Revised OPR Guidance decision March 2024. www.ofgem.gov.uk/publications/revised-opr-guidance-decision-march-2024

C. Targeted financial incentives

Q12 What are your views on direct financial incentivisation of executive leadership and key staff? What would make those incentives effective? Please consider their interlink with the reputational incentives.

4.28 Financial incentives are still capable of playing an important role in the new regulatory regime, even if (at minimum) Core Mandatory Business will be operated on a not-for-profit basis. Instead of focusing on the profit margin, the financial incentivisation can be tailored towards senior management and key staff through renumeration policy.

4.29 A key principle of executive renumeration is alignment to the company purpose and values, with a clear link to the successful delivery of long-term strategy.[63] In a for-profit set-up, this typically includes promoting the long-term success of the company generating profits for shareholders. Under not-for-profit arrangements the focus of DCC's leadership should be primarily on delivering to Licence objectives and against key requirements. To create a stronger link in this regard, we have considered tying measurable outcomes of the reputational and regulatory incentives discussed in section B above to the personal renumeration of key personnel.

4.30 Remuneration policy and principles, incentive design and target setting, as well as executive and senior remuneration are decided by a Renumeration Committee of the Board.[64] The UK Corporate Governance Code[65] recommends that the committee should comprise independent non-executive directors and should be chaired by a person other than the Chairman of the Board. It further recommends that "remuneration schemes and policies should enable the use of discretion to override formulaic outcomes".[66]

4.31 It may not be needed, or appropriate, for Ofgem to prescribe a particular renumeration scheme. Instead, **we propose to introduce the following requirements through the new Licence** (or Articles of Association):

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[63] FRC (2018), UK Corporate Governance Code, Principle P. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/
[64] For details of DCC's Renumeration Committee's report, see: DCC (2023), Annual Report, p.69. www.smartdcc.co.uk/media/wk4d52yw/annual-report-2023.pdf
[65] FRC (2018), UK Corporate Governance Code, provision 32. www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/
[66] Ibid, provision 37.

- **Renumeration Committee must be fully independent, *ie* comprising only Sufficiently Independent Directors**
- **Renumeration Committee must have due regard to DCC's performance against its reputation incentives when setting renumeration principles, targets and policies for executive directors and other key staff.** Key staff could include senior leads responsible for the delivery of main programmes or managing major contracts.

4.32 We invite stakeholder views on this proposal; in particular, we would like to hear from stakeholders about the practical implementation of such schemes and whether we should consider a more or less prescriptive approach.

4.33 Finally, we would reiterate that, subject to the consultation of the Successor Licence, DCC and its Board would remain subject to an overarching set of compliance incentives as Licence breach could result in sanctions from the Authority with the ultimate threat of Licence revocation. The additional governance around a possible stakeholder motion of no confidence discussed in the next section can further reinforce both the reputational and compliance incentive areas.

D. Stakeholder power to issue a vote of 'no confidence' in DCC Board

Q13 What are your views on the proposal to grant stakeholders the power to issue a (non-binding) motion of "no confidence", its objective and requirements? If implemented, what should be the methodology for determining a qualified majority and distribution of votes among stakeholders?

4.34 As the final part of assurance and incentivisation of the Board, we are seeking stakeholder views on our **proposal to grant DCC customers the power to issue a (non-binding) motion of "no confidence" in DCC.**

4.35 The purpose of this mechanism would be to:

- Create a direct accountability link between DCC and its customers
- Provide a way for stakeholders to clearly communicate specific issues causing serious dissatisfaction
- Allow for intervention in issues which are of significant concern but may not meet threshold for regulatory enforcement

4.36 We only propose this mechanism if the decision on the Board composition does not include any direct industry representative (as discussed in chapter 2).

4.37 We have considered and seek views on the following requirements on the motion of no confidence:

- It would have to be passed by a qualified majority of relevant stakeholders (please see below for details)
- It would have to set out specific reasons for which parties were withdrawing confidence, allowing DCC to respond and rectify those issues
- No more than one motion could be passed in a period of 12 months

4.38 Once the motion has been passed and received by DCC, we propose that DCC would be required to, at minimum:

- Within a set timeframe produce a rectification plan, addressing individual issues and their proposed resolution
- Submit the rectification plan to parties and the Authority and report on progress towards resolution of individual issues

4.39 Ofgem's role would be to oversee DCC's compliance with the preparation and implementation of the rectification plan. We are interested in stakeholder views on the degree of flexibility that should be afforded to DCC in this process and whether the plan should be subject to Ofgem's approval.

4.40 To allow stakeholders to launch this no confidence motion with a qualified majority, we would need to create mechanism for allocation of votes to relevant parties. To that end we have identified and seek views on the following four options:

- Option 1: A single vote for each DCC customer a with minimum threshold for either a network usage or funding
- Option 2: Vote allocation proportional to the share of funding (charges paid), subject to a cap on vote share size to prevent outsize influence of a small number of large parties
- Option 3: Vote allocation proportional to the share of network usage, subject to a cap
- Option 4: Stakeholders are split into separate voting groups,; each group is allocated a share of votes

Process for vote allocation

4.41 Giving all stakeholders an equal say through a “1 party 1 vote” mechanism (**Option 1**) would be the simplest to implement. However, we note that granting the largest and the smallest DCC customer the same level of influence may not be seen as fair. This could be partially mitigated by setting a de minimis threshold for network usage or limit the right to vote to only parties paying DCC charges.

4.42 Assigning voting power according to charges paid (**Option 2**) would ensure that those who fund DCC have a proportional share. However, the difference in funding between parties can be substantial. Small stakeholder may therefore have limited say if they were unhappy with the performance of DCC. If this option was implemented without a cap, it would allow a small contingent of DCC customers to consistently launch or even pass no confidence motion causing major disruption to DCC. We would propose that if chosen, this option should be subject to a cap as is the case under the BSC where voting is allocated by the amount of funding. It is worth noting that this option is more complicated and may require financial data from DCC to determine vote shares.

4.43 Assigning voting power to stakeholders by their share of the network usage (**Option 3**) would follow a system similar to that employed by Alt-HAN where vote distribution is based on the number of active meters. This option carries similar risks to Option 2 where a small contingent of large parties can dominate the process. Network usage patterns can also be volatile. It may therefore prove complex to track for the purposes of vote distribution. Network usage is currently not directly aligned to user charges. This option would therefore open up the voting to more parties; however, we recognise that allocation of votes to non-funding parties may be perceived as unfair to funding users. If this option was implemented, we would suggest that a cap to the voting power is implemented. As with Option 2, the implementation of this option may need to be carried out with the assistance of DCC who hold data on network usage and would be more complex than other options.

4.44 Finally, splitting stakeholders into voting groups (**Option 4**) would following the current practice under the SEC. Individual group could vote in their own groups and the outcome of this would decide how the groups would collectively cast their vote in line with that vote. Each group may have a different number of votes, for example, equivalent to the number of seats that each group has on the SEC panel. The categorisation already exists in the SEC, and it may be possible to include this as a function the SEC could carry out. This proposal relies on the existing arrangement of the SEC and the existing code reform work make this option more uncertain.

4.45 All four of these options have benefits and drawbacks as well as an equivalent where they work within another CSDB. We seek stakeholder views on which method may be most appropriate to adopt; our current view is that options 1 or 4 would be the most practicable while ensuring that all DCC stakeholder were involved.

