DCC Price Control: Regulatory Year 2023/24

Publication date:	06/11/2024
Response deadline:	01/01/2025
Contact:	Arno Vanden Eynde
Team:	DCC Oversight and Regulatory Review
Email:	DCCregulation@ofgem.gov.uk

We are consulting on our proposed positions for DCC's costs, revenues, and margin application for the Regulatory Year (RY) 23/24 under the Price Control mechanism. We welcome responses from all 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.

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

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

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

Contents

Foreword

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

DCC submitted its Price Control information (based on the published Regulatory Instructions and Guidance (RIGs) for 1 April 2023 to 31 March 2024) on 31 July 2024.[2] DCC also submitted proposals for adjustments to its Baseline Margin and External Contract Gain Share values.

This document includes our review of the DCC's costs for the RY23/24 and 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.

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

Executive Summary

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

In comparison to last year's forecast, there has been a material increase in costs. There are several drivers for this, but as with previous years, the main reasons for these include DCC updating the forecast costs associated with the procurement of new contracts, unforeseen issues which arose throughout the RY, and previous cost disallowances made through our Price Control determinations caused zero baseline for some areas.

DCC's Price Control submission for the 2023-24 Regulatory Year (RY23/24) described how DCC has continued to support the roll-out of the smart metering network. By the end of RY23/24, DCC had 30 million meters connected to its network, of which 12.2m are SMETS1 meters. During RY23/24, DCC further developed its 4G Communications Hubs programme and, as part of that, designed, built and tested new services and capabilities to upgrade the existing 2G/3G infrastructure in the Central and South Communication Regions.

Overall, DCC's total reported costs for RY23/24 are £684m. This is a 15% increase in total costs compared to last year's forecasts. We note a 57% increase in Internal Costs when comparing the reported costs to the RY22/23 forecast. In comparison to the forecast accepted under the RY22/23 forecast adjusted for inflation, External Costs are 6% higher in RY23/24. Over the Licence term, total costs are now forecast to be £5.904b, 7% greater than last year's forecast. Please note that by "Licence term" we mean up to and including RY25/26. In September 2024, we published our decision to extend DCC's Licence by two years to September 2027.[3] However, as the additional regulatory years had no baseline (approved forecasts), they are excluded from this year's reporting.

[3] Ofgem (2024), Decision on the continuation of the Smart Meter Communication Licence and the rate of Shared Service Charge and Baseline Margin. www.ofgem.gov.uk/decision/decision-continuation-smart-meter-communication-licence-and-rate-shared-service-charge-and-baseline-margin

Cost Assessment

Ofgem has a regulatory duty to determine that costs incurred during a price control period are economic and efficient. As part of this function and in accordance with the Licence and DCC Price Control Guidance: Processes and Procedures ("the Guidance") document, economic and efficient costs are assessed based on information and evidence that we receive, which then inform our decisions.[4] During this process, we cannot assume that DCC's costs are economic and efficient by default. This is particularly important given that DCC operates as a monopoly in a non-competitive environment. We therefore expect DCC to demonstrate that the choices it makes in running its business are economic and efficient and represent value for money for consumers. It must therefore evidence that the routes it has chosen for procuring services, including both internal and external are economic and efficient in the circumstances. That burden of proof lies with DCC.

DCC's submission for RY23/24 has provided reasonable justification for the majority of the costs that were incurred. We also welcome the improvements that DCC has made this year, in line with last year's feedback, around the quality of the reported cost data contained within the submission.

Our assessment of this year's submission has revealed the following key areas of concern:

- **Planning, scoping, and resourcing of projects** – as a monopoly provider, it is important that DCC achieves value for money through all services and capabilities that it procures. We accept that DCC can outsource projects where it does not hold particular skills in-house, or where the nature of the activity is short-term. However, as per last year, we remain concerned that DCC is becoming over-reliant on the use of external consultants, including for activities that are of a nature that is considered BAU and/or likely to be undertaken on a regular or ongoing basis. For example, in RY23/24, DCC spent a total of c.£49m on non-resource activities; this constitutes a 27.6% increase against the incurred spend in these areas compared to RY22/23. As per last year, we are proposing to disallow a proportion of the costs for those contracts where DCC has been unable to demonstrate that it had considered alternative options before defaulting to the outsourcing of a particular activity ie, by taking on either existing staff or by hiring additional permanent staff or contractors, or a combination of both.

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

- **Transparency of scope and costs of projects –** in line with the Licence and our Guidance, as well as previous year's directions and feedback, it is important that before DCC initiates new activities that are relatively material, that it carefully analyses the scope, costs and benefits of such activities, combined with strong customer engagement. We expect DCC to be able to share any robust outputs and evidence to that effect upon request by Ofgem. In RY23/24, we have identified further significant costs, directly related to the delivery of the Business Accuracy programme. As per the last two years, DCC has not been able to share with us any further evidence of how the benefits of this programme, and its various outputs are monitored and realised.

- **Procurement** – DCC operates an outsourced services model, and procurement is key to making sure that services are procured and delivered in a manner that is economic and efficient. In line with previous years, we continue to observe instances where services are procured in a way that is potentially not compliant (ie., via direct awards) with the procurement obligations[5] under the Licence. We have also noted on a number of instances that, where services were procured competitively, the commercial interest to bid for these services was low. In the interests of transparency and best use of competition, we expect DCC to be able to robustly evidence that its requirements are not unnecessarily restrictive and that its procurement opportunities reach the widest range of potential suppliers (whether already contracted to DCC or not). We intend to continue to monitor and scrutinise these areas going forward, as part of the price control and/or our wider work on compliance.

- **Contract management** – a core part of DCC's role is to manage a large number of contracts with External Service Providers responsible for delivering the smart metering infrastructure. DCC is expected to follow best practice in contract management to derive value from these contracts, effectively manage change, and deliver value for money to its customers and consumers. External Costs form the largest part of DCC's costs at ~70%. Although DCC's submission and evidence were sufficient to justify most of its External Costs, based on our assessment of evidence provided to us to date, we are consulting on disallowing a proportion of the costs which relate to issues identified in SMETS2, SMETS1, ECoS and TAF programmes. Specifically, we have concerns about work carried out without a clear mandate or benefit in the ECoS programme, sunk costs and

[5] Licence Condition 16 – Procurement of Relevant Service Capability

continued issues experienced in the SMETS1 programme, high enduring charges paid to an interim DCO service provider, instances of nugatory spend and DCC's ability to manage timelines with cost implications. In several areas, we are also concerned about DCC's internal processes and ability to provide clear evidence to support its justification.

For the cost assessment itself, and subject to receiving further evidence, our position is that **£16.958m from DCC's Internal Costs incurred in RY23/24 are Unacceptable Costs.**[6] The proposed disallowances for this year are largely driven by an increase in expenditure on activities and grounds that has been subject to a cost disallowance in previous years. More specifically, the costs associated with this year's proposed disallowances, for RY23/24, are linked to inefficiencies in the planning (**£6.086m**) and, in particular, the resourcing of activities; further material spend on activities that fall within the scope of the wider Business Accuracy Programme (BAP) (**£4.124m**); proposed disallowances to contractor staff salaries that exceed the relevant benchmarks (**£0.506m**); and reductions in Shared Service Charges (SSC) (**£1.212m**) as a direct result of the proposed cost disallowances. Similar to last year, this year's proposal also comprises **£5.031m** resource costs due to a lack of variance resource costs in the Programme (professional services practice), Operations (Future Connectivity) and Network Evolution (4G Comms Hub and Network) cost centres and programme.

Subject to further evidence, our position is that **up to £8.498m from DCC's External Costs incurred in RY23/24 are Unacceptable Costs.** The issues related to our proposals include work that was carried out without a clear mandate or benefit in the ECoS programme (**£3.424m**); sunk costs (**£2.481m**), and continued issues experienced in the SMETS1 programme (**£0.600m**); high enduring charges paid to an interim DCO service provider (**£0.437m**); instances of nugatory spend (**£0.300m**); unexplained scope of work as a result of operational issues and defects (**£0.515m**); and DCC's ability to manage timelines with cost implications (**£0.740m**).

Furthermore, we are minded to disallow a total of £72.314m **in forecast Internal Costs** (including £8.438m forecast Switching Internal Costs) for RY24/25 and RY25/26. We are also minded to disallow £30.926m **in forecast External Costs** (including £21.496m in forecast Switching External Costs) until the end of the Licence period due to a lack of uncertainty around the future costs.

[6] LC37.8 – Part B: Authority's power with respect to certain costs

Finally, as per previous years, where further satisfactory evidence is received, we will revise our proposed disallowances at the decision stage. Any costs that we ultimately decide were not economically and efficiently incurred may either be excluded from the future calculation of Allowed Revenue or be subject to an undertaking about DCC's future management.

Table 1: Summary of proposed cost disallowances [£m] (including Switching cost disallowances)

	Incurred costs: RY23/24	Forecast costs: RY24/25 - RY25/26
Internal Costs proposal (incl. SSC)	16.958	72.314
External Costs proposal	8.498	30.926
Total	**25.455**	**103.240**

Performance Incentives

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

We are proposing that **£10.256m** of DCC's Baseline Margin should be retained, out of the available £12.306m. This corresponds to a reduction of £2.01m, and comprises:

- A reduction of **£0.261m** as a result of DCC's performance in customer engagement, corresponding to a total score of 2 awarded (out of a possible 3) for the customer engagement incentive.
- A reduction of **£0.404m** due to DCC's performance under the contract management incentive, corresponding to a score awarded of 2.10 (out of 3). DCC's contract management performance was assessed by an independent auditor against a modified version of the National Audit Office (NAO) contract management framework, as well as the scope set out in the OPR Guidance. We adjusted the auditor's score from 2.24 to 2.10 out of 3**.**
- A reduction of **£1.385m**, for RY23/24, following last year's assessment of the SMETS1 Baseline Margin Project Performance Schemes (BMPPAS).

Baseline Margin Adjustment

The Baseline Margin Adjustment (BMA) mechanism was initially included in the Licence to recognise the degree of uncertainty around the nature and risk of DCC's Mandatory Business over time at the time the Licence was granted. It is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business under the Licence.

This year DCC has applied for a £31.537m adjustment to its BM for increases in the volume and complexity of work, changes to timescales, or increased cost certainty of activities. DCC identified 13 drivers this year, 12 of which were identified by DCC in previous submissions. One of the grounds was raised for the first time in this year's application (Licence Renewal); it sat within a new driver (Regulatory Requirements).

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

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

Taking all of these disallowances into account, we are minded to amend DCC's application to an adjustment of **£1.994m** between RY23/24 and RY25/26, a decrease of £29.543m from the application. A significant proportion of BM reduction is due to forecast cost disallowance for RY24/25 and RY25/26. If these forecast costs are justified in future Price Control submissions, DCC will be able to keep the BM associated with these costs.

External Contract Gain Share

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

DCC has applied for a Relevant Adjustment of £4.991m for RY23/24. This adjustment relates to the continuation of re-financing arrangements across Communication Service

Providers (CSPs), the savings achieved through interest rate reductions for Comms Hub financing and savings from DCC's in-house test lab services. DCC estimates £13.28m in savings to industry as a whole for RY23/24, of which it is proposed that £8.318m is returned to customers.

We welcome DCC's ongoing efforts to secure cost reductions to the benefit of its customers and GB consumers. For example, between RY15/16 (DCC's first ECGS Adjustment application) and RY23/24 (including this year's application), **DCC has secured cost reductions of £276.7m relating to savings** in the FSP contracts, Comms Hubs financing and DCC's test labs; and **brought benefits of £158.618m** (c.57% of total cost reductions) to DCC's customers (based on DCC's previous ECGS applications).

Switching Programme

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

We are of the view that DCC's internal costs associated with the Switching Programme in RY23/24 are economic and efficient. However, in line with our decision in previous years, we propose to disallow DCC's forecast costs for Switching due to a lack of sufficient justification. DCC presents its cost forecasts to the Retail Energy Code (REC) code manager shortly before the start of the financial year, and the code manager must then review the DCC budget. Only at the point of REC approval of the budget would we have sufficient certainty and clarity over DCC's Switching costs to be able to approve forecast costs.

From 1 April 2023, DCC has its Switching margin incentivised against the Switching Incentive Regime (SIR). We published our decision to introduce the SIR in January 2023[7], placing 80% of DCC's switching margin at risk against its operational performance and 20% against customer engagement. We are proposing to disallow all of DCC's margin associated with its operational performance and a reduction of £0.018m as a result of DCC's performance in customer engagement, corresponding to a total score of 2.25 awarded (out of a possible 3) for the customer engagement incentive.

[7] SIR decision accessible at:https://www.ofgem.gov.uk/sites/default/files/2023-01/Ofgem Decision - DCC Switching Incentive Regime1674651228949.pdf

Next Steps

We welcome your views and will consider them when we make our decision. Please send responses to DCCregulation@ofgem.gov.uk by 1 January 2025. We intend to publish our decision in February 2025.

1. Introduction

What are we consulting on

1.1 We are consulting on our proposed positions for DCC's costs, revenues, and margin application for the RY23/24 under the Price Control mechanism. As required by the Licence, our assessment of DCC's costs is based on comparing DCC's incurred costs and revised forecast with the previous year's forecast and with DCC's Licence Application Business Plan (LABP).[8] Our guidance document, first published in July 2014 and further updated as of July 2022, sets out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient.[9]

1.2 DCC provides additional transparency on costs directly to its customers through its quarterly finance forums under suitable confidentiality arrangements.

1.3 A stakeholder meeting will also be held in December 2024 to provide DCC's customers and other key stakeholders an opportunity to explore the issues highlighted in this consultation with both Ofgem and DCC.

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

Section 1: Introduction

1.5 This section includes a short summary of the other sections in this document, a summary of DCC's activities during RY23/24, and an overview of DCC's costs during the year.

Section 2: Your response, data and confidentiality

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

Section 3: External Costs

1.7 This section sets out our assessment of the costs incurred by DCC through its contracts with existing FSPs, SMETS1 and ECOS service providers, as well as more recently procured 4G Comms Hubs & Networks and TAF service providers in RY23/24, as well as the updated forecasts for the remainder of the Licence

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

term. It includes an overview of how costs have changed relative to previous year's reporting, DCC's justification for any changes in those costs, and our response to that.

Questions

Question 1: What are your views on our proposals to disallow all of the costs associated with the ECoS monitoring solution and integration cyber security programme?

Question 2: What are your views on our proposed cost disallowance of up to £0.600m in relation to SMETS1 service stabilisation?

Question 3: What are your views on our proposal to disallow up to £2.481m of costs incurred on the device swap-out project?

Question 4: What are your views on the following proposed disallowances in relation to increased charges for the SMETS1 interim DCO contract: (a) £0.437m of operational costs incurred in RY23/24 above the indexation adjustment applied on the base contract, and (b) £9.029m in unjustified forecasts over the Licence term?

Question 5: What are your views on our proposal to disallow all costs of the procurement of a replacement DCC Service Management System (DSMS)?

Question 6: What are your views on our proposal to disallow £0.515m of costs associated with operational issues and defect fixes within the implementation of an updated version of Great Britain Companion Specifications (GBCS)?

Question 7: What are your views on our proposed cost disallowance of £0.740m related to delays in the TAF programme?

Question 8: What are your views on our proposal to disallow £11.347m in forecast FSP External Costs?

Question 9: Do you have any other views on External Costs?

Section 4: Internal Costs

1.8 This section examines DCC's Internal Costs, namely the costs that are incurred by DCC for the purposes of the provision of the DCC service (these exclude External Costs and Pass-through costs). It examines Internal Costs incurred in RY23/24 and DCC's updated forecasts for the remainder of the Licence term, focussing on changes in those costs compared with last year's forecast and the LABP. It sets out DCC's justification for any changes in those costs and our response, specifically considering Payroll and External Services. This section also

investigates DCC's approach to, and the results of, the benchmarking of permanent staff and contractor remuneration.

Questions

Question 10: What are your views on our proposal to disallow a 50% proportion of the RY23/24 resource costs associated with the Network Evolution programme?

Question 11: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 12: What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not to have been resourced in the most economic and efficient way?

Question 13: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

Question 14: What are your views on our proposal to disallow forecast cost variances in RY23/24 and 24/25; and all baseline forecast costs for RY24/25 onwards?

Section 5: Performance Incentives

1.9 This section covers DCC's performance under the Operational Performance Regime (OPR). There are no live Baseline Margin Project Performance Adjustment Schemes that required assessing in RY23/24. It sets out DCC's submission of its performance under these regimes, and our response.

Questions

Question 15: What are your views on our proposed position on DCC's System Performance?

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

Question 17: What are your views on our proposed position on DCC's Customer Engagement?

Section 6: Baseline Margin Adjustment and External Contract Gain Share

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

Questions

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

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

Section 7: Switching

1.11 This section examines DCC's costs associated with the Switching Programme, and our assessment of DCC's performance under the Switching Incentive Regime.

Questions

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

Question 21: What are your views on our assessment of DCC's performance under the Switching Incentive Regime?

Related Publications

1.12 DCC's Licence is accessible at:

www.ofgem.gov.uk/sites/default/files/2023-03/Smart%20Meter%20Communication%20Licence%20-%20Current.pdf

1.13 The DCC Regulatory Instructions and Guidance 2023 is accessible at: www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2023

1.14 The DCC Price Control Guidance: Processes and Procedures is accessible at: www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

1.15 Last year's consultation document is accessible at: www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202223

1.16 Last year's decision document is accessible at:

www.ofgem.gov.uk/decision/dcc-price-control-decision-regulatory-year-2022-2023

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

Summary of DCC costs

1.18 Overall, DCC's total reported costs for RY23/24 are £683m. Excluding pass-through costs, the figure is £654m.[10]

1.19 This is a 12% increase in total costs incurred in RY22/23 compared to last year's forecasts (or a 5% increase with pass-through costs excluded). Table 1.1 shows how the main cost categories in RY23/24 compared to the forecasts of DCC's RY22/23 submission.

Table 1.1: RY23/24 reported costs compared to RY22/23 forecast in current year prices

	RY22/23 forecast (£m)	RY23/24 (£m)	Variance (£m)	Variance (%)
Total External Costs	456	483	27	6%
Total Internal Costs (excl. SS)	91	144	52	57%
CRS total costs (excl. SS)	-	15	15	-
Total Shared Services cost (for Internal Costs and CRS)	8	12	48	50%
Total Costs excl. Pass-Through Costs	555	654	99	18
Pass-Through Costs	39	30	-9	-24
Total Costs	**594**	**683**	**89**	**15**

1.20 The greatest percentage change in the variance comes from the Total Internal Costs (excl. SSC). Internal Costs increased by 57% between the reported costs in RY23/24 and the RY22/23 forecast. Similar to the previous regulatory year, the CRS Total Costs also had a significant variance percentage change. Total Shared Services increased sizeably by 50%, and pass-through costs reported a negative variance percentage change of -24%.

DCC Costs over the Licence Period

1.21 Figure 1.1 reports the trends in DCC's costs over the Licence period as reported in its latest submission. DCC's forecast costs increase, with total costs peaking at £746.57m (in RY23/24 prices) in RY21/22, before decreasing in RY22/23 and rising again towards the end of the Licence term.