5. Interim changes to governance

Section summary

We previously estimated that a 12-36 month extension to the current licence would likely be needed to develop and implement the new Licence. We envisage that (subject to the outcome of this and our future consultations) certain changes may be implemented within this extension period. Through Chapter 5 we are seeking stakeholders' opinions on the key changes we have identified. These key changes may include working with DCC to appoint an independent Chair and a board member with consumer advocacy experience, increase stakeholders' engagement in board meetings and the appointment of an Ofgem observer in a suitable forum to oversee the business handover to the Successor Licensee. Our current view is that these interim changes can be implemented without Licence modifications. As such, we are proposing to focus on reaching an agreement with DCC in the first instance. However, we welcome views from DCC and other stakeholders and will consider these as part of our ongoing redesign of the regulatory framework and our future design of the new Licence. We also seek stakeholder views on possible retention of the current Sufficiently Independent Directors on the successor Board.

14. Do you agree with the identified priority areas of interim changes? Are there other governance changes that should be implemented in the Licence extension period?

15. What are your views on the possible retention of current Sufficiently Independent Directors on the Board of DCC2? What provisions may need to apply to facilitate this?

Background

5.1 DCC's current licence is due to expire in September 2025, subject to possible further continuation (extension) of up to six years.[67] As noted in our 2023 consultation response document, our assessment is that an extension of 12-36 months is most likely needed to develop and implement the new Licence, ensure a smooth business handover to the Successor Licensee.[68] We expect to confirm

[67] Part 1 (Terms in respect of Grant), Section C
[68] Ofgem (2023), DCC review: Phase 1 Decision, paragraph 3.33. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision

the exact duration of a Licence extension no later than September 2024 in line with Licence requirements.[69]

5.2 In our phase 1 response we also set out that as part of the extension we would work with DCC to bring in changes to the governance arrangements where benefits can be realised early. We indicated that this could include increased stakeholder and consumer input to help the transition to a Board with majority independent/stakeholder representation under the new framework in line with our key features on future governance. We also said that we would work with DCC to consider granting Ofgem an observer role solely to oversee Business Handover.

5.3 We now seek stakeholder views on priority areas where changes could be introduced early, subject to agreement with DCC. We also seek feedback on the possibility to retain current Sufficiently Independent Directors.

A. Priority areas for interim governance changes

Q14 Do you agree with the identified priority areas of interim changes? Are there other governance changes that should be implemented in the Licence extension period?

5.4 Subject to the outcome of this and our other upcoming policy consultations, some of the changes discussed in chapters 2-4 may be implemented within the licence extension period. We have identified a set of changes which in our assessment would not require licence changes for reasons of not contravening any provisions within the current Licence. We propose to focus on reaching an agreement with DCC on these in the first instance.

5.5 We seek stakeholder views on the following changes that may be introduced in the remaining term of this Licence, including any extension:

- Appointment of a Sufficiently Independent Director as the successor to the current Chair (subject to the expiry of the current Chair's term)
- Appointment of a Sufficiently Independent Director with consumer advocacy experience
- Enhanced stakeholder engagement with DCC board
- Ofgem's oversight of Business Handover

[69] Part 1 (Terms in respect of Grant), Section C, paragraph 9

5.6 The first of possible changes, subject to the term of appointment of the current Chair, is for DCC to appoint a successor Chair who meets the requirements placed on Sufficiently Independent Directors. This would be in line with our proposal in chapter 2 (paragraph 2.61). The appointment of an independent chair as a successor to the current one would be desirable particularly given the role of the Board in executing Business Handover.

5.7 The second possible change is the appointment of a Sufficiently Independent Director with consumer advocacy experience. This change would help increase consumer focus of the Board and follow our proposal set out in chapter 3 (paragraph 3.12). However, we are minded to leave at DCC's discretion whether this appointment should be made as part of, or in an addition to, its planned timeline for (re)appointment of non-executive Board members.

5.8 Thirdly, we have considered how stakeholders could more effectively input into DCC Board's discussions and better understand how certain decisions are reached. DCC is not prohibited from inviting other parties to attend its board meetings, either on a permanent or *ad* hoc basis. This may include customer representatives, who could provide evidence on issues that directly affect DCC customers. We understand that there is a precedent for such an arrangement. We believe that an enhanced framework for customer engagement at the Board level could improve transparency and benefit DCC Board's understanding of its customers' views and priorities, without the risks associated with a direct representation (as described in Chapter 2, see paragraphs 2.13-2.17).

5.9 Finally, we have given further consideration to the possibility of an Ofgem observer role for the purposes of oversight of the Business Handover. An 'observer status' is not a legally defined position and inclusion of observers on the board can create legal risks for both parties and the individuals serving as observers. There is also a lack of precedent for the regulator to serve as an observer on the board of a regulated entity. As such, we are not proposing to seek an observer status on the Board itself. Instead, we are considering Ofgem's role in a joint governance group to be created for the purposes of overseeing the implementation of the Business Handover Plan. Details of the membership and terms of reference of the group would be subject to Ofgem approval under DCC's revised Business Handover Plan.

5.10 As these changes would not contravene existing Licence provisions, and therefore, in our assessment, not require Licence modifications for implementation, we propose to focus on reaching an agreement with DCC in the first instance. **We would like to hear from stakeholders whether they agree with our shortlist, which of these areas they consider the most important, and whether there are other intermediate governance changes they would like to see and why.**

B. Retention of Sufficiently Independent Directors

Q15 What are your views on the possible retention of current Sufficiently Independent Directors on the Board of DCC2? What new provisions may need to apply to facilitate this?

5.11 Additionally, we would like to invite stakeholder views on the possible retention of current DCC board members who serve as Sufficiently Independent Directors, and whose ordinary term would extend beyond the Licence expiry date. This would likely include any new members appointed during the Licence extension, such as a possible consumer advocacy specialist proposed in paragraph 5.7 above. To provide a degree of continuity of expertise at the Board level and to allow for future staggered appointment of Sufficiently Independent Directors (such that their terms do not co-expire), we have considered whether Sufficiently Independent Directors serving at the time of the Licence transfer could be offered to retain their posts under the Successor Licence. This would be subject to an agreement by the Successor Licensee and those members' continued compliance with the licence requirements, the proposals for which we have set out in chapter 2 and 3.[70]

5.12 **We are interested in stakeholder views on this matter and considerations for implementation, including whether specific licence provisions may need to apply to any retained members**, for example in relation to the duration of their initial term, which may span the current and the successor licences, and any subsequent reappointments.

[70] See especially paragraphs 2.49-2.60 and 3.5-3.10

Table 5.1: Overview of overall governance proposals, detailed in chapters 2-5

Area	Proposed requirements for the new governance model	Chair of the Board	Other Sufficiently Independent Directors	Other non-executive directors	Executive directors	Existing requirement reference (LC)	Consultation section reference
Composition requirement	Prescribed number	N/A	50%	N	N	9.14	2A, 2E
Independence requirements	Prohibited from becoming a director or an employee of, and from holding shares, securities or other financial rights, in DCC's customers or External Service Providers	Y	Y	Y	Y	9.8	2B
Independence requirements	(General): Not required to perform any executive duties within the Authorised Business of the Licensee	Y	Y	Y	N	9.15(b)	2B, 2C
Independence requirements	(First Independence Requirement): Must not be and must not at any time during the 12 months preceding their appointment have been a director or an employee of the Licensee, or a director or an employee of any Affiliate or Related Undertaking of the Licensee	Y	Y	N	N	9.16	2B, 2C
Independence requirements	(Second Independence Requirement): Must not have, and must not at any time during the 12 months preceding his appointment have had, any material business relationship with the Licensee or any Affiliate or Related Undertaking of the Licensee	Y	Subject to Board's discretion and satisfactory explanation to the Authority	N	N	9.17	2B, 2C
Independence requirements	(Third Independence Requirement): Must at no time during their service hold any remit to represent the interests of any particular shareholder or group of shareholders of the Licensee, any Affiliate or Related Undertaking of the Licensee	Y	Y	N	N	9.18	2B, 2C

Independence requirements	(Fourth Independence Requirement) Must not receive any remuneration from the Licensee or any Affiliate or Related Undertaking of the Licensee apart from a director's fee and reasonable expenses	Y	Y	N	N	9.19	2B, 2C
Competency requirements	Have the skills, knowledge, experience, and personal qualities that are necessary for them to perform effectively as non-executive directors of the Licensee	Y	Y	N	N	9.15(a)	2B, 2C
Competency requirements	Must at all times possess sufficient expertise in: • GB energy market (supply and distribution) • Commercial contract management • Data and communication technology	Y (Requirement on Board as a whole)	Y (Requirement on Board as a whole)	Y (Requirement on Board as a whole)	Y (Requirement on Board as a whole)	N/A	3B
Competency requirements	Must at all times possess sufficient expertise in Consumer advocacy	N/A	Y (at minimum 1 person)	N	N	N/A	3B
Competency requirements	Must have a proven Board-level experience in an organisation of similar size and standing as DCC	Y	N	N	N	N/A	3D
Appointment requirements	Appointment made by the Board's Nomination Committee with a form of industry representation	Y	Y	N	N	N/A	3C
Appointment requirements	Appointment by DCC but with due regard and subject to potential review by Ofgem	N/A (↓)	Y	Y	N	N/A	3C
Appointment requirements	Appointment by DCC subject to a consultation with Ofgem and due regard to its review	Y (for initial appointment)	N	N	N	N/A	3D
Incentives	Appointed for a maximum of 3 years with the option for two subsequent re-appointment (total possible term capped at 9 years)	Y	Y	Y	N	9.23	4A

Incentives	Renumeration tied to measurable outputs of reputational incentives set by Renumeration Committee	N	N	N	Y	N/A	4B, 4C
Incentives	Obligated to produce and follow a rectification plan in response to a motion of no confidence issued by a qualified majority of stakeholders	Y (Requirement on Board as a whole)	Y (Requirement on Board as a whole)	Y (Requirement on Board as a whole)	Y (Requirement on Board as a whole)	N/A	4D

6. Centralised Registration Service (Switching)

We are seeking stakeholders' views on whether DCC should remain responsible for the provision of the Centralised Registration Service ("Switching").[71] We have already received some stakeholder feedback on this topic. Some stakeholders have suggested that the Retail Energy Code Company (RECCo) should assume responsibility for contracting with the service providers to deliver these services directly. Building on this feedback, we discuss two options for the provision of Centralised Registration Service (CRS) and set out our assessment of them. Based on our analysis and for the reasons set out in further detail in this chapter, we are currently of the view that there may be sufficient reason to separate the provision of the Centralised Registration Service (CRS) from the Smart Meter Communication Licence and transfer the responsibility to the Retail Energy Code (REC) to be delivered by RECCo.

16. Do you agree with our proposal that it would be appropriate to remove provision of Centralised Registration Service (CRS) from the DCC Licence and transfer the obligation to the Retail Energy Code (REC) to be delivered by RECCo?

17. What are your views on the considerations we have identified under option 1?

Background

6.1 In February 2015, Ofgem issued a decision to lead a programme of work to implement a reliable, fast and cost-effective next day switching service for British consumers, which would be governed by the Smart Energy Code (SEC) and managed by the Smart Data Communications Company (DCC).[72] These responsibilities were set out through consultation with industry and were additional to the scope of DCC's role at the time of the original licence award in 2013. They were added to the remit of DCC's Mandatory Business in the Licence in two phases.[73]

[71] In this document, the term 'Switching' refers to the core switching services provided by DCC to achieve the design designated by the Authority and set out within the REC, as provided in accordance with LC 17 and a direction from the Authority in accordance with LC 15.
[72] Ofgem (2015), Moving to reliable next-day switching. www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast_and_reliable_switching_decision_final.pdf
[73] LC 6.5(d) and LC 15

6.2 Firstly, DCC was given obligations in July 2016 to support the establishment of the CRS, including contributing to the design of the new registration and switching arrangements and for procuring the Relevant Service Capability to deliver the service.[74]

6.3 Following this, in 2018, we introduced the Retail Energy Code and modified the Smart Metering Communication Licence to obligate DCC to become a party to RECCo, resulting in the move of switching governance responsibilities from the SEC to RECCo.[75] We also confirmed that DCC would have the role of overseeing the delivery of Switching during the Design, Build and Test (DBT) phase and be responsible for the operation of Switching following the service going live in July 2022.[76] As part of this, DCC subsequently entered into contracts with service providers to provide three core Switching services – the Switching Operator (SO), the Central Switching Service (CSS) and the Certificate Authority (CA). Please see overview of the Centralised Registration Service and its component parts in Appendix 3. The rationale at the time for DCC to perform this role was to de-risk the implementation of the new switching arrangements by having the party responsible for procurement also responsible and accountable for providing a wrap-around service management function for those contracted service providers. This was seen as preferable to those contracts being inherited by another party to manage. These new licence obligations came into effect in February 2019.[77]

6.4 In our October 2018 consultation, we stated our intention to keep under review whether the Smart Meter Communications Licence holder, *ie* DCC, should remain the responsible party for provision of Switching. We said that the end of the current Licence Term in September 2025 would provide an opportunity for such a review to take place.[78] We also said that consideration of any changes would be made well in advance of 2025 to allow enough time for a transition if necessary.

[74] Ofgem (2016), Decision: DCC's role in developing a Centralised Registration Service. www.ofgem.gov.uk/publications/decision-dccs-role-developing-centralised-registration-service
[75] Ofgem (2018), Switching Programme: Regulation and Governance. www.ofgem.gov.uk/sites/default/files/docs/2018/10/regulation_and_governance_-_way_forward_and_satutory_consultation_on_licence_modifications_4.pdf
[76] Ofgem (2018), Switching Programme: Regulation and Governance - way forward and statutory consultation on licence modifications. www.ofgem.gov.uk/publications/switching-programme-regulation-and-governance-way-forward-and-statutory-consultation-licence-modifications
[77] Ofgem (2018), Decision and Notice of Licence Modifications [to include further Switching obligations]. www.ofgem.gov.uk/publications/decision-and-notice-licence-modifications
[78] Ofgem (2018), Switching Programme: Regulation and Governance - way forward and statutory consultation on licence modifications, p.63, paragraph 7.11. www.ofgem.gov.uk/publications/switching-programme-regulation-and-governance-way-forward-and-statutory-consultation-licence-modifications

6.5 In August 2023, we published our conclusions on the first phase of the ongoing review of the regulatory arrangements for DCC, where we recognised the benefits of shifting existing switching obligations from the DCC Licence to Retail Energy Code (REC) and outlined our intent to consider the future role of CRS.[79]

6.6 In evaluating possible options for the provision of the CRS, we have considered the following:

- Stakeholder feedback in response to our DCC review phase 1 consultation
- Synergies between Switching contracts and other RECCo contracts
- 'Wraparound' services provided by DCC
- Value for money for participants and consumers
- Potential for operational improvements and efficiencies
- Simplification of governance
- Impact of changes to the governance of industry codes under ongoing Energy Code Reform

6.7 Our analysis has led us to our current preferred option to remove the responsibility to provide the CRS from DCC's Licence and transfer it to the REC to be delivered by RECCo. An alternative option would be for DCC to retain the responsibility for the CRS. An assessment of how the two options compare is set out below, as well as the rationale behind our preferred option. Switching remains a key enabler to a well-functioning retail market with significant benefits to energy consumers. The objective of this consultation is to ensure that the CRS function can be delivered efficiently going forward. Regardless of whether the obligation to deliver CRS lies with DCC (under its Licence) or RECCo (under the REC), we do not envisage changes to the underlying rationale, design and operation of CRS, which remains integral to delivering fast and reliable switching.