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

Figure 1.1: Trends in DCC's costs (£m, 23/24 prices)

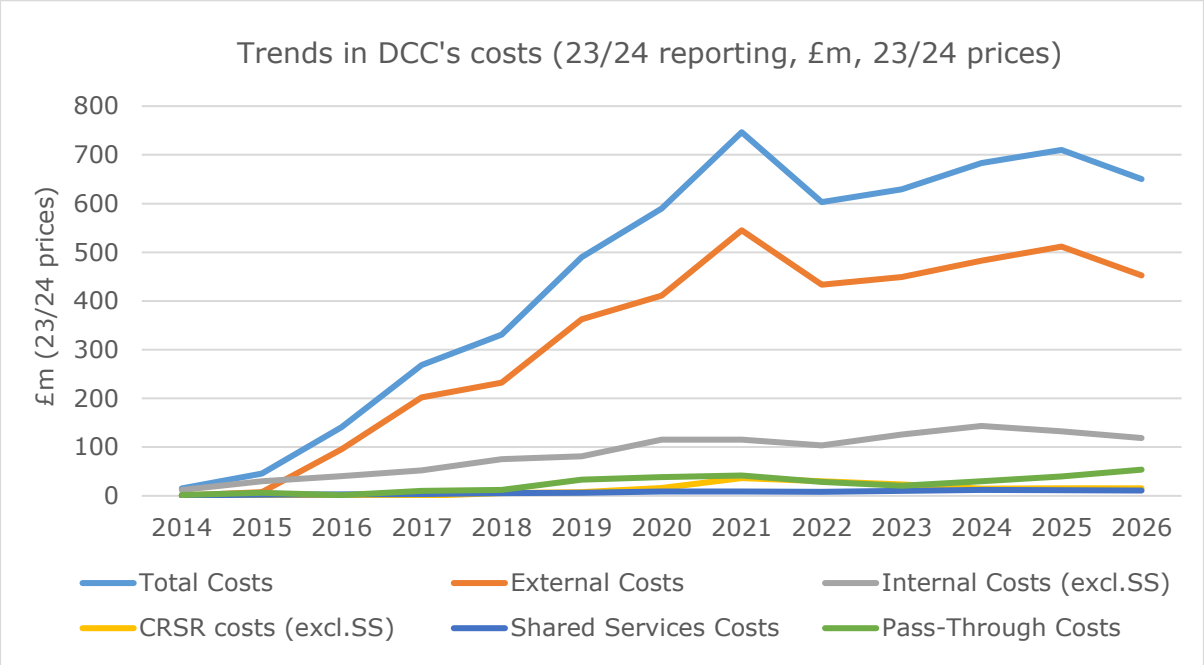


Figure 1.1: Data table[11]

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Total costs	15.31	46.03	141.30	268.48	330.73	490.16	589.86	746.57	602.85	629.07	683.46	710.24	650.65
External costs	0.76	7.71	95.97	202.19	232.31	362.47	411.12	545.17	433.75	449.42	483.03	511.57	452.29
Internal Costs (excl. SS)	12.04	29.78	40.69	52.12	75.58	81.33	115.13	115.13	103.31	126.05	143.52	132.49	118.81
CRS costs (excl. SS)	-	-	-	-	5.63	7.61	16.44	36.51	30.03	23.26	14.82	15.24	15.33
Shared Services costs	0.96	2.23	3.21	3.97	5.62	6.62	8.83	8.93	8.25	10.20	12.20	11.40	10.74
Pass-Through costs	1.56	6.30	1.44	10.20	12.26	32.99	38.44	41.75	28.34	21.09	29.94	39.88	53.77

[11] Totals may not add up due to rounding

1.22 DCC's latest forecast total costs over the Licence period (RY13/14-RY25/26), as contained in its submission, is £5.90b. Excluding pass-through costs, its forecast for costs over the Licence period is £5.59b.

Table 1.2: RY23/24 forecast, and variation compared to RY22/23 forecast over the Licence period (RY13/14-RY25/26) in current year prices

	RY22/23 forecast (£m)	RY23/24 (£m)	Variance (£m)	Variance (%)
External - Baseline	2,225.38	2,265.11	39.73	1.79
External – New Scope	1,861.99	1,922.65	60.66	3.26
Total External Costs	**4,087.37**	**4,187.76**	**100.39**	**2.46**
Internal – Baseline (excl. SS)	1,005.68	1,276.19	270.51	27
Internal – New Scope (excl. SS)	67.63	67.63	0	0
Total Internal Costs (excl. SS)	**1,073.31**	**1,343.83**	**270.51**	**25**
CRS (excl. SS)	115.13	159.83	44.69	39
Total Shared Services cost (for Internal Costs and CRS)	73.64	93.17	19.53	27
Total Costs excl. Pass-Through Costs	**5,194.70**	**5,586.73**	**392.03**	**8**
Pass-Through Costs	329.45	317.97	-11.476	-3
Total Costs	**5,524.15**	**5,904.70**	**380.55**	**7**

1.23 External Costs over the Licence period have increased by 2.5% compared to the RY22/23 forecast to £4.191b. This increase is primarily due to the costs associated with the DSP, SMETS1 SPs, and CH&N SPs. Section 2 summarises the External Cost variations, DCC's justifications and our response.

1.24 Total Internal Costs, excluding Shared Services have increased by 25% over the Licence period compared to last year's forecast, from £1.073.3b to £1.343b. This is largely driven by increases in the Finance, Operations, and Corporate

Management cost centres and Additional Baseline costs. Section 3 summarises the Internal Cost variations, DCC's justifications and our response.

Comparison to the Licence Application Business Plan (LABP)

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

1.26 Figure 1.2 shows how the main cost categories in RY23/24 compare to the forecast at LABP. In aggregate, costs are £3.44b, or 139% higher over the Licence term compared to DCC's forecast as part of the bid.

Figure 1.2: Comparison of RY23/24 costs to LABP in current year prices

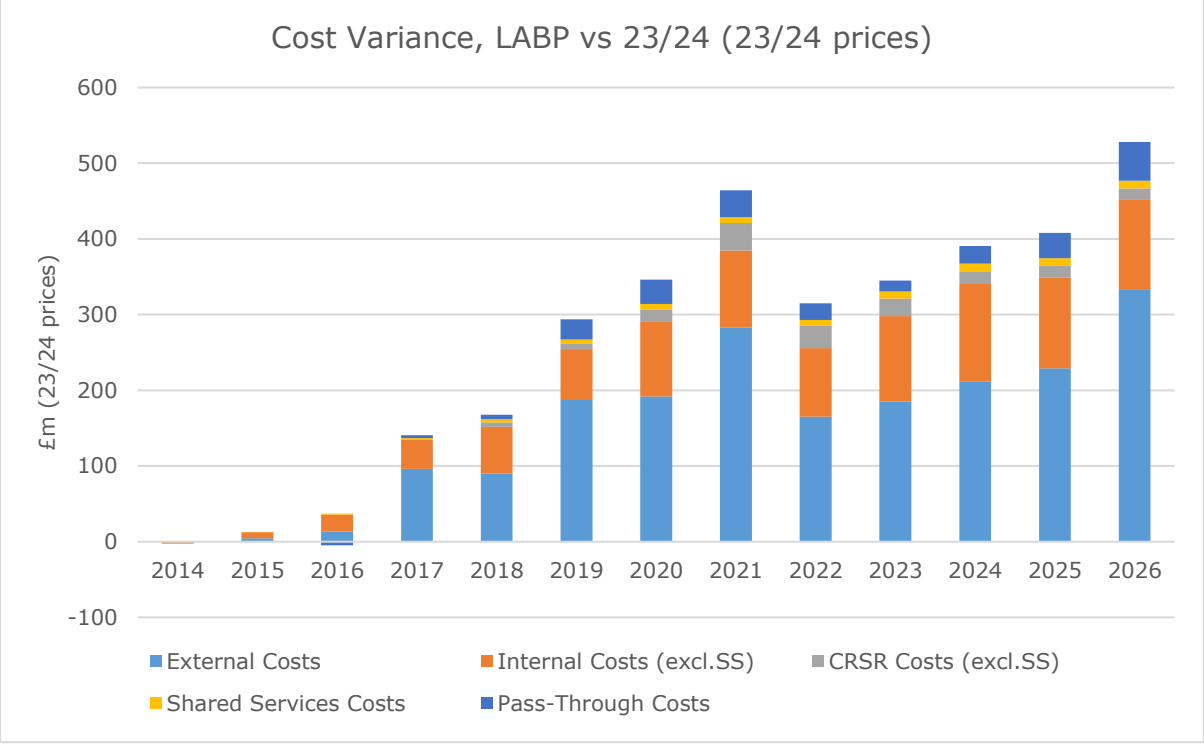


Figure 1.2: Data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
External costs	0.7	4.1	12.9	91.1	85.2	177.2	181.9	267.9	156.5	178.9	189.1	231.7	254.5
Internal Costs	(1.9)	7.6	21.0	36.2	58.6	63.8	93.3	96.4	85.8	117.2	93.4	84.9	90.1

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
CRS costs (excl. SSC)	-	-	-	-	4.7	6.4	15.5	33.7	27.7	21.1	15.1	14.3	15.1
Shared Services costs	(0.2)	0.2	1.4	2.5	4.1	5.0	6.9	7.3	6.9	9.4	8.4	7.6	8.0
Pass-Through costs	(0.4)	(0.1)	(4.7)	3.6	5.6	25.2	30.4	33.5	20.8	13.9	31.2	38.0	44.1

Comparison to Last Year's Forecast

1.27 Figure 1.3 shows how the main cost categories in RY23/24 compared to the forecast created as part of DCC's RY22/23 submission.

1.28 Overall, costs are £380m higher over the Licence term compared to the forecasts in DCC's RY22/23 submission.

Figure 1.3: Comparison to RY23/24 forecast in current year prices.

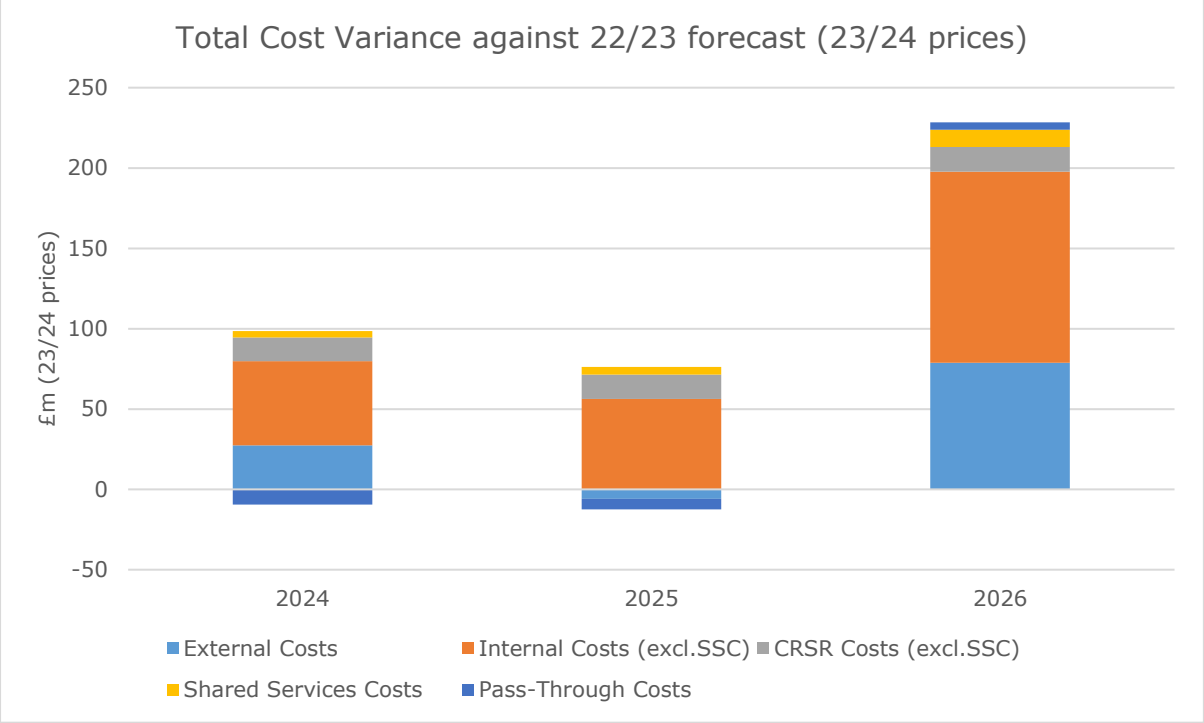


Figure 1.3: Data table

£m	RY23/24	RY24/25	RY25/26
External Costs	27.4	-5.9	78.9
Internal Costs (excl. SSC)	52.3	56.3	118.8
CRS Costs (excl. SSC)	14.8	15.2	15.3
Shared Services Costs	4.0	4.7	10.9
Pass-Through Costs	-9.4	-6.6	4.5

2. Your response, data and confidentiality

Consultation stages

Stage 1

Consultation opened 06/11/2024.

Stage 2

Consultation closes 01/01/2025. Deadline for responses.

Stage 3

Responses reviewed in January and February 2025.

Stage 4

Consultation decision/policy statement at the end of February 2025.

How to respond

2.1 We want to hear from anyone interested in this consultation. Please send your response to dccregulation@ofgem.gov.uk.

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

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

Your response, your data and confidentiality

2.4 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.

2.5 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.

2.6 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in

domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

2.7 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

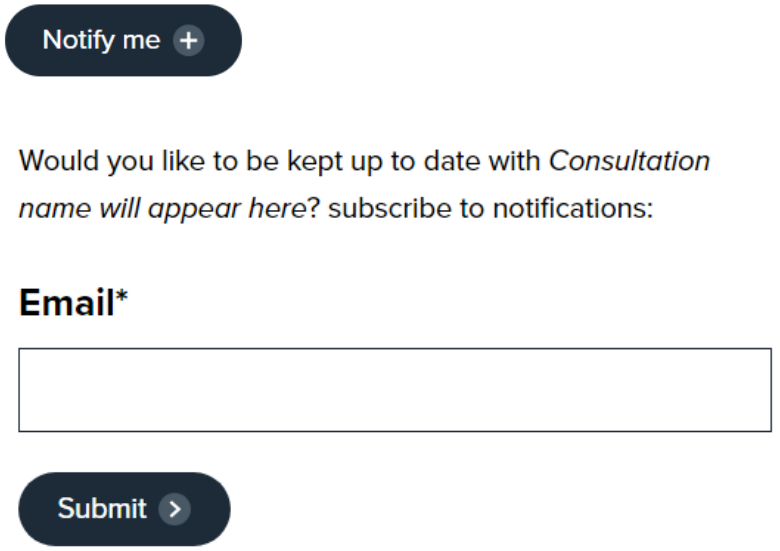
2.8 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

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. Choose the notify me button and enter your email address into the pop-up window and submit. ofgem.gov.uk/consultations



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

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

3. External Costs

A core part of DCC's role is to manage a large number of contracts with External Service Providers responsible for delivering the smart metering infrastructure. DCC is expected to follow best practice in contract management to derive value from these contracts, effectively manage change, and deliver value for money to its customers and consumers. External Costs form the largest part of DCC's costs at ~70%.

Although DCC's submission and evidence were sufficient to justify most of its External Costs, subject to further evidence, our position is that **up to £8.498m from DCC's External Costs incurred in RY23/24 are Unacceptable Costs.** The issues related to these costs include work that was carried out without a clear mandate or benefit in the ECoS programme (**£3.424m**); sunk costs (**£2.481m**) and continued issues experienced in the SMETS1 programme (**£0.600m**); high enduring charges paid to an interim DCO service provider (**£0.437m**); instances of nugatory spend (**£0.300m**); unexplained scope of work as a result of operational issues and defects (**£0.515m**); and DCC's ability to manage timelines with cost implications (**£0.740m**). In several areas, we are also concerned about DCC's internal processes and ability to provide clear evidence to support its justification.

Questions

Question 1: What are your views on our proposals to disallow all of the costs associated with the ECoS monitoring solution and integration cyber security programme?

Question 2: What are your views on our proposed cost disallowance of up to £0.600m in relation to SMETS1 service stabilisation?

Question 3: What are your views on our proposal to disallow up to £2.481m of costs incurred on the device swap-out project?

Question 4: What are your views on the following proposed disallowances in relation to increased charges for the SMETS1 interim DCO contract: (a) £0.437m of operational costs incurred in RY23/24 above the indexation adjustment applied on the base contract, and (b) £9.029m in unjustified forecasts over the Licence term?

Question 5: What are your views on our proposal to disallow all costs of the procurement of a replacement DCC Service Management System (DSMS)?

Question 6: What are your views on our proposal to disallow £0.515m of costs associated with operational issues and defect fixes within the implementation of an updated version of Great Britain Companion Specifications (GBCS)?

Question 7: What are your views on our proposed cost disallowance of £0.740m related to delays in the TAF programme?

Question 8: What are your views on our proposal to disallow £11.347m in forecast FSP External Costs?

Question 9: Do you have any other views on External Costs?

What are External Costs?

3.1 External Costs form the majority of DCC's Allowed Revenue (~71% of total costs in RY23/24). These costs are incurred by DCC's FSPs as well as other service providers delivering the SMETS1, Switching, Enduring Change of Supplier (ECoS), the 4G Comms Hubs & Network (CH&N), and Test Automation and Robotics Framework (TAF) programmes. DCC's key role is to effectively manage these service providers under its contracts to derive value for money and quality service for its customers.

3.2 The original FSPs were appointed following a competitive tender process that was run by the government. They include the Data Service Provider (DSP), and the two Communication Service Providers (CSPs). Together, the FSPs are responsible for delivering the data and communications services to support smart metering across Great Britain.

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

- SMETS1 Service Providers (S1SPs) translating DCC format service requests into a format that SMETS1 meters can understand (in effect acting as upgraded SMSOs12)
- Dual Control Organisation (DCO) software enhancing security arrangements of the SMETS1 solution; initially provided by two service providers, a third service provider was appointed by DCC in RY22/23
- Communications Service Providers (S1 CSPs) whose network allows DCC to communicate and control the SIMs in each comms hub
- In addition, the Commissioning Party service enables smart metering systems, which have successfully migrated to DCC, to be set up as 'commissioned'

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

- Design, build and test of the ECoS Programme arrangements and their integration into the DCC system including communication with the CSS.[12]
- Hosting services & service management (ie ongoing hosting & maintenance of the ECoS Programme)

3.5 The 4G Comms Hubs & Network (CH&N) Programme is delivered by six service providers responsible for the following roles:

- Component Integration – ensuring an integrated system and service design for the other components of the CH&N solution
- Device Management – supporting installation, configuration and monitoring of comms hubs, including deployment of firmware upgrades
- Comms hub provision
- Wide Area Network (WAN) provision to provide a communications service supporting messages to and from 4G comms hubs
- Integration & Assurance
- Cloud Hosting – this is a new contract which DCC entered into in RY23/24

3.6 The Testing Automation Framework (TAF) programme is delivered by one service provider who is responsible for enhancing DCC's capacity for testing through the use of automation and robotics.

3.7 Table A1.1 in Appendix 1 provides an overview of DCC's main contracts with the FSPs, SMETS1, ECoS, 4G CH&N and TAF service providers, their roles and the years of their contract.

How have External Costs changed?

3.8 Over the course of RY23/24, DCC incurred approximately £493m in External Costs, including Switching External costs.[13] Table 3.1 shows a breakdown for each programme.

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

Table 3.1: Breakdown of External Costs incurred in RY23/24

Programme	Costs incurred in RY23/24 in [£m]
SMETS2 – core	340.1
SMETS1	118.1
ECoS	11.3
4G CH&N	9.3
TAF	4.3
Switching	*9.9*
TOTAL	**492.9**

3.9 Overall, the total incurred External Costs (*without* Switching) were £483m, an increase by c.7.5 % from last regulatory reporting year. As detailed in table 3.2 below, External Costs have also increased relative to the RY22/23 forecast, as well as the LABP forecast.

3.10 Compared to the forecast accepted under last year's Price Control adjusted for inflation, External Costs are 14% higher in RY23/24 and 7% higher over the Licence term. In comparison to the LABP forecast (ie costs forecast at the Licence award), External Costs are 71% higher in RY23/24 and 88% higher over the full Licence term.

3.11 Please note that by "Licence term" we mean up to and including RY25/26. In September 2024, we published our decision to extend DCC's Licence by 2 years to September 2027.[14] However, as the additional regulatory years had no baseline (approved forecasts), they are excluded from this year's reporting.

Table 3.2: External Costs variance compared to RY22/23 and LABP forecasts (adjusted for inflation)

	Variance in RY23/24		Total variance over the Licence term (up to RY25/26)	
	£m	%	£m	%
From RY22/23 forecast	27.4	6%	100.4	2.5%
From LABP forecast	211.8	78%	1,990.2	91%

[14] Ofgem (2024), Decision on the continuation of the Smart Meter Communication Licence and the rate of Shared Service Charge and Baseline Margin. www.ofgem.gov.uk/decision/decision-continuation-smart-meter-communication-licence-and-rate-shared-service-charge-and-baseline-margin

3.12 The variance of 2.5% in total External Costs across the Licence period translates into an increase of c.£100m on last year's forecast. Figure 3.1. shows the variance in forecast External Costs per RY.