Option 1: Centralised Registration Service to be transferred to REC and delivered by RECCo

6.8 We do not consider the creation of a separate licence for the delivery of Switching would be necessary. Instead, we propose that the obligation for RECCo to provide Switching could be delivered through changes to the Retail Energy Code. For the

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

avoidance of doubt, under this option the full scope of the CRS, including the Central Switching Service (CSS) and Switching Operator, would be transferred. Please see Appendix 3 for an overview of the component parts of the Centralised Registration Service, which under this option would be in scope of a proposed transfer. This option would retain the necessary control mechanism and accountability to Ofgem, while creating a direct relationship between the recipients of the service and associated governance arrangements. We are mindful of the impacts that the Energy Code Reform (ECR) will have on the future governance of REC. We will continue to consider interactions with the ECR implementation and any synergies or potential overlaps, for example in the licensing of code managers. However, in our current view these do not hinder our proposal under this Option 1.

Option 2: Centralised Registration Service to remain within DCC Licence and delivered by DCC

6.9 The provision of CRS would remain within the DCC Licence following the end of the current Licence Term (due in September 2025 subject to possible further extension). This would mean that any Successor Licensee would be responsible for delivering the CRS.

Rationale for Option 1

Q16 Do you agree with our proposal that it would be appropriate to remove provision of the Centralised Registration Service (CRS) from the DCC Licence and transfer the obligation to the Retail Energy Code (REC) to be delivered by RECCo?

6.10 Several stakeholder responses to our DCC review phase 1 consultation expressed support for decoupling the provision of the CRS from the Smart Meter Communications Licence on account of the delivery of Switching services being materially different to the scope of DCC's other obligations.[80]

6.11 A shift of responsibility for the CRS to RECCo would streamline the current approach of DCC operating as both a REC party and Service Provider to REC parties. This could enhance accountability for Switching and improve the line of sight of service provider performance to both REC parties and REC Performance

[80] Stakeholder responses can be found at: www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

Assurance Board (PAB), in turn helping to make the CRS more responsive to the needs of industry and more effective in communicating and managing incidents.

6.12 This change could also enable more efficient delivery of operational improvements to Switching, as RECCo could engage directly with the service providers and could use the REC Technical Services (RTS) to act as the Design Authority. This could provide faster change delivery and more efficient process for assessing change impacts and lead to potential cost savings for industry and consumers. Direct costs savings could be achieved by removing any duplicated functions, holding service providers to account under their contracts and through subsequent contract reprocurements.

6.13 Additionally, RECCo has matured as an organisation since its inception in 2019, has since transferred and managed services, and is now likely to be better equipped to provide the CRS directly. It is worth noting that RECCo already serves as the corporate vehicle for ensuring the implementation and ongoing management of the services to support the delivery of the Switching Programme.

6.14 Removing the CRS from the DCC licence will allow DCC and any Successor Licensee to focus solely on its smart metering obligations and prevent any potential lack of focus on the CRS.

6.15 Overall, transferring responsibility for the CRS to RECCo could deliver efficient and cost-effective services for consumers and industry. We recognise there is further detail to be developed and are interested in stakeholder's views on our proposal.

Expected benefits

6.16 We expect that with RECCo providing the CRS, governance and decision-making will be streamlined, allowing industry to have greater influence on the delivery of the service. Currently, the roles and responsibilities of the Switching service providers are set out in the REC and all service providers are subject to performance assurance, which is provided through a defined Performance Assurance Framework (PAF) and overseen by the REC Performance Assurance Board (PAB). Any performance charges DCC incurs due to missed service level agreements, as assured by PAB, are levied directly by RECCo and reflected through DCC reducing its charges to RECCo in a monthly invoice. These charges levied against DCC are then reported to Ofgem the following regulatory year and are subsequently taken into account as part of the Price Control determination process. As detailed in stakeholder feedback, this creates uncertainty in relation to the lines of authority for Switching, given that DCC delivers the services as a REC party and not as a contracted service provider. As a result, RECCo is limited in its powers to hold both DCC and service providers to account for any poor performance since the scope of what the REC PAB can enforce is restricted to DCC's margin as stated in the Licence.[81] Under Option 1, RECCo would therefore be able to directly hold service providers to account for their performance via both the PAB and its contract management process.

6.17 Building on this, we expect RECCo will be able to explore options for service enhancements and redress. In particular, a core feature of the CRS is its use of an address related to a Registrable Measurement Point (RMP) which has been matched by the Address Management Service to a set of standardised addresses in GB to create a unique address, called the Retail Energy Location (REL) Address. The REL should represent the address of the premises to which gas and electricity is supplied and is the address the consumer is expected to provide to a potential gaining energy supplier or a Price Comparison Website to locate the meter point(s) at that location. The service provider is required to continuously improve the quality of RELs by using various data sources and enquiries from registered suppliers, given that in some instances the metering point location address and consumer's address may not be the same. If RECCo was responsible for the CRS, suppliers could raise enquiries more efficiently. Equally, RECCo could address these anomalies by using the data available from the CSS Address Management Service and work with responsible parties making use of performance assurance techniques where required.

6.18 Under Option 1, we also expect RECCo would be able to speed up the delivery of change. In particular, RECCo could use the Design Authority function embedded within REC Technical services, which could remove additional steps from the current process and reduce layers of complexity due to RECCo not having to work through a third party. This could be important if the level of change requests increases due to increased switching volumes.

6.19 The Switching Programme is funded by consumers via the energy industry, so it is important that its framework delivers value for money. We understand RECCo has been able to identify areas of possible cost savings, such as removing potential duplication of efforts and driving efficiencies within the Switching Operator role. This includes, for example, removing any additional management

[81] LC 36 (Determination of the Licensee's Allowed Revenue)

layers, or aligning the CRS technical services to other technical services within the RECCo catalogue. Further savings could be realised through the reprocurement of the main External Service Provider contracts upon their expiry.

6.20 RECCo is a not-for-profit organisation, meaning that no margin will be recovered, and these potential savings will be passed on to industry and consumers.

6.21 Under existing arrangements, we are aware that concerns have been raised by industry regarding operational incidents such as missing messages and registrations remaining unresolved for extended periods of time. We expect under Option 1 that RECCo would be well placed to provide effective communication and management of incidents due to the organisation already having in place established channels of direct engagement with industry, for example the REC Issues Group.

Other considerations

Q17 What are your views on the considerations we have identified under Option 1?

6.22 **Assurance:** DCC currently provides the CRS as part of its Licence obligations and is also required to become a party to and comply with the REC. Under option 1, if the CRS is no longer provided for in the DCC Licence, then by extension, the potential remedies in the event of the licensee's non-compliance or potential breach of the conditions relating to the CRS will no longer be available. Instead, governance of Switching would need to be catered for within the REC and the REC arrangements. This may take the form of an independent oversight and assurance via the REC Board and REC PAB.[82] Independent oversight would be important for providing assurance to industry and we understand that members of both the PAB and REC Board are independent of RECCo. However, we are interested to hear from stakeholders whether additional assurance regime may be necessary.