Figure 3.1: External Cost Variance across the Licence period (up to RY25/26) (adjusted for inflation)

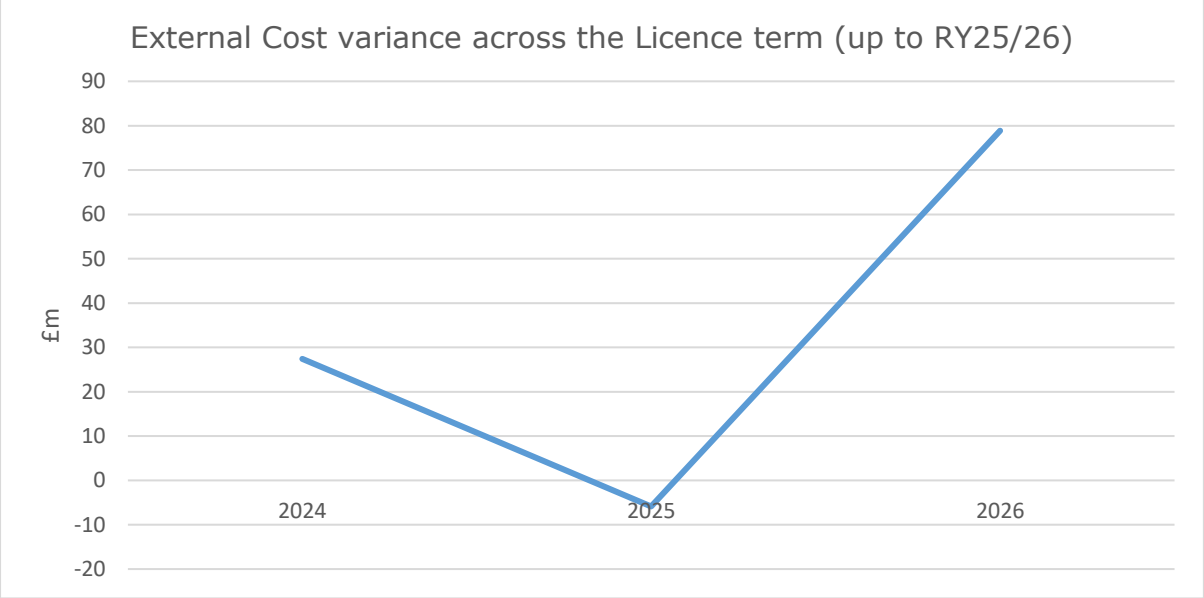


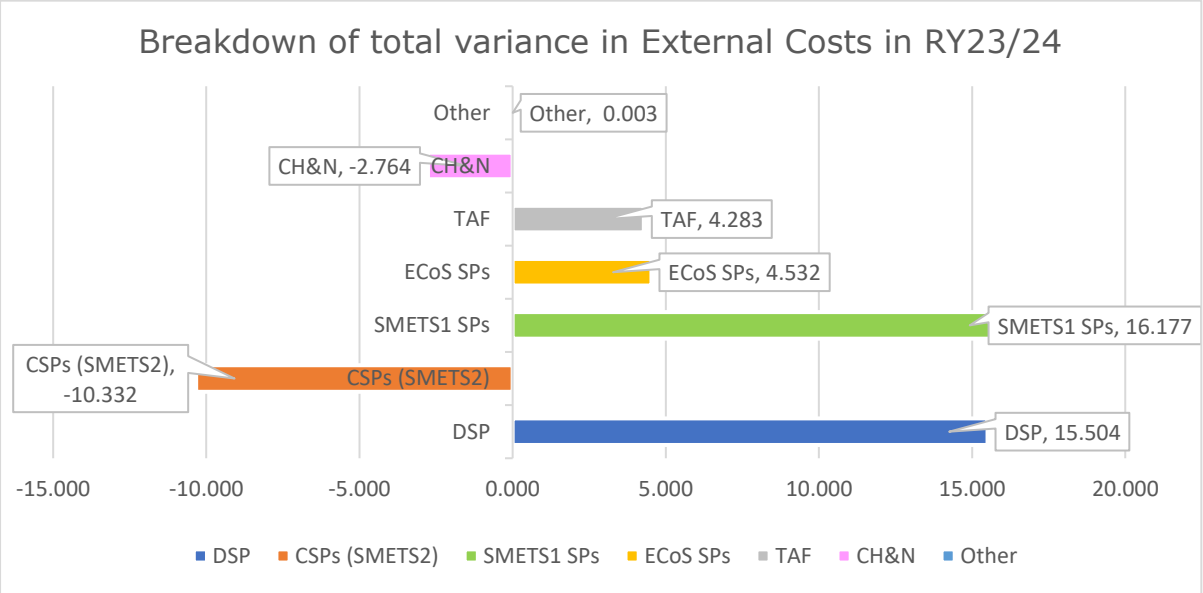
Figure 3.1: Input table

Reg. year	23/24	24/25	25/26
Variance (£m)	27.403	-5.867	78.868

3.13 As shown in Figure 3.2, the increase in External Costs in RY23/24 compared to last year's forecast is mainly driven by DSP and SMETS1 costs. The remaining positive variance is explained by ECoS and TAF costs.

3.14 However, the overall total increase in variance has been offset by negative variance of -£10.332m in CSP costs. It should be noted that this negative variance has been driven by inflation adjustment of last year's forecast, rather than a decrease in total incurred costs. Without adjusting for inflation, total CSP variance for RY23/24 is £5.043m above last year's forecast.

Figure 3.2: External Cost variance breakdown in RY23/24



3.15 Table 3.3 provides further details on how costs have changed for DSP, individual CSPs, SMETS1, ECoS, 4G CH&N and TAF service providers, compared to last year's forecast (adjusted for inflation). In RY23/24, the biggest increase was in ECoS costs at c.67% on last year's projection, although nominally, the largest increase was in DSP costs (c.£15.5m).

Table 3.3: Cost variation by programme compared to RY22/23 forecast (adjusted for inflation)

Service providers	Variance in RY22/23	Over the Licence term
DSP	37%	2%
CSP-N	-5%	<-1%
CSP-C	<1%	2%
CSP-S	-7%	-2%
SMETS1	16%	6%
ECoS SPs	67%	34%
4G CH&N	-23%	29%
TAF	*no forecast in 22/23*	*no forecast in 22/23*

3.16 Examining the variance in forecast costs across the Licence term, we observe a 6% increase in SMETS1 service provider costs (41.182m) and a 29% increase in 4G CH&N costs (23.652m). Together with 2% increase in DSP costs (c.15.715m), as detailed in figure 3.3 below, these are the principal drivers of cost variances from RY23/24 to the end of the Licence term. While there are also increases in the ECoS and TAF, given the comparatively lower overall costs of those programmes relative to DSP, SMETS1 and 4G CH&N, these increases are less pronounced within the overall variance. The overall CSP costs remain broadly in line with last year's forecast, however, there is a significant drop in RY24/25, followed by a sharp increase in RY25/26. This is primarily on account of deferred comms hubs charges.

Figure 3.3: External Cost variance across the whole Licence period

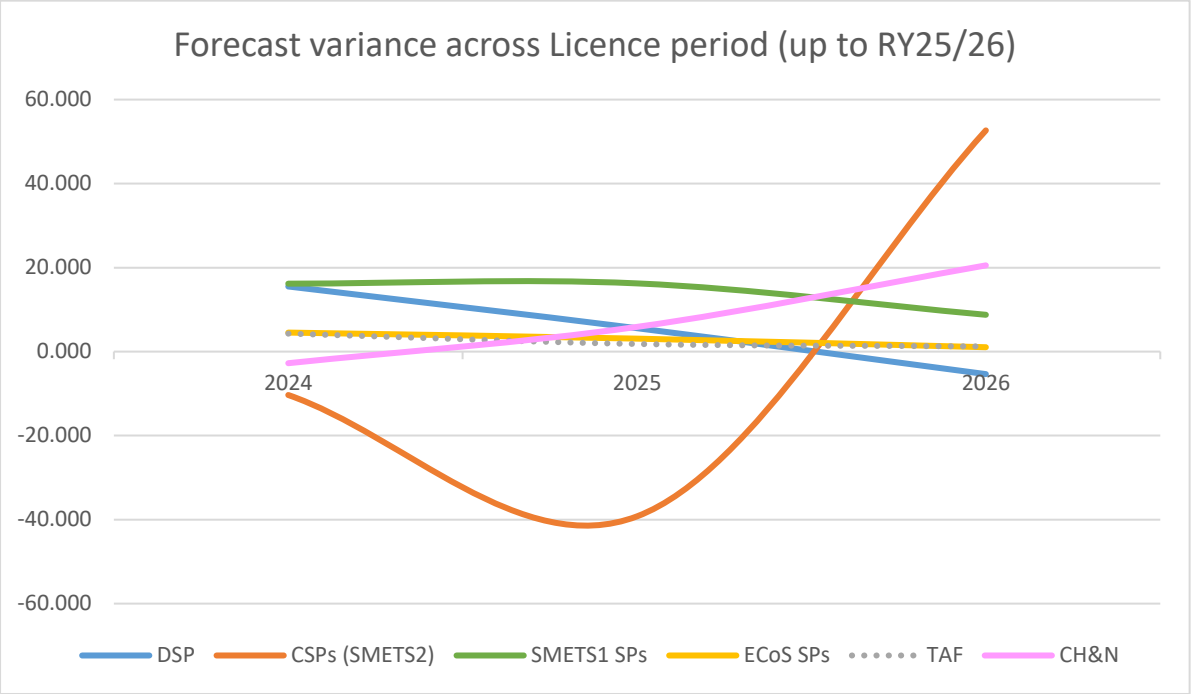


Figure 3.3: Input table

Variance in each reg. year in [£m]	23/24	24/25	25/26	Total variance
DSP	15.504	5.570	-5.359	15.715
CSPs (SMEST2)	-10.332	-39.220	52.666	3.114
SMETS1 SPs	16.177	16.241	8.765	41.183
ECoS SPs	4.532	3.087	1.039	8.658
4G CH&N	4.283	1.810	1.231	7.324
TAF	-2.764	5.888	20.526	23.650
Other	0.003	0.748	-	0.751
Total variance	**27.403**	**-5.876**	**78.868**	**100.395**

DSP costs

3.17 Overall DSP costs were £4.485m lower than in previous years, however, they drove a significant portion of this year's variance when compared against last year's forecast. In other words, DSP costs have decreased but not as much as DCC had forecasted. New DSP costs, not forecasted in RY22/23, were driven primarily by:

- Newly justified SMETS2 change requests (CRs) and project requests (PRs)
- DSP's role supporting the ECoS Programme and SMETS1 Final Operating Capacity (FOC)
- Implementation of Market-wide Half-Hourly Settlement (MHHS)

3.18 These variances were partially offset by lower-than-forecasted User Integration testing costs and Fixed Operational Charges.

3.19 DSP costs are projected to further decrease in RY24/25 and 25/26; however, DCC reported an increase on last year's forecast for RY24/25 driven by costs of newly justified SMETS2 PRs/CRs materialising in RY24/25, continued support for the ECoS programme and further costs of MHHS.

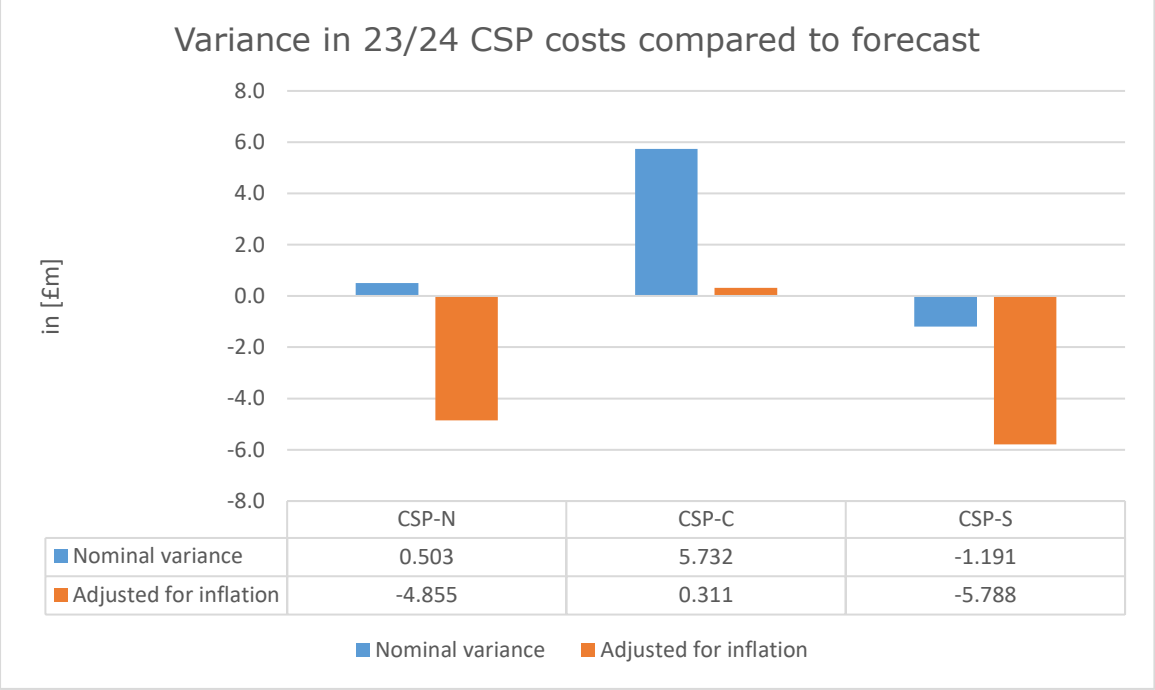
CSP costs

3.20 Although overall CSP costs have grown by c.£28.7m compared to last year, as illustrated in Figure 3.4 below, they show a *negative variance* (of £10.3m) when compared to inflation-adjusted forecast. This means that the increase was less than expected.

3.21 CSP costs in RY23/24 were impacted by:

- Costs of newly justified PRs, particularly in CSP-N and CSP-C
- Higher costs of User Integration Testing (UIT)
- Below-forecast Fixed Operational Charges offsetting the impact of new costs

Figure 3.4: Variance in CSP costs in RY23/24 compared to forecast



3.22 Overall CSP costs are expected to rise further in RY24/25 by c.£25.5m but these increases are also less than previously forecasted with an overall negative variance in forecast of c.-£39.2m. In RY25/26 overall CSP costs are projected to decrease by 62.8m but this is £52.7m more than DCC forecasted last year. CSP costs are projected to remain relatively stable in 2027/28. There was no forecast for these costs in last year's submission, so these variances are excluded from this consultation.

3.23 Changes in the forecasts are primarily driven by variances in comms hubs costs. Overall comms hubs charges will continue to increase as more devices are rolled out. However, as showed in Figure 3.5 below, the increase in RY24/25 is expected to be less than previously forecasted, with variance rising in RY25/26. DCC reported the following key changes to its forecast assumptions:

- Revised indexation assumptions and higher interest rates
- More volumes of comms hubs expected to be installed in future years
- Shorter time period of repayments for comms hubs purchased during RY24/25
- The forecasts for the Central and South region level out from RY25/26 onwards reflecting the roll-out of 4G comms hubs whilst accounting for the full-year impact of purchases throughout RY24/25

Figure 3.5: Variance in comms hub charges per RY (against last year's forecast)

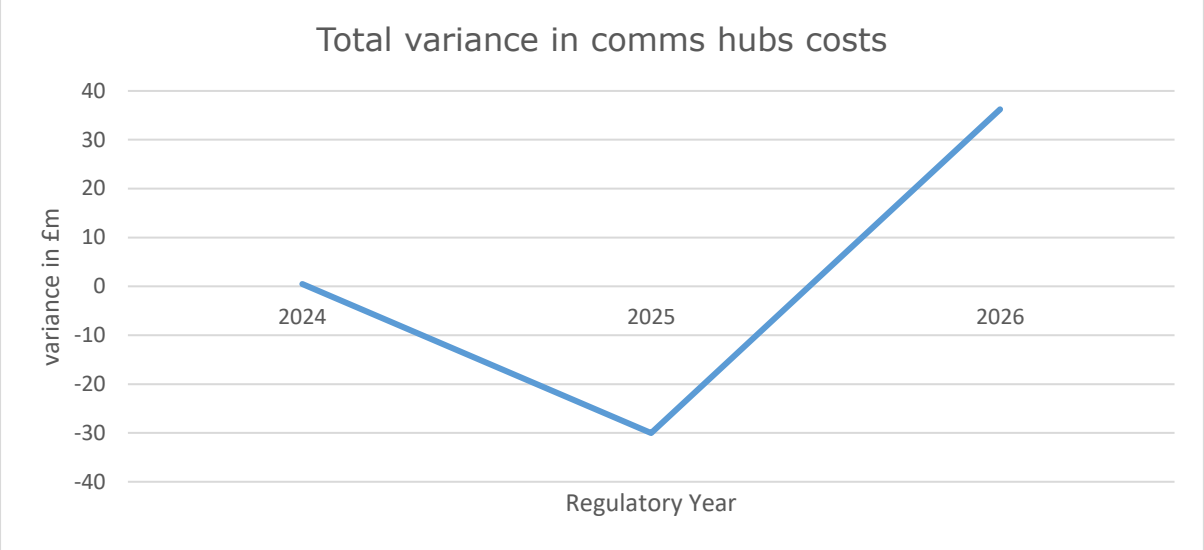


Figure 3.5: Input table

Regulatory year	23/24	24/25	25/26
Variance (£m)	0.453	-30.033	36.229

Costs of SMETS1 service providers

3.24 Total SMETS1 service provider costs increased by c.12% (£12.4m) compared to last year. They have also increased relative to RY22/23 forecast for the current RY as well as the Licence term by 16% (£16.2m) and 6% (£41.2m), respectively. Figure 3.6 below shows the evolution of total SMETS1 costs since RY18/19.

3.25 Table 3.4 breaks down the variance for each service provider in RY23/24 compared to DCC's forecast from last year. It can be observed that in RY23/24 all but one service providers registered increases in incurred costs above previously accepted forecasts. These were driven primarily by:

- Delivery of the Final Operating Capability (FOC) post go-live date comprising resolution of outstanding technical issues, device swap out functionality, and efforts to maximise migrations
- Increase in operational charges, including for S1_DCOc interim emergency contract (procured in RY22/23 as part of DCC's intervention in the SMETS1 supply chain)[15]

[15] Fo more details see Ofgem (2024), DCC Price Control decision RY22/23, 2.1-2.36. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202223

- Technical upgrades for the DCO functionality (across all three DCO providers)
- Capacity uplifts associated with MHHS

3.26 The SMETS1 forecast over the Licence period has increased by c.£41.2m, or roughly 6%, largely driven by increase in operational charges across DCO, S1_SP3b (FOC) and S1_CSP_1 service providers.

Figure 3.6: Total External Cost of SMETS1 service providers over RYs

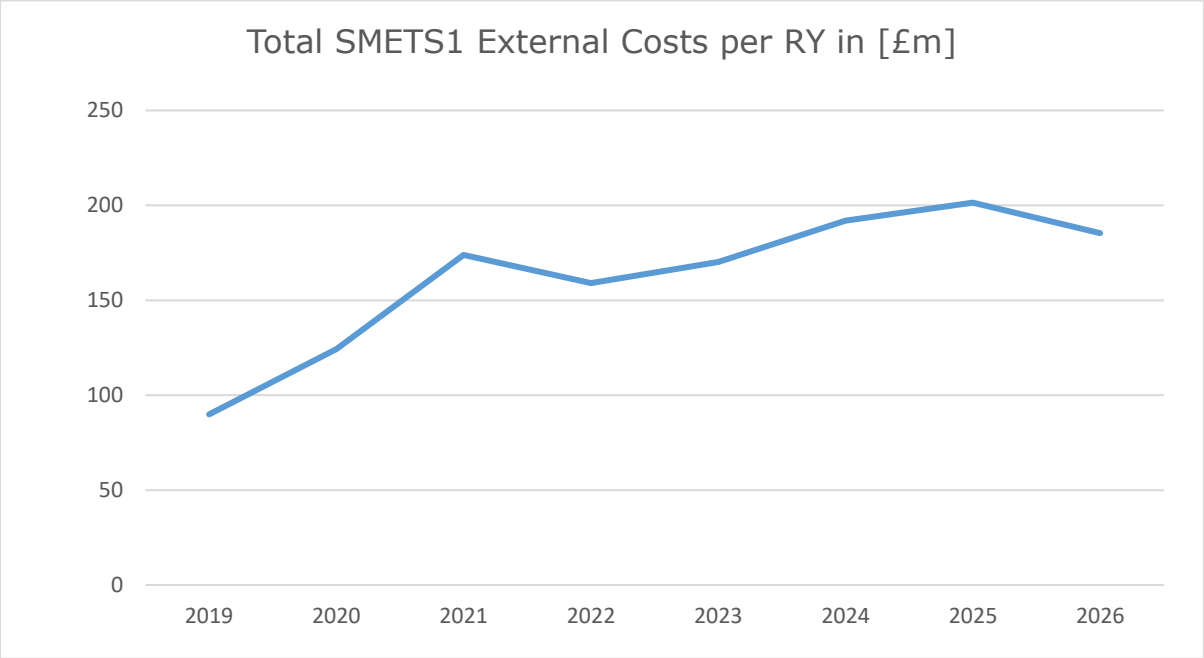


Figure 3.6: Input table

RY	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26
Total costs of SMETS1	55.9	74.8	112.2	88.6	105.7	**118.1**	119.0	114.2

Table 3.4: Cost variances for SMETS1 service providers compared to RY22/23 forecast (adjusted for inflation)

	Variance in RY23/24 [%]	Variance over the Licence-term (up to RY25/26)
S1SP_1	9%	2%
S1_CSP_1	13%	13%
S1SP_2	-6%	-4%
S1_CSP_2	3%	1%
S1SP_3a	48%	0%

	Variance in RY23/24 [%]	Variance over the Licence-term (up to RY25/26)
S1SP_3b	14%	7%
S1_DCOa	46%	12%
S1_DCOb	120%	13%
S1_DCOc	35%	40%
Total variance in [%]	**16%**	**6%**
Total variance in [£m]	**16.177**	**41.182**

ECoS costs

3.27 In RY23/24 External Costs related to the ECoS programme totalled £11.3m. This is a 54% increase compared to RY22/23 with a variance of £4.532m compared to last year's forecast for RY23/24. Across the Licence term, ECoS costs are now expected to total £34.3m, with a variance of 34% (£8.659m) over last year's forecast for the Licence term to RY25/26 shown in table 3.5 below.

3.28 The hosting and managed services component of the ECoS programme has a variance of 25% in RY23/24 and 14% across the rest of the Licence term. This has been driven by costs of a number of smaller changes, DCC's reporting of costs associated with a revised go-live date (incurred in RY22/23) and the addition of forecast operating costs which were not included in last year's submission due to uncertainty about when they would materialise.

3.29 The application build/IT solution component of the ECoS Programme has seen a variance of £2.9m in RY23/24 and £5.5m across the rest of the Licence term; however, this is in part due lack of forecasts in RY22/23. The variance in RY23/24 is driven by a change request for inclusion of a new cyber security solution. The drivers for the forecasted costs variance are the same of the other ECoS component.

Table 3.5: Cost variances for ECoS Programme service providers compared to RY22/23 forecast (adjusted for inflation)

Contract description	Variance in RY23/24 [%]	Variance over the Licence-term [%]
Application Build/IT Solution	*No forecast in 22/23*	*No forecast in 22/23*
Hosting Services & Service Management	25%	14%
Total variance in [%]	**67%**	**34%**
Total variance in [£m]	**4.532**	**8.659**

4G CH&N costs

3.30 The CH&N programme was new as of RY22/23. The programme continued in its design, build and test (DBT) stage in RY23/24. Overall costs were slightly lower in comparison to RY22/23 and DCC reported small negative variances across all contracts, totalling -£2.8m, compared to its last year's forecast.

3.31 Shown in Figure 3.7 below the programme costs are expected to rise in subsequent years as the programme goes into its live stage. DCC reported variances of £5.9m in RY24/25 and £20.5m in RY25/26 against its previous forecasts, driven by the inclusion of previously "uncommitted" spend due to uncertainty.

Figure 3.7: Total costs of 4G CH&N over RYs

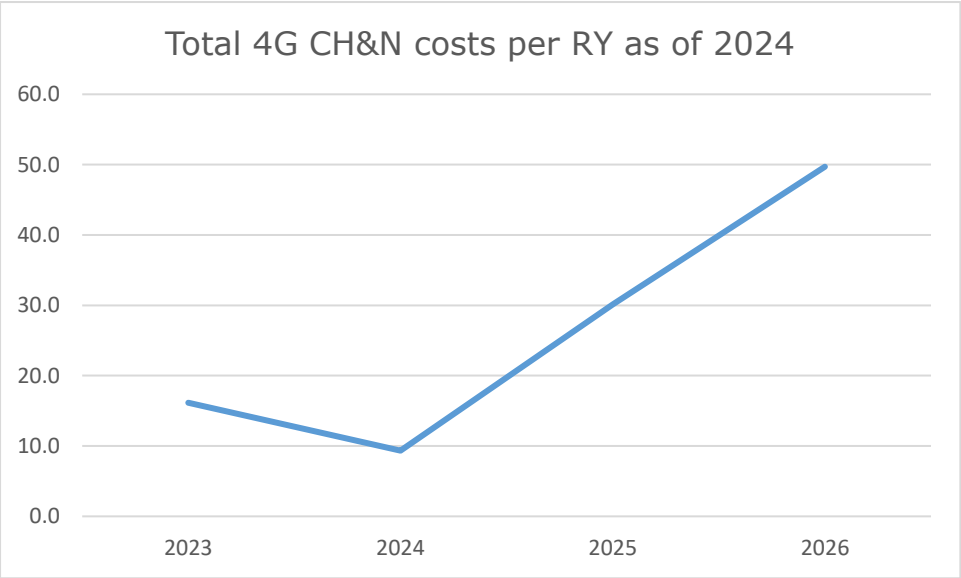


Figure 3.7: Input table

Reg. year	22/23	23/24	24/25	25/26
Total costs (£m)	16.2	**9.3**	30.1	49.7

TAF costs

3.32 The Test Automation Framework (TAF) reported a variance of £4.3m for RY23/24, £1.8m in RY24/25 and £1.2m in RY25/26. This is primarily due to lack of forecasts in last year's submission. Compared to DCC's evidence of procurement submitted to us last year, DCC reported a variance of £1.743m over the lifetime of the programme.

General cost justification

3.33 DCC has to justify its External Costs as 'economic and efficient'. DCC typically does this by reporting and justifying material contractual variations agreed with its service providers – change requests (CRs) and project requests (PRs). This year DCC justified 30 material programme- or project-related CRs/PRs. Material CRs/PRs are understood as those with a 'life value' that exceeds £1m. In line with the established process, DCC justified individual material CRs/PRs through a narrative submission linked to its quantitative reporting for each programme and provided supporting evidence of the scope, drivers and approach to commercial negotiations to ensure value for money.

SMETS2

3.34 DCC reported 6 new material CRs and 7 PRs with the following drivers: testing, SEC release, scaling and optimising in the North, and tech refresh. As set out in table 3.6 below, the combined reported value of these CRs/PRs was £34.09m, of which 6 were raised with DSP, accounting for £19.26m. The remaining 7 were raised with CSPs and had the total reported value of £14.83m.

3.35 The largest proportion of the newly justified SMETS2 costs (40%) related to testing, in particular:

- DSP UIT
- The extension of testing environments for CPC-C&S
- The addition of services to support industry testing, including Production Support Testing, implementation of GBCS v4.1 and defect fixes – we discuss our analysis and proposal with regards to the resulting costs in paragraphs 3.100-3.106.

3.36 The scaling and optimisation in the North project accounted for 23% of the costs and included updates to the messaging channels and work to enable the CSP-N service provider to start mobilisation to uplift the network systems. DCC explained that the project followed extensive engagement with industry, including through relevant groups such as SEC Panel, SEC Operations subcommittee, TABASC and SMDG. DCC sought to demonstrate value for money through details of its negotiations with the relevant service provider on the overall costs and terms & conditions.

3.37 Further individual PRs/CRs were raised to deliver:

- Tech refresh associated with the extension of the DSP contract to 2024
- Consolidated funding for leadership and PMO support teams – this was a continuation of DCC's effort to drive efficiencies in the resources provided by

the DSP service provider required to support delivery of changes and projects. DCC presented a cost-benefit analysis showing the change delivers overall value for money (c.21% over the Licence term)

- SEC release to implement SECMP0007 (firmware updates to IHDs and PMMIDs)

Table 3.6: Summary of newly justified material PRs/CRs, grouped by driver and service provider

Split by driver	# of new CRs/PRs	Cost (£m)
Testing	5	13.63
Tech Refresh	2	4.60
SEC Release	1	1.71
Scaling & optimisation in the North	3	7.93
Other	2	6.24
Split by service provider	**# of new CRs/PRs**	**Cost (£m)**
DSP	6	19.26
CSPs	7	14.83
TOTAL		**34.09**

SMETS1

3.38 DCC's submission identified three principal workstreams within the SMETS1 programme in RY23/24: delivery of the FOC cohort post go-live date, maximising migrations, and device swap-out functionality. As in previous years, DCC continued to work with its service providers to deliver periodical maintenance releases, capacity improvements and defect fixes to ensure a functional enduring solution for the final meter cohort. DCC encountered a large number of issues, some of which were previously "hidden", altogether requiring over 300 fixes. DCC attributed c.£1.97m to this work. We provide our assessment of the costs associated with the delivery of the service stabilisation work for SMETS1 in paragraphs 3.62-3.74 below.

3.39 DCC also progressed work on "device swap-out" after a large supplier expressed interest in the service following a consultation. DCC incurred £2.9m of costs developing a proof of concept, detailed design, testing and building of a feature switch. We discuss this issue in detail in paragraphs 3.75-3.83 below.

3.40 DCC reported 6 new material PRs/CRs with a combined value of £7.67m progressed with DSP/S1SP_1. These included:

- Extension of services to continue with SMETS1 meter migrations by 3 months to 31 March 2024
- Tech refresh and upgrades
- Consolidation of System Regression Testing
- Testing services for June 2023 and June 2024 SEC releases

3.41 Finally, DCC sought to justify new costs across the three DCO service providers. Principally, these comprised:

- Operational costs – DCC reported an increase in operational costs of its recently procured hosting provider (procured in RY22/23 as an interim emergency solution) on account of inflationary impacts. We discuss this issue in paragraphs 3.84-3.93 below.
- Project costs – across all three providers DCC incurred over £7m in various PRs/CRs. Within these the key drivers were:
  - Technical (security, software) upgrades requiring resourcing, testing, and investment into new servers – these totalled c.£4m
  - Backdated cover for service uplift & management between March and May 2023 which introduced new monthly charges (total £0.39m) into DCC's contract with DCOa to help manage the interim solution provided by DCOc[16]
  - Extension of the MDUST service
  - Discovery and Enabling work for DSMS service – we provide our view on this issue in paragraphs 3.94-3.99 below

4G CH&N

3.42 Although the overall costs of 4G CH&N service provider contracts decreased and DCC reported small negative variances, DCC justified 3 new material CRs/PRs raised with the DSP. Together these accounted for £12.56m (of which DCC incurred £2.83m in RY23/24) and comprised:

- SIT and UIT support
- System Integration services, including environments management, release management and leadership
- DSP interfaces

[16] These costs have been subject to our decision in RY22/23. See Ofgem (2024), DCC Price Control decision: RY22/23, paragraphs 2.28-2.32. www.ofgem.gov.uk/decision/dcc-price-control-decision-regulatory-year-2022-2023

3.43 DCC also reported the addition of a new fundamental service capability (FSC) provider to deliver subscription billing for a hosting service for the Device Manager. DCC first entered into a contract with its parent company for an interim 11-month solution to end-2024. As FSC may not be procured from an Affiliate or Related Undertaking,[17] DCC subsequently procured an enduring solution from a third party service provider. In its submission, DCC set out its procurement approach and justification for the selection of both parties. DCC incurred only £3k in RY23/24 but provided forecast costs associated with both the interim and the enduring contracts from RY24/25 onwards. At the time of its price control submission, DCC expected to switch to the enduring provider by September 2024. We will assess the resulting costs of both contracts in our RY24/25 price control.

ECoS

3.44 DCC sought to justify one CR (inclusion of a new cyber security solution) associated with the application build/IT solution element of the ECoS Programme, with total costs of £3.424m. We discuss this CR in more detail in paragraphs 3.52-3.61 below.

3.45 DCC reported a further material CR which related to the ECoS Programme's new go-live date (from mid-February 2023 to 30 June 2023). This was justified by DCC in last year's price control but costs materialise in RY23/24. DCC had consulted on this revised timeline with both ECoS service providers, the SEC Panel and SEC Parties, before receiving approval for a change to the Joint Industry Plan (JIP).

TAF costs

3.46 The overall programme costs (£8.645m) were justified in the price control submission RY22/23. This year DCC sought to justify £1.743m in additional costs on account of payments relating to delays to the handover of the lab for installation of the robotics, and costs relating to updating test scripts. We set out our assessment and view of this issue in paragraphs 3.107-3.113.

Our assessment

3.47 We apply consistent methodology and principles in our cost assessment. These are set out in our Price Control Guidance, which is updated periodically and published on Ofgem's website.[18]

[17] Under LC 16 Part A
[18] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

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

3.49 However, there are the following concerns with DCC's submission:

- DCC failed to include in its initial submission justification for a number of material variances, CRs and PRs. This was particularly so with regards to forecasted variances. This meant we required submission of further evidence.
- Some of the information provided to us in the accompanying narrative was incomplete and we found it necessary to ask c.70 clarification questions, although this was less than in previous year.
- Although DCC answered most of our clarification questions, DCC was unable to timely or fully respond to some of our questions regarding customer engagement and cost reporting.

3.50 We would reiterate that, in line with LC 37 Part A, DCC must provide an explanation for all material variances in its incurred and forecast costs. To manage the regulatory burden on both Ofgem and DCC, DCC is asked to apply a materiality threshold to its cost justifications. If no or insufficient justification is provided in support of newly incurred costs, such costs may be considered to be Unacceptable. We cannot assume costs are economic and efficient without evidence.[19]

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

[19] Ibid, paragraph 2.60.

ECoS Monitoring solution and Integration

Context

3.52 Enabling energy consumers to change supplier securely and easily is one of the fundamental purposes and benefits of the smart meter rollout. DCC is responsible for the ECoS (Enduring Change of Supplier) programme which is now mandatory under the Licence. The programme went live on 29 June 2023.

3.53 In RY23/24, DCC issued several CRs to its service provider delivering the technical hosting and service management to add new functionalities that would allow for the exchange of data (service performance, business transactions and secure data) between DCC and ECoS Parties. DCC combined these CRs into a single change totalling £3.424m in set-up and operational costs.

DCC's justification

3.54 DCC sought to justify the expenditure by explaining the driver for this work was to get richer information to better manage the network and respond to incidents. DCC explained that the changes were intended to provide greater detail and access to data from the supplier's infrastructure to aid DCC's analysis and improve DCC's ability to respond to potential technical or security incidents. However, DCC also stated that, as this is not a customer facing improvement, they did not consult with customers.

3.55 DCC noted that the 'do nothing' option would have meant having less information to use to respond to incidents.

3.56 DCC also stated that by the end of 2024, DCC will make a determination about whether to bring the cyber-security services in-house or discontinue them. Currently, DCC intends to bring services in-house from January 2025 onwards.

Our view

3.57 We acknowledge that DCC have sought to achieve value for money with savings through consolidating the CRs. This is good practice, and it is encouraging to see this approach being implemented.

3.58 However, we are concerned about whether this **programme of work was necessary.** DCC was unable to produce any evidence of regulatory requirement, nor point to any gap in the functionality that this function should fill. We observed that the ECoS programme had not yet gone live when the CR was raised so we infer that it was not raised to address any performance issues. Indeed, DCC did not show evidence of any issues with the existing service which would require these changes to be implemented at an additional cost.

3.59 We are concerned that no customer engagement has taken place on the necessity, scope or cost of the changes. If one of the drivers for the work relates to security concerns, it is our view that this should have been discussed with the SEC security subcommittee.

3.60 In the context of the overall ECoS programme, the enduring operational costs of this change (£1.958m) are high, given there is no clear benefit outlined.

3.61 We invited DCC to submit further evidence to justify this expenditure as part of its consultation response. However, based on current information, we do not view this expenditure as justified and are **minded to disallow all costs** that DCC sought to justify this year - **£3.434m.**

SMETS1: service stabilisation

Context

3.62 In 23/24 DCC continued to deliver mandated activities under the SMETS1 programme to enrol outstanding first-generation smart meters onto its network. The focus was primarily on progressing FOC migrations. As in previous years, the programme has suffered slow progress with multiple technical issues necessitating interventions resulting in over 300 fixes to maintain stability and uplift performance. These interventions led to additional incurred costs. Yet DCC reported that the list of issues identified in 2022 had "not decreased as rapidly as might be expected due to further 'hidden' issues within the system."

3.63 Also akin to previous years, DCC's Annual Service Report highlights continued underperformance by the two service providers responsible for the FOC cohort for most of the regulatory year.[20]

DCC's justification

3.64 DCC sought to justify additional costs across the following areas:

- **Maintenance releases**: continuing from previous years, monthly releases included defect fixes and low complexity changes. The costs of the maintenance releases totalling £0.937m were incurred across the supply chain.
- **Operational Capacity Improvements**: To continue to scale and increase the operational capacity of the SMETS1 solution to meet industry demand, including changes to respond to quarterly price cap updates which have

[20] Smart DCC (2024), Annual Service Report, Regulatory Year 2023/24. Available at: www.smartdcc.co.uk/media/qtkfihrr/dcc-annual-service-report-2023-2024-final.pdf

seen periodic spikes in demand on DCC's network. DCC expended £0.557m on these improvements.

- **Device Recovery** to attempt the re-establishment of communications devices which had not rolled back correctly to avoid the need for site attendance and swap out. Last year, DCC explained that these roll-back failures occurred at higher than expected volumes due to a DCO issue. DCC attributed £0.156m to these activities.
- **Enduring certificate rotation** to update the values of security certificates, a mandatory activity. DCC proceeded with a change to provide solution for the entire FOC estate but the initial solution was discarded on account of being too complex and costly. DCC opted for a different solution expected to be delivered in 2025, however reported a small spend on the initial solution.
- **Payment for legacy work** for "opt-in/opt out". This work was never authorised and therefore cancelled at an early stage.

3.65 Additionally, DCC reported £0.198m of costs expected to be paid to service providers to resolve **operational incidents**.

3.66 DCC sought to show that it had successfully avoided paying for a number of activities, such as defect fixes, where it considered them to be the responsibility of its external service providers. DCC argued that root causes of issues are often difficult to determine due to interdependencies and that socialising costs was overall the more economic option to conclude the programme.

3.67 In respect of service provider performance, DCC provided evidence of reinstating application of service credits for one of the providers, which led to performance improvements towards the end of the regulatory year. This is borne out by a shift from amber to green ratings within DCC's Service Report.

Our view

3.68 We recognise the technical complexity of the SMETS1 solution and the work DCC and industry carried out to deliver the benefits of the enrolment programme. However, as in previous years, we are concerned about the costs of continued delivery, inconsistent service provider performance and DCC's ability to drive value for money by holding its supply chain to account.

3.69 Firstly, we are minded to accept DCC's justification in respect of costs required to deliver operational capacity improvements. As more meters are enrolled, it is reasonable to expect upscaling of the technical solution to accommodate a larger number of devices. Equally, we recognise the impact of capacity constraints at price change events which were extraneous to DCC's control.

3.70 Secondly, we are currently not satisfied that costs associated with defect fixes and DCO operational incidents have been incurred economically and efficiently. As set out in our RY21/22 and RY22/23 decisions,[21] we do not consider that DCC customers, and by extension consumers, should bear the costs associated with under-delivery or poor performance of DCC's service providers. Passing costs to customers must be demonstrably the only or the most economic and efficient option. We are concerned that DCC has continued to incur costs which should, at minimum, be shared with the service providers, specifically:

- Consequential costs of adverse impacts of defects across DCC's supply chain
- Costs of operational incidents attributable to a service provider
- Costs of device recovery activities driven by failures within the DCO

3.71 Based on the evidence made available to us, we are not satisfied that DCC has struck the right balance in risk sharing by fully accepting these costs. On account of a shared responsibility between DCC and its SPs, in the absence of evidence of an appropriate level of risk sharing and **in line with our RY22/23 decision, we propose to disallow 50% of costs of maintenance releases, operational incidents and device recovery changes, totalling £0.487m.**

3.72 Thirdly, we are concerned about costs expended on enduring certificate rotation and payments for legacy work. In both instances, DCC incurred costs for solutions which were not suitable (certificate rotation) or authorised ("opt-in/opt-out") and abandoned, resulting in nugatory spend without any benefits. In the absence of any further justification for this expenditure, **we are minded to disallow these costs in full, totalling £0.113m.**

3.73 **In total, we are proposing to disallow £0.600m in costs incurred for SMETS1 service stabilisation.**

3.74 We welcome that DCC has reinstated service credits to one of the underperforming service providers. DCC should continue to actively drive performance of its contractors to ensure value for money and good quality service. We expect DCC's 2024/25 Annual Service Report to see a movement towards green RAG rating reflected in a lower number of defect fixes and incidents.

[21] Ofgem (2023), DCC Price Control Decision Regulatory Year 2021/22, paragraphs 2.16-2.18. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202122.
Ofgem (2024), DCC Price Control Decision Regulatory Year 2022/23, paragraphs 2.47-2.51. www.ofgem.gov.uk/decision/dcc-price-control-decision-regulatory-year-2022-2023

SMETS1: Device swap-out

Context

3.75 Device Swap-out functionality allows for swapping of SMETS1 meters in certain circumstances. It was not delivered as part of the original SMETS1 solution but DCC was under an obligation to provide it should it be requested by customers. Following a consultation in 2022, one large supplier expressed interest in the solution.[22] DCC therefore set up a programme of work to prepare a proof of concept.

3.76 DCC progressed work on device swap-out in RY23/24 which included the detailed design, PIT testing, SIT test preparations and building of a feature switch. In July 2023, DCC was notified by the interested supplier of its withdrawal from the solution. DCC had incurred £2.877m in costs for pre-July 2023 design, build and test activities and the subsequent "unpicking" of the code from its service provider's environment. These costs have been confirmed as sunk in their entirety.

DCC's justification

3.77 DCC sought to justify the expenditure on the grounds of regulatory requirements. DCC provided written justification for a main change request driving the scope of work, totalling £2.007m.

3.78 DCC explained that it halted all work as soon as it was made aware of the supplier's withdrawal and any additional expenditure related solely to reversing coding changes.

3.79 However, when asked, DCC was unable to provide details of its engagement with the sole customer on the scope and costs of the solution.

3.80 DCC also noted that, in order to meet timelines, and due to the complexity of the solution and ongoing negotiations, all work under the main CR was covered by temporary funding mechanisms without the contractual change being signed by DCC and the service provider.