6.23 **Economies of scale:** DCC provides an additional wraparound service management function which is associated with the three main switching contracts. For example, DCC is responsible for the switching service desk, switching portal, and the switching service management system which provides service management capabilities covering end-to-end switching arrangements. It

[82] RECCo is currently subject to independent oversight for its delivery of other REC services, such as data enquiry, theft and metering arrangements, through the REC governance arrangements.

is also responsible for the switching change advisory board, which governs the implementation of operational change by switching data service providers. By DCC retaining responsibility for the CRS, these service provider contracts will continue to benefit from economies of scale arising from DCC's role in providing smart metering. However, equally, it may be possible for RECCo to replicate the economies of scale through leveraging some of its own existing services such as the REC Service Desk and REC Change Management process. We will take these into consideration when making our decision.

6.24 **Contract transfer:** Table 6.1 provides detail of the existing External Service Provider contracts for the provision of CRS, which have been procured and are managed by DCC. We expect that under Option 1, these contracts would be capable of being novated to RECCo. We recognise that DCC has built relationships with these External Service Providers and we would expect that in the event of a transfer, RECCo would build on these relationships ahead of any novation to ensure a successful transfer. We understand that RECCo already has experience in novating service contracts in the retail market. We would expect that in the event of contract novation, RECCo would carry out business readiness activities, early engagement with both DCC and its service providers, and an impact assessment to ensure an orderly transition without disruption to either Switching or RECCo services.

6.25 **Contract procurement timeline:** We recognise there may be concerns associated with the timeline and management of re-procurement of the contracts. In our view this can be managed if a potential transfer takes effect from September 2025 at a time without re-procurement activity expected to be taking place. We understand that RECCo has already been involved with DCC in DCC's planning for the re-procurement of the Systems Integrator contract, which is due to expire in September 2024. We would expect both parties to continue to cooperate regardless of the outcome of this consultation.

Table 6.1: Contract Expiry Dates

Contract	Service provider	Contract expiry dates (absolute expiry includes possible extensions)
Systems Integrator Contract	NetCompany	September 2024
Service Management Contract	CapGemini	January 2027 (2029)
Registration Services Contract	Landmark	May 2027 (2029)

6.26 **Knowledge retention:** We recognise that DCC staff currently working on the Switching service have developed expertise in the area; for instance, technical knowledge to triage incidents and service requests or identifying resolutions to recurring switching incidents, which are important for the efficient operation of services. As such, we acknowledge the importance of considering how DCC staff can be transferred to RECCo under the relevant legislation to ensure knowledge retention and a continued efficient operation of Switching. We are discussing with DCC and RECO how this can be facilitated.

6.27 **Impacts of transition:** As with any potential transfer, there is a risk of resource and regulatory burden on parties in terms of delivery and timescale under option 1. We would not expect extensive changes to be required to either the Code or Licence framework, given that RECCo already exists as a vehicle for managing the Switching service. We also recognise potential risks associated with the technical transition. While the main services, including hosting of the CSS, system and component integration, service management system and Certificate Authority, should be capable of transfer by contract novation, there may remain areas where further work and assurance may be required. For example, the CSS relies on an interface to the Data Service Provider (DSP) and Enduring Change of Supplier (ECoS) service for information exchange for switching. If any interface issues arise during the transfer of the main service, RECCo may have to build new interfaces into the DSP and ECoS. Similarly, to maintain user interface, industry may need to amend their environments to access RECCo rather than DCC systems, which could require participating in testing activities. We are engaging further with DCC and RECCo to understand the process for technical transition and its potential impacts, including the time, cost and security implications. We will take identified impacts into considerations when making our decision and would expect RECCo to develop a transition plan for areas which would be impacted, detailing mitigation strategy for key risks. We are keen to hear from stakeholders as to how option 1 may impact them as well as any additional risks they see.

Conclusion

6.28 We have put forward two options for the future of the CRS and presented option 1 as our current preferred option. We are keen to hear stakeholder views on both options as well as the considerations we have identified to help inform our overall analysis prior to reaching our decision. We will base our conclusion on the way forward on the basis of stakeholder responses as well as further engagement with DCC and RECCo.

Appendices

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Appendix 1 – Summary of board composition and role of the regulator and stakeholders in DCC Licence and other select industry entities

Name	Board composition set out in code or licence	Current board	Ofgem and stakeholder role in board appointments	Ofgem and stakeholder role in removal	Board term set out in licence or code
DCC	Must have 2 Sufficiently Independent Directors *Relevant Licence = Smart Meter Communication Licence*[83]	3 shareholder representatives, 2 executive members, 3 independent directors	Ofgem oversees DCC's compliance with requirement on its corporate structure set out in the Licence (esp. LC 9). No direct role in the appointment process	*None*	Independent directors are limited to an initial six-year term but may be reappointed for additional six years. No express limitations on other board members
RECCo	The majority of REC Board Members must not be employees of Parties *Relevant Code = Retail Energy Code*[84]	Chair and 4 non-executive directors all are independent members	Ofgem appointed the initial board. For subsequent appointments, nomination committee appoints (in consultation with the Authority) a candidate and parties vote on board appointments	Ofgem can remove board members Board members can be removed as the result of a vote of no-confidence by the Parties (supported by at least 75% of the Parties who cast a vote)	Appointment for 2 years with the ability to be reappointed

[83] LC 9 (Independence and autonomy of the Licensee)
[84] Retail Energy Code, Section 5. Accessible at: https://recportal.co.uk/the-rec-public

Alt HAN Co	Must consist of minimum 3 members *Relevant Code = Smart Energy Code*[85]	2 elected chairs; 3 NEDs from energy companies	No Ofgem powers, stakeholder forum approve board appointments	*None*	Appointment for 2 years with the ability to be reappointed (section Z)
SECCo	SECCo Board composition follows the composition of the SEC Panel *Relevant Code = Smart Energy Code*[86]	Chair of the SEC Panel appointed as the Chair 2 persons elected by the Large Supplier Parties 2 persons elected by the Small Supplier Parties 1 person elected by the Electricity Network Parties 1 person elected by the Gas Network Parties 2 persons elected by the Other SEC Parties 1 person nominated by DCC 1 person nominated by Citizens Advice	Stakeholders vote in their Party Category for Panel members SECCo Board follows the composition of the Panel.	*None*	Panel Chair appointment is for three years with the ability to be reappointed Elected panel members appointment is for two years with the ability to be reappointed
Elexon	Minimum 2 independent non-executive directors. Limit of 2 employees of BSCCo, one of whom must be the chief executive.	Elexon Board and BSC Panel Chair 3 Industry non-executive directors	Stakeholders ratify appointment of nomination committee at next annual BSC	Directors can be removed as the result of a Binding Resolution approved by stakeholders (Voting Parties)	Appointment for 3 years with the ability to be reappointed

[85] SEC, Section Z – Alt HAN Arrangements. Accessible at: https://smartenergycodecompany.co.uk/the-smart-energy-code/
[86] SEC, Schedule 4 (SECCo). See also Section C (Governance).

	Majority of board including the BSCCo chair must have relevant electricity industry experience *Relevant Code = Balancing and Settlement Code*[87]	2 Independent non-executive directors (chosen from BSC panel) CEO of Elexon			
System Operator of Northern Ireland (SONI)	A majority of the directors, including the Chair, must be Sufficiently Independent Directors. There must be no more than one non-executive director who is not a Sufficiently Independent Director. There are requirements on specific sector experience *Relevant Licence = SONI Licence*[88]	*As required*	Where the Authority (NI Authority for Utility Regulation) concludes that an appointment would give rise to a breach of specific licence requirements, and directs the Licensee to not make the appointment, the Licensee must not make the appointment	*N/A*	Appointment for 3-6 years with the ability to be reappointed once. Maximum term limited to 9 years

[87] BSC, Section C4 (Governance of BSCCo). Accessible at: https://bscdocs.elexon.co.uk/bsc/bsc-consolidated
[88] UREGNI (2024), SONI, Condition 42. Available at: www.uregni.gov.uk/publications/notice-decision-modifications-condition-42-soni-tso-licence

Appendix 2 – Summary Impact Assessment

Why has a qualitative impact assessment been included?