Our view

3.81 We recognise the regulatory obligation on DCC to provide the device swap-out solution, subject to customer interest based on a positive cost benefit analysis.

[22] DCC (2022), SMETS1 Conclusions on Device Swap Out. www.smartdcc.co.uk/consultations/smets1-conclusions-on-device-swap-out

However, we have concerns about the scope of work which DCC had undertaken and the level of expenditure resulting in the sunk costs.

3.82 The information submitted by DCC provides justification for £0.396m in costs to deliver proof of concept. We would expect DCC to engage with the supplier to ascertain the scope of any further work required prior to progressing to design, build and test stage. In the absence of clear evidence showing that DCC was expected to proceed with further activities, we are minded not to accept costs incurred beyond the proof of concept stage and are therefore **proposing to disallow up to £2.481m**.

3.83 Furthermore, it is concerning that all financial cover was provided by temporary funding arrangements without a signed Change Authorisation Note (CAN). In previous years[23] we repeatedly expressed concerns about DCC's use of instruments providing a temporary cover for ongoing work while negotiations with the relevant service provider are underway. While their use can be justified under exceptional circumstances, they also expose DCC and its service providers to an increased commercial risk, as highlighted by the independent OPR contract management auditor in RY22/23.[24] Whilst the absence of a CAN alone is not the basis for the proposed disallowance, we note that DCC may have avoided the level of sunk costs had a CAN been in place. We therefore consider this to be relevant information for consultees to consider.

SMETS1: Increased charges for interim DCO contract

Context

3.84 As explained in last year's consultation,[25] following the demise of one of DCC's service provider's subcontractors, DCC directly transferred the service to a new service provider as an interim, emergency solution. DCC incurred, and sought to justify, set-up costs associated with the build of the solution and subsequent operational costs consisting of monthly charges for the service.

[23] See Ofgem (2023), DCC Price Control consultation: Regulatory Year 2022/23, paragraphs 3.91-3.93. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202223
Also Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, paragraph 2.51. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202122.
And also Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, paragraphs 2.31-2.39. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202021
[24] Ofgem (2023), DCC Price Control consultation: Regulatory Year 2022/23, paragraph 5.63. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202223
[25] Ofgem (2023), DCC Price Control consultation: Regulatory Year 2022/23, paragraph, paragraphs 3.52-3.63. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202223

3.85 Last year we recognised that pending the implementation of an enduring solution, DCC will continue to incur costs to keep the service operable. However, on account of a lack of market testing and competition, hastily agreed terms and conditions, and inefficiencies compared to the original integrated design, we did not consider the enduring costs to be fully economic and efficient.

3.86 This year DCC reported another increase in operational costs by 13% from April 2023. This means the operational charges are 61.5% above the baseline of the original solution. DCC reported further increases in the forecast costs such that by RY27/28 DCC projects operational charges to be 150% higher than under the original solution. Figures 3.8 and 3.9 below provide the details.

DCC's justification

3.87 DCC sought to justify this increase by application of a contractual indexation adjustment of 8.7%. On request, DCC provided details of monthly charges dating back to August 2022. This evidence reveals a steady increase in charges from November 2022 before indexation adjustment is applied in April 2023.

Figure 3.8: Monthly charges of the current and original solutions. Charges as of April 2023 apply to the whole RY23/24

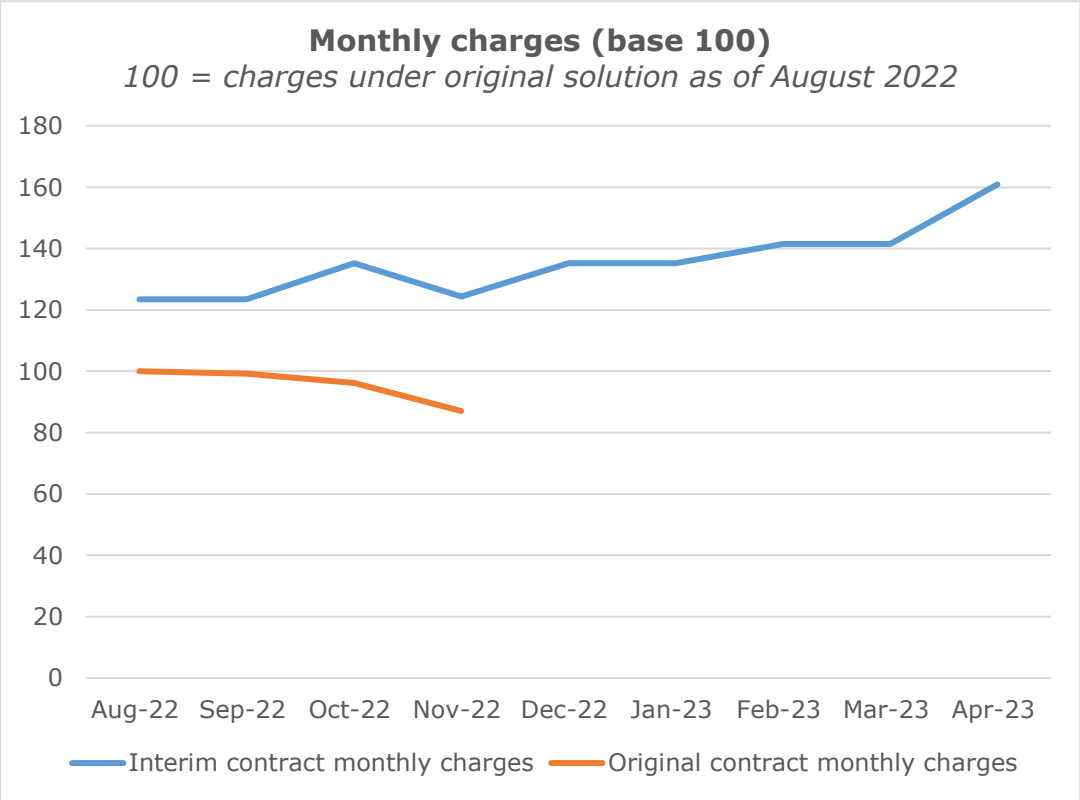
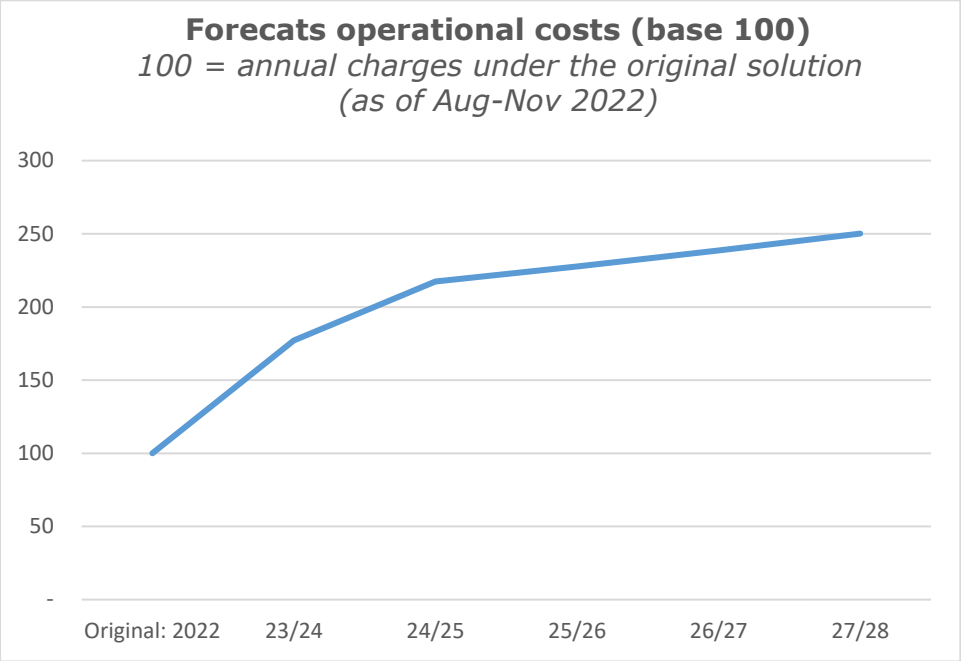


Figure 3.9: Forecast costs (*cf* costs of original solution)



Our view

3.88 An indexation adjustment is a standard feature of commercial contracts, allowing a supplier to reflect natural increases in the price level of commodities and services. However, we are concerned about the unexplained continued increases in the base contract charges on top of which DCC has accepted the indexation adjustment.

3.89 The initial base contract charges as of January 2023 were 35% higher than the original solution (August 2022). These charges then increased by a further 9.5% by April 2023, before application of indexation at 8.7%. DCC has not explained or justified the increases in the base charges.

3.90 Furthermore, although this year's reporting is 13% higher than last year's forecast, DCC's explanation only accounts for an 8.7% increase due to indexation. DCC submits its price control information to Ofgem by end-July following each regulatory year. It is unclear why in its RY22/23 submission (submitted in July 2023) DCC did not correctly report on the operational charges for RY23/24 which it had already been incurring from April 2023. This raises concerns about DCC's ability to correctly track and report its costs.

3.91 In the absence of further explanation and justification, we are minded to only accept indexation adjustment applied on the base contract charge as of January 2023 and **propose to disallow £0.437m of operational costs incurred in**

RY23/24 above this threshold which have not been justified as economic and efficient. We are concerned that DCC has not been able to effectively manage the costs of this interim contract, highlighting the importance of procuring an enduring solution with costs subject to the market test.

3.92 In relation to forecast costs, we understand that DCC is in the process of procuring an enduring contract. However, DCC has not provided justification for the significant increase in its forecast costs, including following the expiry of the current interim contract and its replacement by a new solution. We are therefore minded to accept the forecast costs for RY24/25 (and subsequent years) only to the value of RY23/24 costs uplifted by 3% to account for inflation in financial year 24/25.[26] **The resulting disallowance proposal is set out in table 3.7 below.**

3.93 We expect DCC to put in place a compliant, efficient and reliable solution as soon as possible. In the meantime, DCC must ensure it derives value for money from the interim contract.

Table 3.7: Proposed disallowance per RY

Reg. year	23/24	24/25	25/24	26/27	27/28
Proposed cost disallowance in [£m]	**0.437**	1.722	2.085	2.424	2.759

DSMS: nugatory spend

Context

3.94 In 2023 DCC started a programme of work to replace DCC's Service Management System (DSMS), as the contract was coming to an end in 2024. DSMS provides the platform for interactions between DCC and its customers; it also includes capabilities and functions such as incident management and information repository for coverage data.

3.95 DCC reported expenditure of £0.300m on a project request for "[DSMS] discovery and service enabling work" with one of its incumbent service providers.

[26] The Consumer Prices Index including owner occupiers' housing costs (CPIH) rose by 3.0% in the 12 months to April 2024.
www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/april2024

DCC's justification

3.96 DCC explained that, following market engagement, it had commissioned work from a chosen service provider to carry out early phase discovery and design work from May to July 2023.

3.97 DCC halted all work following dialogue with DESNZ and Ofgem. DCC subsequently arrived at a settlement with the service provider, accepting £300k in costs for work delivered to date. DCC argued that it had successfully avoided further costs sought by the provider.

Our view

3.98 We reviewed DCC's approach to the DSMS procurement in June 2023 and were not satisfied that DCC had provided sufficient evidence to show that it met the standards on procurement of Relevant Service Capability set out in the Licence.[27] We concluded that DSMS had not been procured on a competitive basis and expressed concerns about the approach unduly favouring the selected service provider.

3.99 We note DCC's decision to opt for a different approach to procurement following our findings. However, we currently do not view the expenditure related to the design work as economic and efficient as the work was commissioned on the basis of a selection process which did not adhere to the Licence requirements. We have seen no evidence to show that the activity delivered any benefits and therefore view it as nugatory spend. **We are therefore proposing to disallow the cost of this procurement in full, totalling £0.300m.**

SMETS2: GBCS 4.1 SIT, UIT and Pilot Support

Context

3.100 DCC raised a change request for implementation of an updated version (v.4.1) of Great Britian Companion Specifications (GBCS). GBCS describes the detailed requirements for communications between Smart Metering Devices in consumers' premises.

3.101 The scope of the CR comprised:

- Delivering mandated over the air firmware updates to PPMIDs and HCALCS under SECMP0007[28]

[27] LC 16
[28] SECMP0007 'Firmware updates to IHDs and PPMIDs', accessible at: https://smartenergycodecompany.co.uk/modifications/firmware-updates-to-ihds-and-ppmids/

- Comms hub changes to address operational issues associated with re-joining Gas Smart Metering Equipment
- Defect fixes and production incident fix for two parties within DCC's supply chain

DCC's justification

3.102 DCC sought to justify £1.029m in costs associated with this CR. DCC explained that the update to GBCS is a regulatory obligation with associated testing required for a successful implementation. DCC provided details of its negotiations with the service provider, including a challenge on the scope of the testing activities, leading to overall cost reduction by c.29%.

3.103 However, DCC was unable to explain why it was necessary to include the costs associated with operational issues, defect and incident fixes. DCC stated that it did not have information about the impact the defects had (if any) on the final price of the CR.

Our view

3.104 We acknowledge DCC's obligations in respect of implementing updated GBCS versions and are minded to accept the costs associated with SECMP0007 delivery, included payments for necessary accompanying testing activities.

3.105 However, we at present lack satisfactory evidence regarding DCC's inclusion of operational issues and defect/incident fixes, particularly as these relate to other providers within DCC's supply chain. DCC has not explained why it was economic and efficient to bear these costs, or indeed, why they were included in the scope of this CR. It is concerning that DCC has not been able to provide information on the impact of these defects on the costs paid to the service provider. We therefore do not see the costs of this CR as fully justified as economic and efficient.

3.106 In the absence of further justification, **we are minded to disallow £0.515m**, or 50% of the total costs, assuming an equal split between SECMP0007 activities and hitherto unjustified work remedying operational issues, incidents and defects. We invite DCC to provide further justification as part of its consultation response, including explanation of the root cause and impact of the issues. We expect DCC to be able to control the scope and costs of any contractual variations; this includes holding its supply chain to account for any underperformance, such as incidents or defects.

TAF: Impact of delays

Context

3.107 DCC developed the Test Automation Framework (TAF) to improve its testing capability to deliver better system solutions at lower cost for customers. In 2022, DCC submitted a business case to DESNZ to improve the effectiveness of regression testing through extended automation and the use of robotics.

3.108 The project commenced in 2022 and DCC reported its initial costs and justified the procurement of the service provider in last year's price control. Costs were agreed at £8.645m over the project timeframe.

3.109 In RY23/24, DCC reported £10.348m in total costs. As such, we sought justification for the additional £1.703m.

DCC's justification

3.110 DCC sought to justify this additional spend as arising due to costs associated with the reconfiguration of labs in order to install the robotics.

3.111 DCC stated in its justification that £0.740m of the incurred costs arose from payments relating to the delays in the handover date of the lab. The evidence provided by DCC states DCC missed an agreed milestone of handling over the lab which caused a cascading impact on costs.

Our view

3.112 We recognise that delays may be due to external factors over which DCC may not have control. However, DCC did not provide any reason for missing the milestone.

3.113 Subject to further information being received, we are minded disallowing the total costs of the delays - **£0.740m**. Mismanagement of project deliverables which incur costs cannot be considered economic and efficient.

Forecast costs (FSPs)

Context

3.114 DCC's total forecast External Costs up to RY25/26 have increased by £100.4m.[29] DCC also submitted forecasts for RYs 26/27 and 27/28 of £463.6m and £473.0m, respectively. However, these forecasts had no baseline in previous years and so we exclude them from the overall variance. However, we still considered them in our assessment.

[29] When compared to last year's forecast adjusted for inflation.

3.115 Our guidance sets out the principles for updating forecasts.[30] In general, forecast costs should only contain economic and efficient costs and meet the threshold of being significantly more likely than not to occur. If DCC fails to justify any forecast costs as being economic and efficient we may remove them from the forecasts as part of the determination.

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

3.117 One such instance related to the extension of CSP-C&S SIT-A and UIT-B test environments. DCC is required to provide test environments to assure changes to the DCC infrastructure before they are placed in the 'live' environment. One of DCC's service providers currently delivers an on-premises solution while DCC is developing a cloud solution. The project has seen two 2-year extensions of this solution. We were concerned that the delays in the implementation of the Cloud solution were unnecessarily increasing costs and delaying the savings and benefits of a cloud-based solution, and asked DCC to provide justification for the delays and whether moving to the cloud solution could be staged such that some of the savings could be realised sooner. DCC incurred £1.357m in costs in RY23/24 and forecasts £11.349m over the rest of the licence period.

DCC's justification

3.118 DCC's justifications for the queried FSP forecast costs included:

- Extension of existing services over the additional two-year licence term.
- Financing of costs incurred over a five-year period for the Design, Build, Test phase of the CH & Networks programme
- Extension of the Consolidated Funding for Core Leadership and PMO Support Teams initially contracted in RY21/22 with DSP to drive efficiencies in the resources required from DSP in support of changes and projects.
- Upgrade to DSP's core operating service before the extended lifecycle support ended in June 2024. DCC explained that the forecast was based on commercial terms finalised in May 2024 and a full narrative will be provided in next year's submission

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

- UIT services (Triage and Defect Management) support which was justified in RY22/23 and was subsequently extended to RY23/24. This service will continue to be renewed on an annual basis
- Delivery of various phases of the CSP-North Scaling & Optimisation project up to Q1 2027
- Continued provision of the existing OMS which is renewed on an annual basis

3.119 In respect of the extension of the SIT-A and UIT-B test environments, DCC stated that "moving to the cloud will avoid paying £2.4m of tech refresh costs in year 1 (24/25), and potentially a further £3.1m in 27/28." However, DCC did not provide justification for the delays nor any explanation regarding the basis for forecasting £6.241m for CSP-Central and £5.107m for CSP-South.

Our view

3.120 We are minded to accept DCC's FSP forecasts. However, we note that some queried CRs/PRs described above meet the materiality threshold. We would therefore expect to see a more comprehensive justification detailing the drivers, value for money and other relevant information typically provided for material PRs/CRs in DCC's submission. Forecast costs should provide a reasonable baseline against which to compare costs at the next Price Control – as such, their reporting should be accompanied by appropriate justification.

3.121 In relation to the testing environments solution, subject to further sufficient information being received, we **propose to disallow and remove from DCC's forecasts £11.347m,** detailed breakdown below in table 3.9. We are minded **not** to disallow the 1.357m in incurred costs as we agree with DCC's position that a cloud solution can deliver future savings. However, we propose to disallow the forecasted costs. This will provide DCC with the opportunity to get the program back on track while committing DCC to justifying the incurred costs in RY24/25. DCC should note that in the next year's submission we expect more forthcoming and complete information and justification for costs and delays.

3.122 Overall, DCC's forecasting continues to be inconsistent. While we acknowledge that parts of DCC's business, such as live programmes, can at times be challenging to accurately project, large parts of DCC's Allowed Revenue have moved to live operations and their costs should be sufficiently stable and

predictable. This is especially important as we commence the process of moving towards an *ex-ante* price control regime.[31]

Table 3.8: Proposed forecast FSP External Cost disallowances

CR/PR	Description	2024/25	2025/26	2026/27	2027/28
CSP-C	SIT-A and UIT-B extension post July 2021	1.493	1.572	1.588	1.588
CSP-S	SIT-A and UIT-B extension post July 2021	1.221	1.287	1.299	1.299
TOTAL		**2.714**	**2.859**	**2.887**	**2.887**
GRAND TOTAL					**11.347**

Accuracy of Impact Assessments for SEC changes

Context

3.123 A crucial part of the governance process for SEC changes is the assessment of costs and benefits of proposed modifications. DCC is responsible for delivering impact assessments outlining the costs of implementing a code modification. The costs analysis is a key input into determining whether the SEC Change board and Panel approve, or recommend to Ofgem for approval, material code changes.

3.124 In previous years we commented on the importance of DCC providing timely and accurate impact assessments to ensure that DCC customers, the SEC Panel and Ofgem have a clear and transparent view of the costs of code changes in the context of SECMP0007.[32] We have since seen evidence of other changes, including June 2023 and November 2023 SEC releases, showing disparities between initial and final costs, once testing costs are factored in. In RY23/24 this amounted to c.£6.2m.

[31] See: Ofgem (2023): DCC Review: Phase 1 Decision, chapter 5. www.ofgem.gov.uk/publications/dcc-review-phase-1-decision
[32] Ofgem (2022), DCC Price Control consultation: RY21/22, paragraphs 2.68-2.74. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202122

DCC's justification

3.125 In response to our questions, DCC explained that Final Impact Assessments (FIA) signed off by the SEC Change board do not cover "post-PIT" testing activities. These are agreed by the Test Advisory Group for SEC releases after the approval of mods by the Change board. This is because:

- The exact testing requirements are determined only after individual modes are approved and a release is formed 3-5 months later
- SEC releases combine individual modifications as well as other non-SEC mod (*ie* DCC-led) changes – this is to drive efficiencies in testing

3.126 The overall budget for a release, including all testing activities, is approved by DCC's board. DCC explained that this includes regression testing the costs of which the TAG does not have a sight of.

3.127 DCC said that going forward it will propose to include an estimate of the post-PIT testing costs in its FIAs to provide a more accurate view of the final costs at the point of mod approval.

Our view

3.128 We recognise the process for SEC change implementation can be technically complex. However, we are concerned about the continued lack of cost transparency within the governance process, particularly given the significant disparities observed in 2023 SEC releases and that some costs (*eg* those associated with regression testing) are not visible to the TAG. It is important that DCC customers, and Ofgem, have an accurate picture of the costs and benefits of a code change prior to its approval.

3.129 We welcome DCC's commitment to improve cost estimates and visibility and expect these changes implemented as soon as possible. We will continue to monitor the issue going forward. Based on the current evidence, we do not propose to make a cost disallowance; however we invite consultees to provide views or evidence on this issue.

4. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY23/24 and its updated forecasts. DCC has provided sufficient justification for the majority of these costs. In total, we are proposing to disallow **£16.958m** of the Internal Costs.

The proposed disallowances for this year are largely driven by an increase in expenditure on activities and grounds that has been subject to a cost disallowance in previous years. More specifically, the costs associated with this year's proposed disallowances are linked to inefficiencies in the planning (**£6.086m**), and in particular, the resourcing of activities; further material spend on activities that fall within the scope of the wider Business Accuracy Programme (BAP) (**£4.213m**); proposed disallowances to contractor staff salaries that exceed the relevant benchmarks (**£0.506m**); and reductions in Shared Service Charges (SSC) (**£1.212m**) as a direct result of the proposed cost disallowances for RY23/24. Similar to last year, this year's proposal also comprises a **£5.031m** resource cost due to a lack of justification of variance resource costs in the Programme (professional services), Operations (Future Connectivity) and Network Evolution (4G Comms Hub and Network) cost centres and programme.

We are also minded-to disallow **£63.876m** of DCC's forecast Internal Costs (including Shared Service Charge) over RY24/25 and RY25/26 which comprises of both resource and non-resource costs. This is due to insufficient justification for the additional resource and increasing costs.

Please note that by "Licence term" we mean up to and including RY25/26. In September 2024, we published our decision to extend DCC's Licence by two years to September 2027. However, as the additional regulatory years had no baseline (approved forecasts), they are excluded from this year's reporting.

Questions

Question 10: What are your views on our proposals to disallow a 50% proportion of the RY23/24 resource costs associated with Security, Operations and Network Evolution programme?

Question 11: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 12: What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not have been resourced in the most economic and efficient way?

Question 13: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

Question 14: What are your views on our proposal to disallow forecast cost variances in RY23/24 and 24/25; and all baseline forecast costs for RY24/25 onwards?

What are Internal Costs?

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

How have Internal Costs changed?

4.2 Figure 4.1 shows the distribution of costs by GL code over the Licence period, based on DCC's RY23/24 submission. Internal Costs (excl. Shared Service Charges, SSC) have peaked in RY23/24 at £155.724m[33], this is £52m more than was forecasted in RY22/23. The GL codes are generally dominated by payroll costs – this reflects the fact that DCC is a relatively asset-light company with a primary focus on contract management and programme delivery. Total Internal Costs are therefore driven primarily by salaries and headcount, and non-resource costs.

[33] This figure includes Shared Service cost.

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

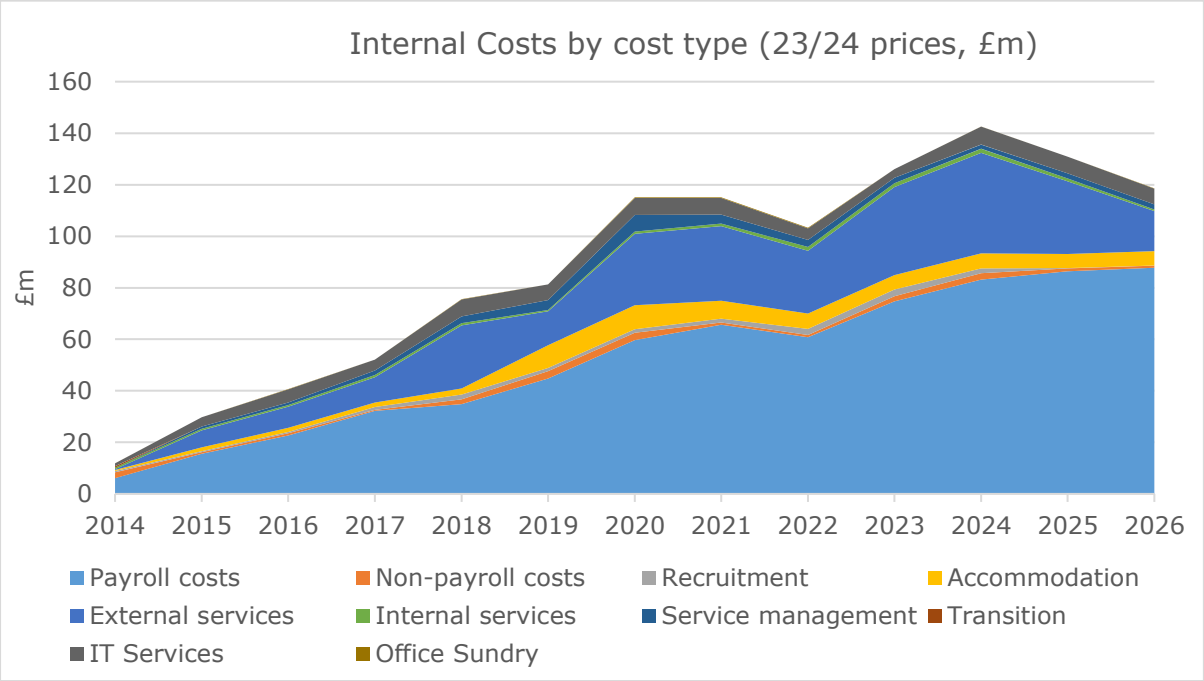


Figure 4.1: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Payroll costs	6.1	15.6	22.7	32.2	34.9	44.8	59.7	65.7	60.8	74.7	83.1	86.4	87.8
Non-payroll costs	2.3	0.6	0.8	0.4	1.8	2.8	2.8	0.8	0.9	1.9	2.5	1.1	0.8
Recruitment	0.5	0.4	0.5	1.1	1.8	1.2	1.4	1.6	2.3	2.6	1.8	0.1	0.1
Accomm.	0.4	1.5	1.6	1.8	2.4	8.8	9.2	7.0	6.0	5.7	5.8	5.5	5.6
External Services	0.3	6.5	8.2	9.8	24.5	13.2	27.8	28.9	24.3	34.1	39.1	28.2	15.6
Internal Services	0.6	0.6	0.7	0.8	0.9	0.5	0.8	1.0	1.5	1.6	1.6	1.1	0.6
Service Management	0.0	0.9	0.9	1.8	2.6	3.8	6.6	3.5	2.7	2.1	1.6	1.9	2.0
Transition	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IT Services	1.1	3.5	5.2	4.2	6.6	6.1	6.6	6.5	4.5	3.3	7.0	6.4	6.1
Office Sundry	0.0	0.1	0.1	0.0	0.1	0.0	0.2	0.3	0.3	0.0	0.0	0.1	0.1

4.3 **Figure 4.2** shows the distribution of Internal Costs. The Corporate Management, Finance and Design and Assurance cost centres together with the Network Evolution programme continue to be the largest cost drivers in RY23/24.

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

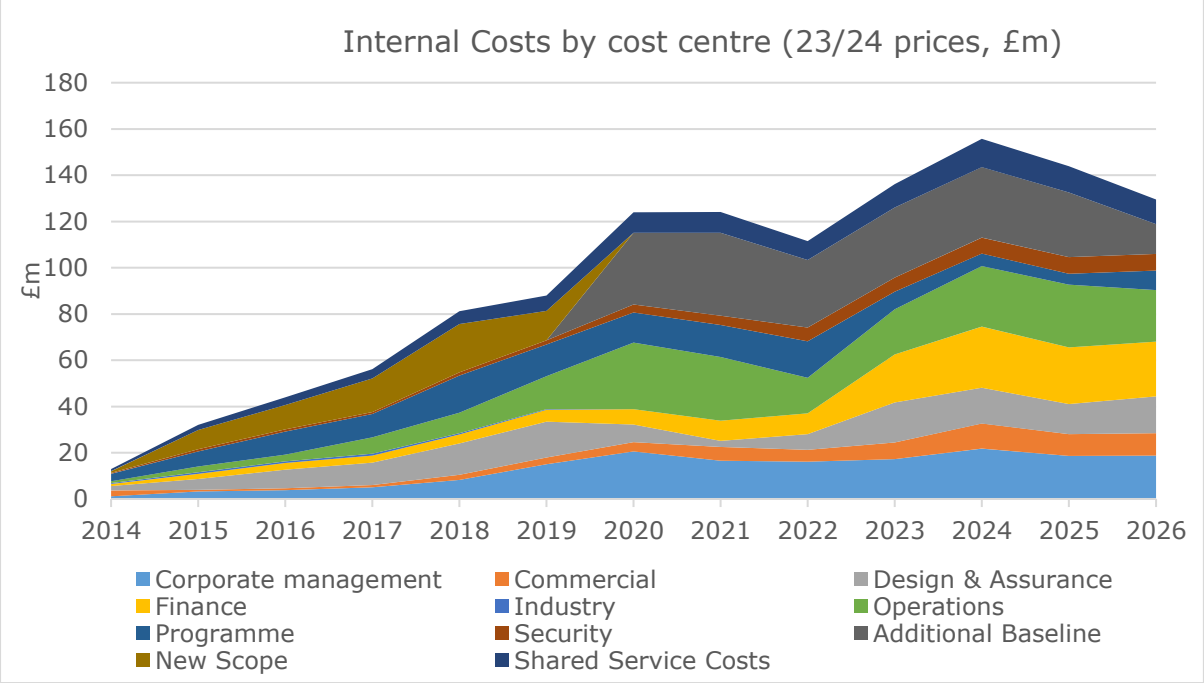


Figure 4.2: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	1.1	3.2	3.8	5.1	8.2	15.1	20.6	16.5	16.2	17.2	21.8	18.7	18.7
Commercial	2.6	0.7	0.9	1.0	2.2	2.9	4.0	6.0	5.1	7.2	10.9	9.3	9.7
Design & Assurance	1.9	4.7	8.0	9.7	13.6	15.5	7.6	2.6	6.8	17.4	15.4	12.9	16.0
Finance	0.9	2.3	2.9	3.0	3.9	5.2	6.7	8.7	8.9	20.7	26.4	24.5	23.6
Industry	0.4	0.7	0.7	0.8	0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operations	0.8	2.4	3.0	7.0	9.0	14.3	28.8	27.5	15.3	19.5	26.2	27.2	22.2
Programme	3.3	6.5	9.9	10.2	16.1	13.7	13.0	13.9	15.8	7.6	5.4	4.7	8.5
Security	0.4	0.9	0.9	0.9	1.3	1.8	3.4	4.0	6.0	6.1	6.9	7.1	7.2
Additional Baseline	0.0	0.0	0.0	0.0	0.0	0.0	31.1	35.9	29.2	30.3	30.5	28.0	12.8
New Scope	0.7	8.3	10.6	14.5	20.9	12.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shared Service Costs	1.0	2.2	3.2	4.0	5.6	6.6	8.8	8.9	8.3	10.1	12.2	11.4	10.7

Variances on last year's forecasts

4.4 In RY23/24, Internal Costs, excluding Shared Services, were £143.52m. This is £52.33m (57%) higher than forecast in RY22/23 and £129.65m higher than the LABP forecast. Over the remainder of the Licence period, Internal Costs are forecast to increase by a further £227.41m relative to the RY22/23 forecast, and by £968.04m compared to the LABP.

4.5 Figure 4.3 shows the variance in costs by GL code compared to the RY22/23 forecast. Payroll costs account for the greatest proportion of the variation in Internal Costs over all forecast years. In RY23/24, the proportion of the External Services variation was c.54% followed by payroll costs approximately at 39.5%.

Figure 4.3: Internal Cost Variance by GL code relative to RY23/24 forecast (excluding Shared Services) in current year prices

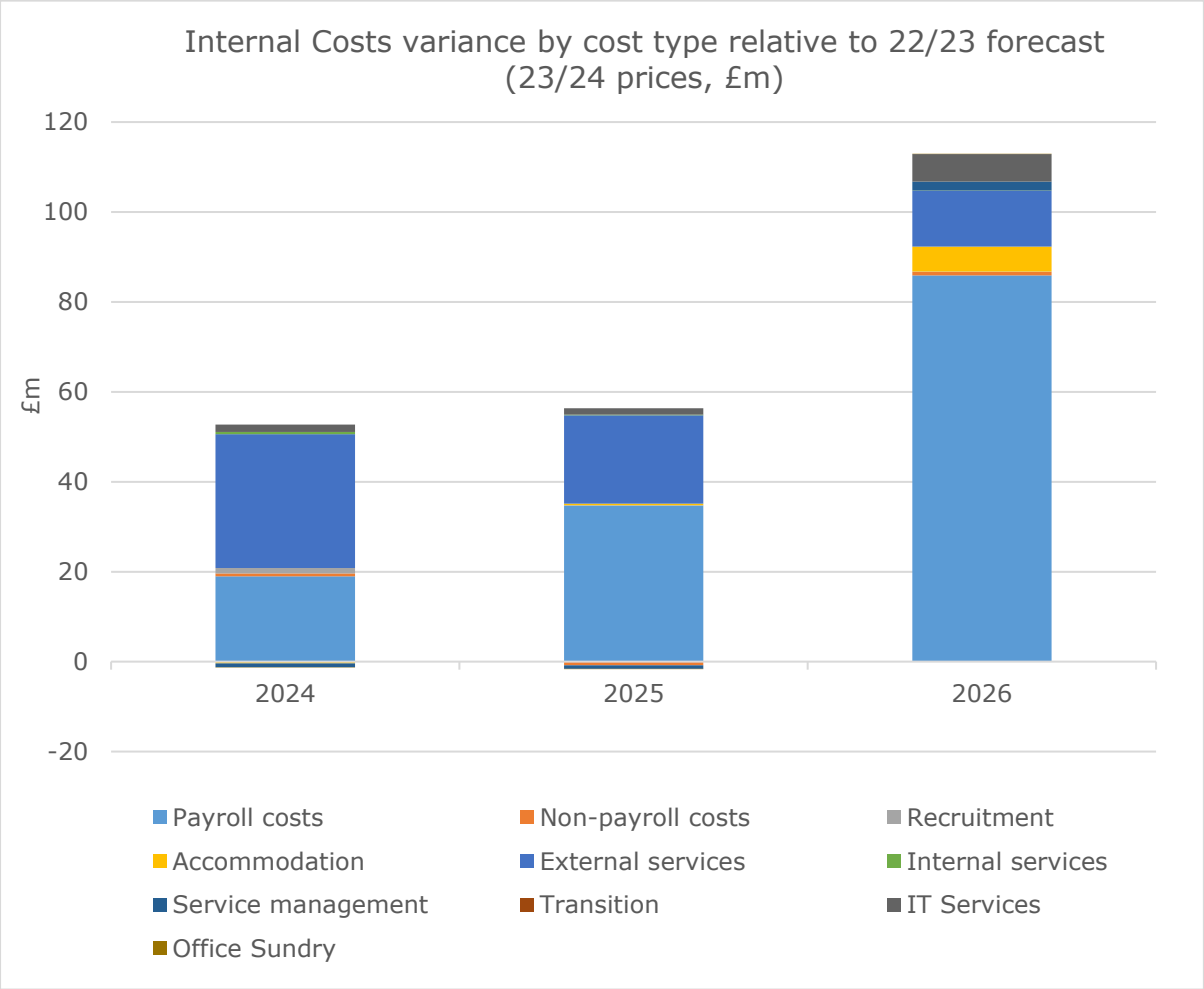


Figure 4.3: data table

Payroll (£m)	RY23/24	RY24/25	RY25/26
Payroll costs	18.9	34.7	85.9
Non-payroll costs	0.7	-0.8	0.8

Recruitment	1.2	0.1	0.1
Accommodation	-0.4	0.3	5.6
External Services	29.7	19.7	12.4
Internal Services	0.5	0.1	0.0
Service management	-0.8	-0.8	2.0
Transition	0.0	0.0	0.0
IT services	1.7	1.4	6.1
Office sundry	-0.1	-0.1	0.1

Payroll

4.6 DCC has applied for the payroll costs shown in Table 4.4. Payroll costs incurred in RY23/24 are more than forecasted in RY22/23 and continue to increase over the forecast in future years.

Table 4.4: Payroll costs compared to last year's forecast, in current process

Payroll (£m)	RY23/24	RY24/25	RY25/26
RY22/23 accepted forecast	60.825	48.99	-
Cost variance in RY23/24	22.321	37.46	86.00
Total	**83.15**	**86.44**	**86.00**

Headcount

4.7 Figure 4.4 shows DCC's staff headcount has increased from 704 full time equivalents (FTEs) in RY22/23 to 783 FTEs in RY23/24. This constitutes a c.3% increase compared to last year's forecast for RY23/24. The number of permanent staff has increase from 591 FTEs to 619 FTEs. This is significantly under last year's forecast of 692 permanent FTEs for RY23/24.

4.8 Headcount is expected to increase for permanent staff to 687 FTEs and for contractors to 110 in RY24/25. DCC did not provide forecasts for its headcount beyond RY25/26.

Figure 4.4: DCC headcount (FTEs, excluding service desk staff)

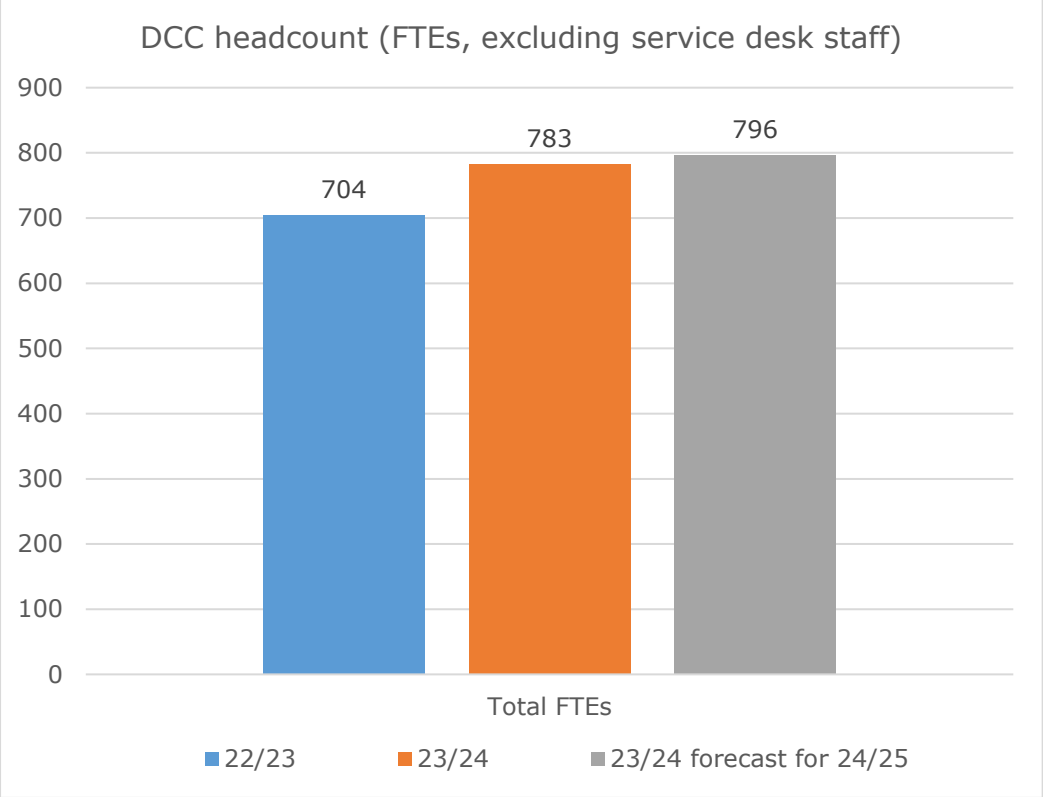


Figure 4.4: data table

Cost Centre	Actual RY22/23	Actual RY23/24	Forecast RY24/25
FTEs	704	783	796

Permanent-contractor staff ratio

4.9 In RY16/17 the ratio was around 40% contractor to 60% permanent staff; in RY17/18 there was a significant reduction in DCC's dependence on contractors and the ratio reduced to 22% contractor to 78% permanent staff; in RY20/21, the ratio remained consistent at this level with 21% contractor to 79% permanent staff; in RY21/22 the ratio remained identical to last year; in RY21/22 the ratio decreased to 14.5% contractor and 85.5% permanent staff. According to the regulatory reporting the ratio for RY23/24 has again increased to 21% contractor and 79% permanent staff.