A2.1 This summary impact assessment is intended to provide stakeholders with a concise view of our headline proposal for a majority independent Board under the Successor Licence, in relation to our objectives, evidence analysis and expected impacts. We are seeking views on the options we have put forward and invite further evidence to consider in taking a decision.

What is the problem under consideration? Why is Ofgem intervention necessary?

A2.2 DCC is a legal monopoly, operating under the terms of the Smart Meter Communication Licence ("the Licence"), granted by the government and regulated by Ofgem. Ahead of the expiry of the current Licence, we are reviewing the regulatory arrangements to be put in place for DCC under a Successor Licence. We are consulting on changes to DCC governance under the Successor Licence, with focus on requirements on the board composition.

A2.3 In our August 2023 Phase 1 consultation response, we concluded that DCC Board should be majority stakeholder/independent controlled with consumer representation.[89] This was complemented by our decision that, at minimum, DCC Core Mandatory Business would operate on a not-for profit basis. Through this consultation, we are seeking views on the specific governance arrangement that would be most suitable for DCC to implement this and drive the best outcomes in line with our stated principles.

What are the policy objectives and intended effects including the effect on Ofgem's Strategic Outcomes

A2.4 In the first phase of our review, we set out our view that a shift towards a stakeholder or independent-led, purpose-driven model would on balance better deliver to our five key principles (see 'Rationale' below) through stronger accountability framework. The key desired outcomes we want to drive through governance design in the new model are:

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

- Focus on the provision of a quality, cost-efficient and secure smart metering service through alignment of incentives – a shift from a *reliance* on complex margin-based incentives to the use of incentives as an *assurance* tool
- Transparent and effective cost management, including mitigation of scope creep risks
- Customer-centric and consumer-conscious ethos in the organisational culture and decision-making
- Clear lines of accountability but also operational independence for delivery of day-to-day service
- Ensuring that DCC possesses sufficient skills and expertise to perform its role well

A2.5 Our reforms follow Ofgem's strategic priority to establishing an efficient, fair and flexible energy system, with the objective of enabling consumer-focused flexibility.[90]

What are the policy options that have been considered?

A2.6 We have considered the following options for the board composition to deliver our stated aim:

1. **A stakeholder (customer) majority led board with an independent chair**. In this option a majority of the board would represent DCC customers and would be nominated/ratified by them. We have considered two ways in which this majority could be selected: Under Arrangement A DCC customers would vote on their representatives to the Board using a constituency model. Under Arrangement B DCC customers would nominate candidates as a whole. The candidates would be reviewed by the Board's Nomination Committee which would select a shortlist. DCC stakeholders would then vote to approve that candidate(s). We describe possible methods of vote allocation in chapter 4, section D of the consultation.
2. **A stakeholder (customer) plurality board with additional independent board members** Under this arrangement, there would be no overall control of the Board with customer representatives (or independent directors) holding the plurality of votes. Customer representatives would be selected in one of the methods set out under Option 1, additional independent members who would be selected by the Board's Nomination Committee.

[90] Ofgem (2024) strategic objectives. www.ofgem.gov.uk/our-strategy-and-priorities

3. **A shareholder-led Board with a stakeholder forum with separate functions akin to arrangements in place for the Alt-HAN Co**. The industry forum would function as a decision-making body, for example on questions of service delivery and associated costs, while the shareholder-controlled board would oversee implementation, the internal organisational management and compliance with the licence.
4. **An independent majority board** comprising 50%+1 "Sufficiently Independent Directors" without direct representation from DCC customers, but with a potential requirement on the Board to possess suitable industry experience.[91]

A2.7 Based on our analysis, our current preferred option is Option 4 (majority independent board) with enhanced indirect accountability to stakeholders.

Preferred option

"Hard to monetise" impacts

Implementation of an independent board, acting to deliver a set of Licence objectives on behalf and for the benefit of DCC customers and consumers, would support a shift towards purpose-driven governance with a focus on the core service, priority issues and development of necessary competencies. This would, in turn, drive improvements to the quality of service.

Together with a reformed cost control (subject to further consultation, expected to transition to an *ex-ante* regime) with an enhanced customer engagement element, the independent model would also drive greater cost transparency and efficiency, whilst removing any profit-maximising objective via increases in Internal Costs.

The independent model would avoid capture by any vested interests, making it well-placed to fairly assess any trade-offs in delivering to DCC's Licence objectives.

[91] Subject to a proposal discussed in Chapter 3, 3.5-3.10.

<u>ASSUMPTIONS</u>

Under any model:

A1. There would be at least one member on the board from the parent organisation (shareholder), one independent board member in the Chair, and an independent board member with consumer advocacy experience or a direct consumer representative for the stakeholder led models.

A2. DCC will continue to be regulated by Ofgem under its Licence. Ofgem retains the power of enforcement. Regulatory obligations on Ofgem remain broadly the same regardless of the chosen option but areas of focus would differ.

Under a majority-independent model:

A3. Sufficient expertise: We assume that DCC will be able to draw on a sufficiently wide talent pool of suitably qualified individuals to be appointed as Sufficiently Independent Directors. We have considered options to relax the application of one or more Independence Requirements so as not to disqualify potential suitable candidates.[92]

A4. Sufficient motivation and incentivisation: We assume that a majority-independent board can be sufficiently motivated through Licence objectives and requirements, reputational incentives, regulatory compliance and term limits.

<u>RISKS</u>

R1. An independent board may be less effective in holding the company executive to account. We are proposing to mitigate this risk by creating a requirement on targeted financial incentives on the executive leadership and key staff.[93]

R2. Without direct representation, there is a risk of less direct accountability to customers. We are proposing to mitigate this risk through a customer recourse in the form of a non-binding motion of no-confidence[94] and a formalised enhanced customer engagement framework as part of reformed cost control arrangements (subject to our upcoming consultation)

R3. There is a risk that the Board may lose focus in the absence of strong leadership. We are considering mitigating this risk by increasing the Licence requirements on the Chair and potential role of Ofgem in the initial appointment.[95]

R4. There is a risk that an independent governance model may be less attractive to potential bidders for the Successor Licence. We are proposing to mitigate this risk by through further market engagement.