Payroll Costs

4.10 We are proposing payroll disallowances across three cost centres, totalling **£5.031m** for the RY23/24. For reference, see table 4.5 for further details.

Table 4.5: Proposed forecast disallowances per cost centre in RY23/24

Cost Centre	RY23/24 Disallowance (£m)
Service Delivery	£1.624
Operations	£0.117
Network Evolution	£3.290
Total	**£5.031**

Service Delivery

Context

4.11 The Service Delivery cost centre ensures that DCC's portfolio of change programmes meets all regulatory and operational requirements. The cost centre is accountable for the delivery of changes to the smart metering ecosystem, including modifications to the Smart Energy Code (SEC) and the Retail Energy Code (REC), the expiration of existing third-party service contracts and the implementation of new enterprise systems such as procurement software.

4.12 The cost centre is broken down into three payroll sub-teams, of which one is the Professional Services practice. Total payroll variance across the cost centre in RY23/24 was reported as £1.710m, with only one of the sub-teams (ie, the Professional Services practice) showing a positive material variance, greater than the materiality reporting threshold of £150k. The total cost variance for the Professional Services practice sub-team for RY23/24 was reported at £2.766m.

DCC's justification

4.13 DCC explained that the costs variations for RY23/24 were due to:

- The time sheeting system, that was only recently introduced in RY23/24, and did not fully capture the resource allocation accurately
- A low baseline for the year, following Ofgem's disallowances related to the RY22/23 price control submission. DCC noted that the sub-team's resource allocation had not changed and that the overall team size had remained consistent with previous years

Our view

4.14 We do not consider that DCC has appropriately justified the cost variances for RY23/24, associated with the Professional Services practice sub-team.

4.15 Given the lack of justification in this area, we propose to disallow any variance cost in excess of the team's costs in RY22/23 ie, £2.103m. **We therefore propose to disallow £1.624m of the incurred cost in RY23/24.** We may reduce the proposed disallowance accordingly if we receive satisfactory evidence through the consultation response. We welcome views and evidence from stakeholders on this issue.

Operations

Context

4.16 The Operations cost centre provides a single point of contact for DCC customers in which they can seek to receive support on onboarding to services, incident management and support for the smart meter rollout. The cost centre also contains the following key functions: Service Operations, Operational Change and Transition, In Life Supplier Management, and Customer Relationship Management. Operations provide assurance functions to ensure service providers deliver quality service to DCC's SEC Parties against contractual key performance indicators (KPIs).

4.17 The cost centre is broken down into 15 payroll sub-teams. Total payroll variance in the RY23/24 was reported as £2.157m, with 10 sub-teams showing a material variance greater than £150k.

DCC's justification

4.18 DCC reported the main drivers of cost over the RY23/24 as follows:

- Zero baselines for the programme resources, which were new sub-teams being reported separately due to the implementation of a new DCC time sheeting mechanism
- Other variances are driven by the move of the In-Life Change team to Operations
- The extension of essential contractors in Data Analytics and Strategic Operations

Our view

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

4.20 However, we propose disallowing £0.117m of incurred costs under the Future Connectivity Program Resource sub-team. This team is developing a strategic business case that considers the inherent limitations of existing connectivity technologies, including the sunsetting of 2G/3G in the UK; assesses how future

connectivity technologies could be adopted to meet the needs of DCC's customers; and ensures that the final choice of technologies will underpin the evolution of the network up to 2050. Through our clarification question, we have found that DCC has been working on the fibre network connection and that these costs, reported within the sub-team, are associated with DCC's support of innovation activity.

4.21 As we noted in our RY22/23 Price Control decision in February 2023, we remain concerned that DCC appears to be placing undue focus on innovation activity and the development of new products and proof of concepts, whilst its core service (ie, delivery of critical core projects, and delivery of the First Enduring General Objective) is not at a standard that its customers require.[34] We expect DCC to focus on the delivery of the Mandatory Business before expanding into exploring additional areas of activity. As DCC's incurred costs are recouped through charges to its Users, we do not consider it appropriate that DCC is engaging in exploratory work, which is being charged back to its customers, where there are not defined mandated requirements upon DCC.

4.22 Because the Future Connectivity Programme has worked on other programs that do not relate to innovation, DCC has been unable to provide a proportion for the work relating to fibre connectivity. We have taken an upper estimate of this work of 50% of the resource in place of further explanation. Therefore, in line with our 22/23 position, we propose to disallow the costs of £0.117m relating to innovation activity.

Network Evolution Programme

Context

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

4.24 Last year we disallowed all forecast variance costs for the Network Evolution programme. This was partially due to the degree of uncertainty linked to the programme as well as a lack of satisfactory justification from DCC of the

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

associated forecast costs. All RY23/24 costs were therefore reported as a variance.

4.25 DCC committed a significant increase in resources towards the Network Evolution programme in RY23/24. Comparing to the disallowed RY23/24 forecast costs in the RY22/22 submission, we observed a significant variance in the CH&N programme of £6.583m. The RY23/24 incurred cost figure is also £3.661m above the incurred costs reported in RY22/23 for Network Evolution programme. We note that all other sub-programmes were broadly within the threshold.

4.26 The CH&N programme designs and procures future-proof communication hubs and networks. This programme of work enables smart metering services to be provided beyond 2033 when all 2G and 3G service will be decommissioned.

DCC's justification

4.27 DCC listed activities undertaken by each sub-team, including consulting and engaging with stakeholders; evaluating and assuring designs produced by delivery partners; design of the future target operating model; ensuring all designs met the required security standards; building and testing the core CH&N solution; and planning and assuring all testing activity.

Our view

4.28 The activities forecasted for the RY23/24 for the CH&N programme in the RY22/23 submission largely mirror what was reported by DCC in the RY23/24 submission. It is therefore unclear why this programme has incurred over £6.583m in additional costs. We have requested DCC to provide additional information and evidence to justify these costs, however we have not received any satisfactory explanation of how the increased costs relate to an increase in activity within the programme relative to RY22/23.

4.29 In the absence of any satisfactory evidence, and in line with previous Price Control years, **we propose to disallow 50% of the difference between the RY23/24 incurred costs and the RY22/23 forecasted costs in the RY22/23 submission for the 4G CH&N programme, due to lack of justification**.

4.30 Based on the variance being £6.583m, **we propose a disallowance of £3.296m for the Network Evolution Programme.** Should we however receive further satisfactory evidence through the consultation response, we may

reduce the proposed disallowance accordingly. We welcome views and evidence from stakeholders on this issue.

Shared Service Charge

Context

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

4.32 In the RY16/17 Price Control decision, we decided that in future years we would not require further justification for the SSC associated with Baseline Activity for Price Control purposes.[35] For New Scope activities however, DCC must provide full justification to demonstrate that any SSC relating to these activities is economic and efficient.[36]

4.33 DCC does not apply SSC on External Services (ES) procured for Additional Baseline activities.[37] DCC has previously also opted not to apply SSC on some other components such as the costs associated with Brabazon House, which houses DCC's test labs.

4.34 In RY21/22, DCC applied for an SSC on Internal Services (IS), IT Service (IT) and Office Sundry (OS) services for Network Evolution Programme (NEP), which is considered to be an Additional Baseline activity. In our RY21/22 Price Control Decision, we disallowed the SSC on those costs and made clear that applying for an SCC on non-resource costs for Additional Baseline activities was inconsistent with DCC's approach in previous years, and therefore, should be properly justified.[38]

DCC's justification

4.35 This year, DCC applied the SSC at a rate of 9.5% on Baseline costs, which amounted to £12.203m in RY23/24 and £93.166m in forecast costs to the end of the Licence term.

[35] DCC Price Control Decision: Regulatory Year 2016/17 | Ofgem
[36] Activities that are associated with the delivery of requirements that are additional to those that the Licensee was expected to deliver at the time of Licence Award. The Switching Programme is considered New Scope.
[37] Additional Baseline activities are associated with requirements that the Licensee was expected to deliver at the time of the Licence Award, but which had not been fully costed in the LABP. For example, SMETS1 enrolment and adoption costs are considered Additional Baseline.
[38] DCC Price Control Decision Regulatory Year 2021/22 | Ofgem

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

Our view

4.37 As per previous years, we are minded to accept the 9.5% SSC associated with the Baseline costs of DCC's core smart metering service.

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

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

4.40 DCC has not applied for an SSC on any categories of activity which we have previously determined as excluded from eligibility for an SSC. **In light of this, we are minded to allow the full amount of SSC that DCC has applied for in RY23/24 and forecast years except for the portion associated with Internal Costs which we have proposed to disallow as Unacceptable Costs. This amounts to a proposed disallowance of £1.212m in RY23/24 and £5.201m in forecast costs to the end of the Licence term.**

Benchmarking

Context

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

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

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

DCC's justification

Benchmarking process

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

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

4.45 DCC provided further detail on its recruitment processes. It explained that any proposal to offer above the salary range must be referred to the chief product officer, chief financial officer and chief strategy and regulatory officer CSRO with an accompanying business case, on an "as needs" basis. In addition to this, whilst approval would be virtual (eg by email, telephone, or video call), and no formal panel meeting would be required, the outcomes must be recorded for Price Control purposes.

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

Permanent staff

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

4.48 As was noted in previous years, DCC explained that its aim is generally to offer remuneration rates that equate to the market average for permanent members

of staff up to the 50th percentile (50P). However, DCC states it may offer higher than the 50P of the benchmark to attract the right candidates. This can be due to the role requiring niche or technical skills, or merely the lack of supply in the market. Thus, recruiting managers have the discretion to offer up to 10% above the benchmark with approval required by the HR Business Partner. If the salary is in excess of this, a business case is required for approval.

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

4.50 Like last year, DCC included all permanent staff which incurred costs in RY23/24 (and not only new staff) in their benchmarking analysis. It argued that this puts more roles in scope for analysis and ensures existing employees remain compliant after in-flight pay increases. This analysis showed that 72 permanent roles had a positive variance above the 50P10 benchmark out of 712 roles in the scope of the benchmarking exercise, representing approximately 10% of the total benchmarked roles. For context, last year, 78 out of 704 roles (11%) permanent roles had a positive variance above the benchmark.

4.51 These 72 roles had a combined marginal variance of £0.328m above the benchmark. For only roles that were first hired in RY23/24, however, the marginal variance was £0.048m. Overall net variance for permanent roles was negative, at £5.312m below the benchmark.

4.52 DCC provided some justification for the roles hired above the benchmark. However, it did not provide any business cases showing that it had followed its own internal processes described in its Price Control submission.

Contractors

4.53 A total of 202 contractors were in the scope of the RY23/24 benchmarking analysis, with a total cost of £23.432m. Of these, 58 (29%) roles had a positive variance above the benchmark. For comparison, 255 contractors were in the scope of last year's analysis with a total cost of £22.2m, and 42 roles had variance above the benchmark. This means that contractor costs have increased both overall and on a per-contractor basis, and a greater proportion of contractor roles are above the benchmark in RY23/24.

4.54 Marginal variance for contractor roles was £0.506m, compared to £0.421m last year. Net contractor variance, however, was negative, at £3.333m below the benchmark, with 71% of contractors paid below the benchmark. For context, 83% of contractors were paid below the benchmark last year with a negative net marginal variance of £5.520m below the benchmark.

4.55 In its submission, as in previous years, DCC reiterated its argument that salaries/rates paid below the benchmark, and the overall negative net variance for both permanent staff and contracts should be considered "savings" which offset the salaries paid above the benchmark.

4.56 However, this year, DCC exempted 18 contractor roles from the benchmarking exercise for the reason of insufficient benchmarking data.[39] This represents 8% of all contractors employed in RY23/24. For context, only one contractor was exempted from the benchmarking exercise in RY22/23 due to a lack of available data.

Our view

4.57 Overall, we are pleased with the quality of DCC's staff benchmarking reporting. However, we are disappointed that marginal contractor variance has increased overall compared to RY22/23, and that both the number and proportion of variant roles has increased. Furthermore, net contractor variance, while still negative overall, has deteriorated compared to RY22/23.[40]

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

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

[39] Roles are also exempted for other reasons such as if they incurred no costs in the relevant RY or are a director-level role.
[40] It is closer to £0 than in RY22/23.

Permanent staff

4.60 We welcome that in RY23/24 DCC has continued applying its internal process to hire staff at salaries below the 50th percentile +10% (50P10) benchmark. The number of variant roles has stayed fairly consistent with last year, and we are pleased marginal variance has decreased from £0.069m to £0.048m.

4.61 **Given the above, we are not proposing any disallowances against DCC's permanent staff costs**. We encourage DCC to keep working to ensure its permanent staff costs are economic and efficient.

Contractors

4.62 As a result of the increase in marginal contractor variance this year, we requested DCC to submit to us the business cases for a sample of contractors hired above the 50P10 benchmark. DCC did not submit any business cases for the requested roles, although it did provide further justification for some of them. It is disappointing that DCC has not submitted any business cases or similar documents showing it has followed its own hiring policy. This is particularly the case given that, since RY21/22, DCC has claimed to have improved the governance in this area, with the declared intention to be able to provide better justification for the Price Control submission.

4.63 **As a result of the above, we are minded to disallow some costs where they materially fall above reasonable market rates and were not properly justified.** We calculate this disallowance as equal to the total marginal variance over the 50P10 benchmark of all contractor roles employed during RY23/24. This is the same methodology we have applied since RY20/21. **This amounts to a proposed disallowance of £0.506m.**

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

Exemptions to the benchmarking process

4.65 We regret that DCC has exempted 18 contractor roles from the benchmarking this year due to a lack of benchmarking data. While we accept that some niche and particularly technical roles may not have many comparators elsewhere in the industry, we would still expect DCC to produce some evidence of the contingency processes it follows to decide staff remuneration in the absence of a suitable benchmark.

4.66 **We are not proposing any disallowances as a result of DCC's decision to exempt some roles from the benchmarking process**. However, we expect to see the number of exempted roles to decrease next year.

Non-Resource Costs

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

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

4.69 Total Internal Costs for RY23/24 have increased by a variance of £56.5m against last year's baseline. 58.5% (or £33m) of this year's variance was driven by non-resource activities, more specifically Internal, External and IT Services. In absolute costs, DCC has spent a total of c.£49m on non-resource activities; this constitutes a 27.6% increase against the incurred spend in these areas compared to RY22/23.

4.70 Figure 4.5 below shows the evolution of External, Internal and IT Services costs by RY.

Figure 4.5: External, Internal and IT Services costs by RY (£m, 23/24 prices)

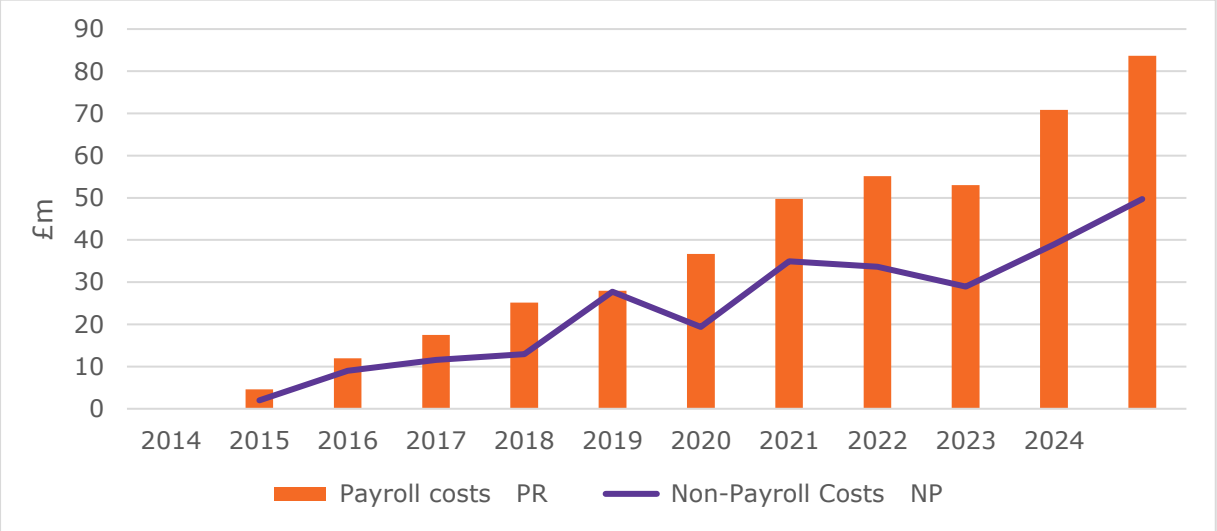


Figure 4.5: data table (£m)

RY	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24
Payroll	4.6	11.9	17.5	25.2	27.9	36.7	49.8	55.2	52.9	70.8	83.7

RY	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24
Non-Resource	1.5	8.2	10.8	11.6	25.6	16.2	29.3	30.6	26.4	36.9	48.5

4.71 As per the past few years, we remain concerned about the approach that DCC is taking in regard to the procurement of services. DCC operates an outsourced services model, and running competitive procurements are fundamental to making sure that services are procured and delivered in a manner that is economic and efficient. Over the course of the RY23/24, we have identified further instances where services are procured in a way that is potentially not compliant (ie, via direct awards) with the procurement obligations[41] under the Licence.

4.72 We have also noted on a number of instances where, notwithstanding the services were procured competitively, the commercial interest to bid for these services was low. In the interests of transparency and best use of competition, we expect DCC to be able to robustly evidence that its requirements are not unnecessarily restrictive and that its procurement opportunities reach the widest range of potential suppliers (whether already contracted to DCC or not).

4.73 Finally, we have also noticed that DCC is increasingly relying on the use of framework contracts for the procurement of services; whilst we do not oppose to the use of such frameworks in principle, we are of the view that these are not always appropriate other than for the procurement of frequently purchased and predefined goods and services.

4.74 Whilst we are not proposing any disallowances on the basis of these grounds solely this year, we do intend to continue to monitor and scrutinise these areas going forward, either as part of price control and/or our wider work on compliance.

4.75 The following sections highlight the areas where we have identified a number of concerns, and where we are proposing a disallowance of costs. Our proposals for this year are largely driven by an increase in expenditure on activities and grounds that has been subject to a cost disallowance in previous years. More specifically, the costs associated with this year's proposed disallowances are linked to inefficiencies in the planning, and in particular, the resourcing of

[41] Licence Condition 16

activities; as well as further material spend on activities that fall within the scope of the wider Business Accuracy Programme (BAP).

Planning, scoping and resourcing of projects

Context

4.76 As per the last two years, we remain concerned about DCC's approach to ensure that it carefully manages the timelines, risks and resourcing of projects through advance planning and engagement.

4.77 Particularly in regard to the resourcing of projects, we are becoming increasingly concerned about DCC's over-reliance on the use of consultants through year on year increased spend on External, Internal and IT services. For example, DCC's expenditure on non-resource activities has grown by approximately 82% over the past two years; in comparison, resource costs have increased considerably less over the same two-year period, by 57%.

4.78 Given the magnitude of the development of these costs, we requested, as per our approach for RY22/23, that DCC shares with us the evidence of the internal process (e.g. outputs of the "Front Door" process) that it had followed to determine the most economic and efficient resourcing option, for a number of projects. We selected this sample on the grounds of these activities being of a nature that is considered BAU, either on a regular or ongoing basis. The sample included activities such as:

- Business Case writing
- Legal support
- Commercial and programme management support
- Regulatory and Strategic support
- Test assurance support
- DCC technical support

4.79 The aggregate cost of the respective projects amounted to approximately £13.4m for the RY23/24 and £6.647m for the RY24/25 and RY25/26.

DCC's justification

4.80 During the clarification stage, DCC responded that it assesses the need to contract for specialist expertise and / or capacity on a case-by-case basis, depending on the outcomes to be achieved and the in-house availability (or otherwise).

4.81 DCC further explained that it had shared with Ofgem the Request for Proposals (RFPs) and Award Recommendation Reports (ARRs), which set out the governance route that DCC had followed for the respective procurements.

4.82 In RY22/23, DCC explained that the "Front Door" process had been introduced at the start of 2023 to provide the necessary structure and controls (including on scope, risks and resourcing) around the initiation and delivery of new projects. In relation to whether any of the selected projects had gone through the "Front Door" process, DCC explained that none of the projects met the criteria for that process. DCC additionally clarified that the "Front Door" process would not manage BAU (i.e. day to day) operational / administrative activities and in-life change unless there is a need to mobilise a project to deliver a change to business outcome.

Our view

4.83 We agree that DCC is required to outsource certain projects where it does not hold particular skills in-house, or where the nature of the activity is short-term. However, where that is not the case, we expect DCC to be able to demonstrate that it has considered alternative options before defaulting to the outsourcing of a particular activity i.e. by taking on either existing staff or by hiring additional permanent staff or contractors, or a combination of both.