R5. To complement our proposal for a majority independent Board, we have also included proposals on a set of reputational incentives. This could increase the administrative burden on DCC and Ofgem due to potential associated additional regulatory reporting and requirements. Our proposal to grant stakeholders the power to issue a non-binding motion of "no confidence" could also place additional burden on industry due to the proposed requirement to reach a qualified majority.[96]

[92] Chapter 2, 2.57-2.60
[93] Chapter 4, 4.28-4.33
[94] Chapter 4, 4.34-4.40
[95] Chapter 3, 3.32-3.38
[96] Chapter 4, 4.13-4.27

Summary table for all options

Option	Main effects on Consumer outcomes*	Benefits	Key considerations (risks)
Stakeholder majority	An industry-led model may include a direct consumer representative	• Direct link with DCC customers would be expected to align decision-making to customer needs, with the expectation of refocus in delivery towards the core service and for the benefit of stakeholders and, ultimately, consumers. • Improve transparency in decision-making and contract management, affording industry more control over expenditure	• Industry-appointed directors could face potentially irresolvable conflicts of interests. This is because any industry representative would be bound by statutory (general) duties under the Companies Act 2006, compelled to either act on behalf of industry stakeholders but at risk of breaching their legal duties, or act independently but risk undermining the expectations placed upon them by stakeholders during their appointment. • Governance by a diverse group of industry stakeholders may be impractical due to differing opinions and priorities of different stakeholder groups • There is a risk that a small group of influential stakeholders end up controlling the board • Risk of a smaller talent pool to draw expertise from • Additional administrative and resource burden on industry in nomination voting and providing the board members for DCC

Stakeholder Plurality	In the absence of an outright majority for any group of directors (no overall control), the position of a consumer representative may be more influential compared to other models	• *Same benefits as stakeholder-majority model* • Additionally, inclusion of more independent board members would mitigate against the risk of skills shortages by providing access to wider expertise	• *Same risks as stakeholder-majority model* • Additionally, without a majority the board may lack leadership and may lead to slow decision-making • Implementation would require highly prescriptive set of licence requirements to maintain the balance with no overall majority. An overly prescriptive approach could easily put DCC in non-compliance, for example if a board member left, tipping the plurality into a majority for one set of directors.
Shareholder Board and stakeholder forum	Stakeholder forum would be made of a larger group than all other options and so would give the widest input from DCC stakeholders, which could include consumer representatives	• Would preserve shareholder position on the Board, giving the shareholder control over key corporate decisions while allowing for direct stakeholder representation via the decision-making forum • While a board is operationally limited in size, the forum could allow for a more direct and diverse representation of different stakeholders, including smaller parties	• Participation in the forum would require stakeholders to commit time and resource. This option may therefore present the largest administrative burden on DCC customers, which may limit the ability of especially smaller parties to effectively participate • Differences in views and priorities among diverse group of members of the forum may result in operational constraints, slow decision-making, and loss of strategic vision • The division of responsibilities that would fall within the scope of this forum would have to be identified, and careful thought needed on how

			responsibility is shared between the forum and the board. There is a risk that the resulting design would effectively remove the shareholder from key questions, and so would severely limit its powers and accountability for implementation • Possible Ofgem oversight for both the board and forum would increase burden to track decisions and responsibility of each
Independent Majority	While DCC is not consumer-facing, an independent board may be best able to address consumer issues by unbiased assessment of its obligations and impacts	• Would provide operational independence from both the customer base and the shareholder, thus mitigating against the risk of undue influence by any vested interests. This may include dominance by shareholder seeking to above all maximise revenue for the parent company or control by a subset of industry stakeholders, which may not fairly represent needs of the diverse base of DCC customers. • Would deliver the widest range of skills, experience and expertise by	• Compared to industry-led models, an independent majority board may be at risk of lacking recent relevant sector experience • This option has a risk that independent experts may be hard to attract and retain • Inherently more challenging to effectively incentivise independent directors. We have set out proposals for incentivisation of non-executive members via term limits and reputational incentives, and targeted financial incentives on senior leadership and staff.[97] • The independent model may require some additional oversight from Ofgem – for example, if

[97] Chapter 4, 4.7-4.33. See also table 4.1

		drawing on the largest pool of talent compared to other options. Even without a direct industry representation, sector knowledge could be secured via requirements on sufficient expertise. • Implementation would require smaller number of structural changes from the current DCC governance, with less burden on industry parties	new reporting requirements are placed on DCC.[98] However, we do not expect this to have substantial impact on resource requirements.

* We consider that all options would be suitable to improve consumer outcomes by focusing on two areas of consumer impact: quality of service (as experienced by consumers as end-users of smart metering) and cost efficiency (DCC charges are allowable under the price cap).[99]

[98] See proposals in Chapter 4

[99] Ofgem (2024) Smart metering net cost change methodology (Annex 5). Available at: www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatory-programmes/energy-price-cap-default-tariff-policy/energy-price-cap-default-tariff-levels

Additional information

Do you have any additional data or quantifiable evidence in relation to any of the risks identified in this IA, or any relevant additional information?

A. Rationale

A2.8 We set out in our phase 1 consultation[100] the 5 principles that would guide the DCC review. Decisions we make during the review should seek to match these principles. The principles are:

1. Drive delivery of a quality, cost-efficient and secure service: ensure customers receive efficient, reliable, secure and coordinated smart metering service; equip and incentivise DCC to deliver value for money, anticipate and manage change, and deliver against its strategic goals
2. Be customer-centric and consumer-focused to give DCC customers confidence that DCC's activities are aligned with expectations and based on consumer needs
3. Enable full accountability and decisive governance: ensure roles and responsibilities in DCC's governance arrangements are clearly defined, there are clear lines of accountability, and DCC is aligned with industry, regulatory and wider energy policy, while having sufficient operational independence to deliver day-to-day service
4. Allow DCC's role to evolve in an uncertain environment: capture the scope of DCC's role and provide flexibility for its transparent evolution in a changing future environment, while accounting for DCC's monopoly position
5. Maximise the value of DCC infrastructure by enabling the exploration of re-use of assets subject to appropriate control mechanisms, which should protect the provision of fundamental service and competition, and ensure fair distribution of risk and reward

A2.9 In assessing the governance options, we focus primarily on principles 1,2 and 3:

- To meet principle 1, the governance must ensure that DCC Board has objective decision-making processes to achieve the organisation's objectives and is sufficiently skilled and motivated to perform its role to a high standard.

[100] Ofgem (2023), DCC review: Phase 1 Decision. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision. For details on principles, see Ofgem (2022), DCC review: Phase 1 Consultation, esp. p.26, table 2.1 www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

- To meet principle 2, the Board should consider and understand the priorities and needs of both customers and consumers, and be sufficiently incentivised, and accountable, to fairly reflect these in decision-making.
- To meet principle 3: the Board should be sufficiently operationally independent such that it can deliver core service and, if appropriate, drive additional value from the infrastructure and innovation without undue influence or vested interests. DCC should be able to make decisions in such a way that its Board can be held accountable. This accountability is directly to Ofgem to comply with its obligations under the Licence but also more broadly to DCC customers and energy consumers more widely.

B. Evidence

A2.10 In reviewing the options for the board composition, we have considered:

- **Governance of other Central System Delivery Bodies (CSDB)** (for a summary of the CSDBs board composition and stakeholder and Ofgem role, please see Appendix 1): We assessed the effectiveness of different governance models of sector entities to develop our options and understand lessons that could apply to DCC. Most of these models were examples of different industry-led arrangements where the interests of industry stakeholders are represented directly through various panels and boards. However, as DCC delivers its role against the objectives and obligations of its Licence (and relevant codes) and is not an industry code administrator or a body representing parties to the code(s), we found that some of the important lessons learnt from the governance of industry panels or administrators are not directly applicable to DCC. Whereas direct forms of industry representation can work well on industry panels and boards, they would be at risk of risk of conflicts of interests in the case of DCC: Any industry-appointed directors would be potentially compelled to either act on behalf of industry stakeholders, and so be at risk of breaching their legal duties (under the Companies Act 2006), or act independently but risk undermining the expectations placed upon them by stakeholders during their appointment. This is one of the reasons for which are proposing a majority independent model.
- **Principles and recommendations of the UK Corporate Governance Code (2018 and 2024):**[101] The Code provides guidance for best practice in corporate

[101] UK Corporate Governance Code (2018 and 2024), available at: www.frc.org.uk/library/standards-codes- policy/corporate-governance/uk-corporate-governance-code

governance. DCC itself is required under its Licence, unless the Authority otherwise consents, to comply with the main principles of the Code.[102] Key findings relevant to our proposals included: recommendation that at least one half of the board, excluding the Chair, should be composed of non-executive directors whom the board considers to be independent; recommendation that the Chair should likewise be an independent non-executive director; factors likely to impair director's independence and how they can be applied; and principles and recommendations in relation to the roles of key committees: the Nomination Committee and the Renumeration Committee. These findings support our more detailed proposals, eg those discussed in Chapter 2, Sections B and C.

- **Other licences that Ofgem grants**, considering Ofgem's role within the governance of the licensees – we compared the extent of Ofgem's role in the regulation of other licensed entities, including arrangements under which it is appropriate for Ofgem, or other parties, to be involved in matters of organisational governance. Our findings informed our proposals in Chapter 3, Sections C and D.
- **Input from internal and external stakeholders, including Ofgem's academic panel and legal advice**, which allowed us to test our thinking and consider how our analysis aligned to other areas of Ofgem's work, such as ongoing Energy Code Reform project[103] and the establishment of National Energy System Operator.[104] This input and engagement helped to confirm our analysis in respect of the main proposals and supported, among others, the options for incentivisation we present in chapter 4.

Summary

A2.11 Out of the four presented options the majority independent model is our current preferred option to adopt in the Successor Licence.

A2.12 In our view, the model would allow the Board to access the widest range of knowledge and expertise. It preserves DCC's operational independence and can be

[102] LC 7.3

[103] Ofgem (2024) Energy code reform: implementation consultation. Available at: www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation

[104] Ofgem, DESNZ (2024) National Energy System Operator licences and other impacted licences; Annex E: Electricity System Operator licence conditions, condition B1.7. Available at: www.gov.uk/government/consultations/national-energy-system-operator-neso-licences-and-other-impacted-licences-statutory-consultation

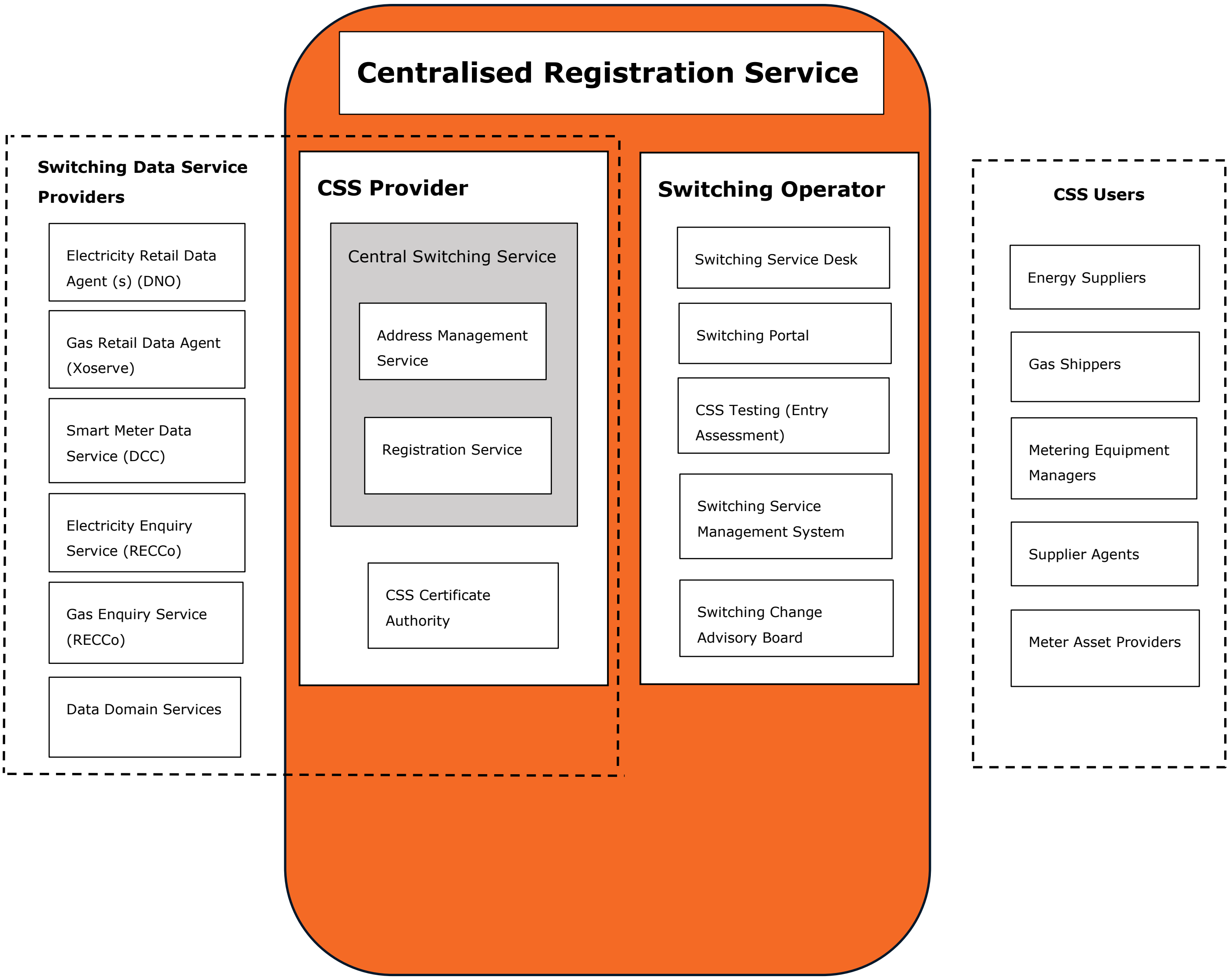
expected to foster the most objective decision-making processes to fulfil the organisation's objectives.

A2.13 While there may be concerns around retention, incentivisation and industry experience of an independent majority, we consider that on balance these risks can be more easily mitigated compared to the risks of conflicts of interests which arise in other models.

A2.14 We believe that an independent majority board would still be able to deliver to customer needs and ensure that DCC's activities are based on DCC's customers' evolving expectations. Any form of direct industry representation would be challenging from a regulatory and legal standpoint due to the significant risks of conflicts of interests that could arise. Instead, we propose to drive accountability and customer (and consumer) voice indirectly via requirements on board appointments and other governance arrangements.

A2.15 While we recognise that all options have their merits and proven record in other organisations, in context of DCC's position as a licenced entity, the nature of its business, and the overall shift towards a purpose-driven not-for-profit organisation, it is our current view that the independent model would be the most suitable and viable. **We seek stakeholder views on our analysis and welcome additional evidence that we should take into account when making our decision.**

Appendix 3 - Overview of the Centralised Registration Service (CRS)



Appendix 4 Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

(Include here all organisations outside Ofgem who will be given all or some of the data. There is no need to include organisations that will only receive anonymised data. If different organisations see different set of data, then make this clear. Be a specific as possible.)

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for ***(be as clear as possible but allow room for changes to programmes or policy. It is acceptable to give a relative time e.g. 'six months after the project is closed')***

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data.
- access your personal data.
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it.
- ask us to restrict how we process your data.
- get your data from us and re-use it across other services.
- object to certain ways we use your data.
- be safeguarded against risks where decisions based on your data are taken entirely automatically.
- tell us if we can share your information with 3rd parties.
- tell us your preferred frequency, content and format of our communications with you.
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas (Note that this cannot be claimed if using Survey Monkey for the consultation as their servers are in the US. In that case use "the Data you provide directly will be stored by Survey Monkey on their servers in the United States. We have taken all necessary precautions to ensure that your rights in term of data protection will not be compromised by this".

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system. (If using a third-party system such as Survey Monkey to gather the data, you will need to state clearly at which point the data will be moved from there to our internal systems.)

10. More information for more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".