4.84 Complimentary to the Licence obligation on DCC to ensure that it runs its business in a manner that is economic and efficient, it should also be noted that the DCC Price Control: Processes and Procedures ("Guidance") explicitly sets out our view that DCC must recruit the necessary skills in-house for those activities that are likely to be undertaken on a regular or ongoing basis.[42][43]

4.85 DCC did not provide further evidence of how, for the sample of the respective procurements, it had assessed and determined that the outsourcing of these projects was the most economic and efficient option. We are therefore proposing a disallowance of a proportion of the costs for each of these activities by comparing (where available) the respective consultancy rate cards against the benchmarking data DCC are required to submit to us as part of the annual price control. Where rate cards were not available, we have assumed a cost

[42] LC37.2 – Assessment of Mandatory Costs
[43] Price Control Processes and procedures guidance 2022 (ofgem.gov.uk)

disallowance by applying a scaling factor against the incurred cost, based on the average cost disallowance rate for where direct benchmarking was possible.[44]

4.86 For the purposes of the benchmarking, we have assumed that each of these projects would consist of a mix of both permanent and contractor staff, as opposed to them being carried out by permanent staff only. For the avoidance of doubt, our benchmarking has also taken into account additional non-base salary add-on costs, including costs associated with pension, National Insurance, recruitment, car allowances and bonusses.

4.87 **We are proposing to disallow a proportion (£6.086m) of the costs in RY23/24 that are linked to activities that we consider not to have been resourced in the most economic and efficient way. For RY24/25 and RY25/26, we are proposing to disallow the full cost (£6.647m), associated with these activities.**

Business Accuracy Programme

Context

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

4.89 At the outset of the programme, DCC reported that the total costs were projected at c.£6m with an efficiency gain of £11.8m post the implementation of the programme and until the end of the initial Licence term in RY25/26. Around £1.8m of direct savings were expected to be realised because of automation and the subsequent reduction of resource costs; c.£10m of indirect efficiencies would be achieved through improved benchmarking of suppliers' costs, performance, and processes.

4.90 In RY21/22, we rejected all incurred costs, £2.56m, associated with the BAP on the grounds that there was insufficient evidence of how the projected benefits would be tracked and realised. Our decision was also made on the basis that there was a lack of transparency towards customers in respect of the full scope and costs associated with the BAP. Finally, as part of our decision, we also raised concerns about the potential duplication of costs given the overlap in scope between the BAP and various projects (similar in nature) which DCC

[44] For approximately 70% of the projects, we were able to directly benchmark the consultancy costs against the available benchmarking data that DCC submits to Ofgem as part of price control.

carried out in previous years as well as some of the services already provided for under the Shared Service charge (SSC).

4.91 In RY22/23, DCC reported an additional incurred cost, directly associated with the BAP, of £3.845m. We disallowed this cost in full on the same grounds as in RY21/22 as DCC was not able to share any robust evidence of how and by when the projected benefits would be tracked and realised.

4.92 In RY23/24, DCC reported an additional incurred cost to the BAP of £0.773m.

DCC's justification

4.93 As part of the RY23/24 submission, DCC reiterated that the majority of the benefits of the BAP are in relation to building a platform which is more reliable (reducing errors), more flexible and transparent (creating better insight in decision making), and more accurate (allowing better assessment of risk).

4.94 According to DCC, these benefits will result in:

- Efficiency savings through the adoption of a new commercial system, allowing improved control and ability to challenge costs from procurement through to contract management
- Reduced costs through improvement to DCC's internal Project Management Office (PMO) and portfolio capabilities
- Standardisation and improvement to finance processes and data structure to improve efficiency and cost transparency
- Introduction of the "Front Door" process to ensure better alignment and increased control over proposed activity across DCC
- Implementation of a time recording tool to improve cost management of programmes
- Improved processes for business planning, increasing cost challenge, resulting in improved effectiveness of delivery and reduced variances to budget
- Improved invoicing and purchase order processes allowing more efficient management of costs
- Introduction of a financial planning tool to improve the accuracy, timeliness, and granularity of cost forecasts
- Enhanced management reporting capability through the development of a business wide data warehouse and management reporting tool

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

4.96 As part of the clarification stage, and in line with the previous two years, we requested that DCC shares further evidence of how and when the programme's benefits will be realised together with a methodology of how the realisation of these benefits are tracked and monitored. DCC referred to that effect to the 2023 BAP project closure report, which it had shared with us in RY22/23, and which lists the benefits and costs of the programme as well as a high-level benefits realisation plan. Alongside the BAP project closure report, DCC also shared with us the BAP benefits tracking paper which lists down the benefits as projected in 2022.

4.97 As part of our analysis of the submission we also observed that, over the course of RY23/24, DCC made further material investments of £3.350m in the improvement and implementation of new systems and business processes in the following areas:

- Development of a business (Enterprise) **Change Management Framework** and mobilisation of an **Enterprise Portfolio Management Office** (EPMO)
- Introduction and development of an **Enterprise Planning** process and **Enterprise resource management**
- Implementation of the **new Commercial system** (Ivalua) to manage end-to-end commercial processes from sourcing to requisition
- Enduring **support** of the **One Data Hub** (a centralised reporting platform to enable consistent and accurate reporting to the various DCC functions)
- Design, build and deployment of a **new Commercial Pipeline** to support the business with the forecasting and planning of future commercial activity
- Development of an implementation approach and plan to move away from the existing Change Delivery Method (CDM) and instead adopt the **Prince2** project management methodology
- Transformation of the **In-Life Supplier management** function to improve various aspects of its activities covering the way it is organised and operates, the tools and methodologies utilised, the interactions with service providers, and the structures and frameworks in which it operates.

4.98 According to the information which DCC has shared with us since RY21/22, including evidence of customer engagement as well as the 2023 BAP project

closure report and the 2022 BAP benefits tracking paper, we consider that the activities above represent workstreams and / or deliverables under the BAP. We therefore asked DCC to explain why these activities had not been reported as BAP related costs. We also asked DCC whether it had updated the BAP's cost benefit analysis (CBA) to account for these additional projects, and if so, how this had impacted the business case.

4.99 In response to this, DCC noted the following:

- **Business/Enterprise Planning**: the creation of the Front Door process and road-mapping tool were in scope of BAP however business / enterprise planning was not. DCC also noted that the ongoing costs of running the "Front Door" process, and any subsequent improvements were not included within the scope of the BAP
- References to **resource planning** in the benefits tracking paper involved functional resource planning (ie cost centre based) as opposed to enterprise-wide resource planning
- Implementation of the new **Commercial System** (Ivalua): the creation formed part of the original BAP scope however the ongoing licensing costs and further capability and change were not included
- **Lifecycle management**: the system was included within the scope of the BAP; however, the Lifecycle Management Process Transformation was excluded as per the 2023 Closure Report
- References to the **Commercial Pipeline** in the benefits tracking document were functions and programmes based as opposed to enterprise based
- The **creation** and **enduring support** of the **One Data Hub** was included within the original scope of the BAP, including the ongoing licensing costs

Our view

4.100 As per our position in previous years, we welcome all efforts from DCC to realise cost efficiencies and provide greater predictability and accuracy around costs and delivery for all of its different programmes and activities.

4.101 However, when such investments (such as the BAP in this case) are being initiated, we expect DCC to be able to demonstrate how and when the benefits of such investments will be tracked and monitored, realised, and eventually returned to customers. As previously communicated to DCC, we cannot assume that a particular investment or programme will realise the projected efficiencies.

4.102 In respect of the costs that DCC directly reported to us as being part of the BAP, we did not receive any further evidence nor any robust cost benefit analysis that precisely sets out how and when the programme's savings and efficiencies would be realised.

4.103 As for the additional projects, which were not directly reported by DCC under the cost category BAP, we have concluded that with the exception of the Lifecycle management all other activities formed an integral part of the programme's revised scope (as documented in the 2022 BAP closure report).

- We disagree, for example, with DCC's argument that the enterprise and resource planning specific activities did not form part of the BAP as the BAP's focus was function based rather than enterprise based. It is in our view, apparent from the BAP closure report, that the business / enterprise planning process is aimed at the "accuracy in forecasting, integrated planning, and a standardised, consistent approach to budgeting, activity planning, and resourcing at an enterprise level i.e. between and across Programmes, Operations and Functions".
- According to the 2022 BAP closure report it is also apparent that enhancements to the Change Delivery Methodology (CDM) (now being replaced by Prince2) originally fell within the scope of the programme.
- Also, given the BAP's focus on the improved accuracy of data and processes through an integrated approach (ie across programmes, operations and functions) rather than on a functions only basis, we are of the view that last year's investments in the commercial pipeline were one of the outputs of the programme.

4.104 Finally, claims from DCC that the costs for these additional projects do not form part of the original scope of BAP, raises concerns around the transparency of the reported costs. We expect both Ofgem and customers to have full visibility of the total spend and scope of a large investment, such as BAP, including where changes to scope are being made. It is important that the scope of any projects is clearly defined and that customers are presented with a robust cost benefit analysis that supports the investment.

4.105 **We are proposing to disallow all costs that we consider to be directly associated to the delivery of the BAP. The total disallowance cost amounts to £4.124m for RY23/24 and £1.133m for RY24/25 and RY25/26.**

4.106 As per previous years, we welcome views and evidence from stakeholders on this issue.

Forecast Resource Costs

Context

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

4.108 In its Price Control submissions, DCC usually provides justification for two years of forecasts and does not attempt to justify any costs that it expects to incur beyond two years. This is because costs may become more uncertain the further into the future they are. Historically, we have disallowed the forecast baseline costs until the end of the licence term due to a lack of justification.

4.109 Whilst we consider that DCC has justified the majority of the payroll forecast costs, we have concerns over a proportion of these cots. We have asked DCC for that reason to further clarify their methodology for estimating and validating future resource needs across the business. Whilst DCC has explained to us their methodology for resource planning, it was not able to demonstrate the use of that methodology via concrete examples, ie some of the forecast costs for RY24/25 and RY25/26. We discuss this in more detail in the following sections of this chapter.

DCC's justifications

Design and Assurance cost centre

4.110 DCC explained that in RY23/24, the Business Analysis sub-team was reallocated to the Design and Assurance cost centre from the Professional Services Practice sub-team in the Service delivery cost centre. DCC has forecasted a variance of £1.821m and £1.304m in respectively RY24/25 and RY 25/26 due to this activity having a zero baseline.

4.111 Based on the projected increase in demand, DCC has also forecasted an increase in the architecture, engineering, testing, and technology innovation sub-teams in RY25/26.

Programme (Service Delivery) cost centre

4.112 DCC explained that it anticipates that the Professional Service practice sub-team costs will remain stable. The lower cost variance compared to RY23/24 can be attributed to a higher baseline. Costs are expected to continue at stable levels in RY25/26. The anticipated increase in RY25/26 is attributed to the difficulty in accurately forecasting staff allocations to programmes, as these programmes are not yet sufficiently developed to allow for precise allocation of service delivery staff. the variance in this sub-team being £1.278m in 24/25 and £7.176M in 25/26 the latter is due to the lack of baseline.

4.113 Costs for the Programme director sub-team are expected to remain stable in the coming years. The anticipated increase of £0.466m in RY25/26 is attributed to the challenge of accurately forecasting staff allocations for future programmes, which must mature sufficiently before service delivery resources can be allocated with certainty.

Security cost centre

4.114 DCC projects a forecast cost variance in the Security Operation sub-team of £0.762m and £1.520n in respectively 24/25 and 25/26. DCC explained that this is largely due to a zero baseline. It also forecasted an increase in the Cyber Fusion Programme resource as it continues to onboard Service Providers. This cost variance amounts to £0.413m in 24/25 and £0.396m in 25/26 due to a zero baseline.

Operations cost centre

4.115 DCC explained that the new time sheeting has resulted in additional programs being included within the cost centre. The Capacity Programme resource is a new programme to support MHHS with a forecast cost of £0.802 and £0.614m in RY24/25 and RY25/26, respectively; The SEC Releases program supports the implementation of SEC releases; the forecasted cost of this program is £4.859m in RY24/25 and £1.617m in RY25/26

4.116 In November 2023, the 'In-life change' team of 28 FTEs was moved into the Operations cost centre from the Service Delivery cost centre, as part of the Project Blue programme, which was intended to improve the delivery of in-life maintenance and change. This team now sits within the Operational Change and

Transition (OCAT) directorate, and the resourcing is equivalent to previous years. DCC explained that the cost variance associated with the team is £1.417m in RY24/25 and £0.572m in RY25/26 due to a zero baseline.

4.117 DCC further reported that several teams, such as the Customer relationship management team, the Data Analytics and Strategic Operations team and the Product & Networks team show a cost variance in the RY25/26 forecast cost relative to the forecast for RY24/25 of respectively £0.3m, £0.561m and £0.25m.

SMETS1

4.118 DCC had one Testing Manager, one Testing Lead and one Testing Analyst in RY23/24 and have forecasted that they may incur further costs if further changes are made to the Transition and Migration Approach Document. DCC explain that the ongoing assignment of roles in the Commercial and Regulation team and a zero-baseline due to disallowances imposed last year will lead to a variance in RY25/26. DCC forecast a variance of £0.899m in RY25/26.

MHHS Programme

4.119 RY23/24 is the first year that forecast costs have been reported by DCC under this programme. DCC explains that the costs can be expected to increase across the sub-teams of commercial and regulation, design and assurance and operations in RY24/25 and in the operations team in RY25/26 as the programme reaches its implementation phase. Within the service delivery team, DCC explained that an increase in costs can be explained by a large increase in activity to ensure they deliver the programme. DCC forecasted a variance of £1.609m in RY24/25 and £0.268m in RY25/26.

Network Evolution Programme

4.120 DCC has stated that resources will increase across several sub teams in the upcoming regulatory years, as programmes move towards implementation and to align with the design, test and build element. DCC has forecasted a variance of £11.345m in RY24/25 and £6.165m in RY25/26.

4.121 For the 4G and Comms Hub Programme, DCC has forecasted a variance of £3.118m in RY24/25 and £3.925m in RY25/26. DCC explains that this variance can be explained because of resource levels due to the requirement to manage the design, build and test element of the CH&N programme continuing up to go live.

Corporate management

4.122 DCC provided justification for the Licence renewal sub-team which DCC intends to recruit for in RY24/25, which will handle three main workstreams: Licence extension, transition to an ex-ante price control by April 2025, and design and appointment of the successor Licensee. With the increase in work, DCC anticipates it will need to recruit three directors, four managers and eight subject matter experts (SMEs) for a two year-period to provide support to the Chief Licence Renewal Officer.

Finance cost centre

4.123 In November 2023, DCC established the EPMO (Enterprise Portfolio Management Office) which replaced the previous Portfolio and PMO team. The creation of the EMPO team resulted in a people consultation in March 2024, followed by a recruitment campaign. DCC stated that the reason for the increase in the variance for RY24/25 is due to mobilisation of the EPMO team and it anticipates the variance to reduce for RY25/26.

4.124 DCC also stated that the EPMO team would be responsible for taking on five core services, which include enterprise planning, resource management, delivery framework, assurance and reporting. DCC states that the mobilisation of the EPMO team will help drive increase in predictability, transparency, cost efficiency and effective outcomes.

Our view

4.125 We consider that, notwithstanding the various requests for justification during the clarification stage, the forecast costs for the areas above have not been sufficiently justified. **For that reason, we are proposing to disallow these forecast costs variances. The total forecast cost variance associated with the above roles and services total £24.038m for RY24/25 and £24.581m for RY25/26. Table 4.3 below provides a breakdown of these disallowances.**

4.126 We are also proposing to disallow all cost variances in DCC's baseline forecasts from RY26/27 onwards as no evidence was provided to justify these costs. **This amounts to a disallowance of £242.025m (excluding the associated SSC which are reported in the section above).**

4.127 Other than the forecast costs variances being largely driven by the implementation of a new time sheeting system and the baseline costs either being low or high, DCC did not provide any further satisfactory evidence that explained the cost variances for the Service Delivery sub teams, ie Professional Service practice and Programme director. **We are therefore minded to**

reduce the forecast costs for these teams to the levels of the RY23/24 incurred costs. We are proposing to disallow £1.278m for RY24/25 and £5.119m for RY25/26.

4.128 DCC did not provide a suitable explanation for the increased forecast costs, for the RY24/25 and RY25/26, for the Security Operations and Cyber fusion programme sub-teams, other than making reference to this being largely driven to a zero baseline. **We propose to reduce the forecast costs for these teams to the levels of the RY23/24 incurred costs. We are therefore minded-to disallow £0.935m for RY24/25 and £1.011, for RY25/26.**

4.129 We note DCC's explanation that resourcing levels for the SEC releases and the In-Life sub-teams within the Operations cost centre remain in line with previous years. However, we have not received any further information that supports the cost variances for the forecast years. With regard to the Capacity Programme resource sub team. DCC has not provided a reasonable explanation for the forecast costs. **We are proposing to disallow £3.937m and £2.297m for RY24/25 and RY25/26.**

4.130 We recognise the importance for DCC to be sufficiently resourced to undertake the work on the Licence extension, the transition to an ex-ante price control as well as the design and appointment of the successor Licensee. We are however not convinced that the proposed resourcing levels are sufficiently justified for the respective workstreams. **We are proposing to disallow for RY24/25 and RY25/26 for the Licence Renewal sub-team, which amounts to £3.532m. This largely corresponds to resourcing levels used to support these workstreams over the course of RY23/24.**

4.131 We do not consider the forecast costs variances for the SMETS1, Network Evolution and MHHS programmes to be sufficiently justified. Given the degree of uncertainty associated with these programmes, **we are proposing to disallow £12.954m in RY23/24 and £7.332m for respectively RY24/25 and RY25/26.**

4.132 We have not received a satisfactory response from DCC which explains the forecast costs variances within the Design and Assurance cost centre. Given the degree of uncertainty of some of these costs materialising, **we are proposing to disallow £1.821m and £5.154m for respectively RY24/25 and RY25/26.**

4.133 Given the uncertainty around the mobilisation of the EPMO team, and the operation of it in the next few years, **we propose to disallow the forecasts**

for the RY24/25 and RY25/26, amounting to £2.450m and £3.075m respectively.

Table 4.3: Proposed forecast disallowances per cost centre in RY24/25 and RY25/26

Cost Centre	RY24/25 (£m)	RY25/26 (£m)	Total (£m)
Corporate Management	0.663	2.869	3.532
Finance	2.450	3.075	5.525
Commercial	-	-	-
Design and Assurance	1.821	5.154	6.975
Programme (Service Delivery)	1.278	5.119	6.397
Security	0.935	1.011	1.946
Operations	3.937	2.297	6.234
SMETS1	-	0.899	0.899
MHHS	1.609	0.268	1.877
Network Evolution	11.345	6.165	17.510
Total	**24.038**	**26.857**	**50.895**

5. Performance Incentives

Section summary

This section covers DCC's submission of its performance under the Operational Performance Regime (OPR), which includes System Performance, Contract Management, and Customer Engagement Incentives.

Under the OPR, we are proposing for DCC to retain the full margin associated with the system performance incentive for RY23/24. In respect of the contract management incentive, under which an auditor assesses DCC's performance against the National Audit Office (NAO) framework, we are proposing to adjust the auditor's score from **2.33 to 2.14 out of 3.** This results in a proposed margin reduction of **£0.383m**.

For the customer engagement incentive, we received submissions from both DCC and SEC Panel on DCC's performance during RY23/24. After assessing both submissions, we are minded to award a score of **2**, corresponding to a reduction of DCC's BM by **£0.261m**.

Consultation questions

Question 15: What are your views on our proposed position on DCC's System Performance?

Question 16: What are your views on our proposed position on DCC's Contract Management?

Question 17: What are your views on our proposed position on DCC's Customer Engagement?

System Performance

Context

5.1 The revised OPR system performance measures have been in place since RY22/23. Under the revised regime, DCC's system performance is incentivised through five measures: 'Service Availability', 'Firmware Management', 'Install & Commission', 'Prepayment (Interim Response Times)', and 'Change of Supplier'. These measures are composed of a selection of the performance measures reports to the SEC. Where applicable, DCC's performance against these measures is assessed across meter generations (SMETS1 and SMETS2) and, for SMETS2, also across meter network regions: North, Central, and South.

5.2 Since RY22/23, three of the five measures carry an equal weighting while the other two have no weighting attached. Table 5.1 below sets out the current

weighting against the margin at risk for the system performance incentive for each measure.

Table 5.1: OPR System Performance measures

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

DCC's Justification (SRV8.11)

5.3 As part of our RY22/23 Decision, we decided to zero-weight one of the five sub-measures within the Install & Commission measure: 'Service Reference Variant (SRV) 8.11 (Update HAN Device Log)'.[45] This decision followed arguments by DCC in its 22/23 Price Control submission that its performance against this sub-measure was not fully within its control.[46] Our decision only applied to SRV8.11 performance for RY22/23.

5.4 Later, in March 2024, we published our revised OPR Guidance Decision, in which we decided to zero-weight SRV8.11 for the revised OPR for RY24/25 onwards.[47] As none of the changes made in this Decision affected RY23/24 (due to it being published within RY23/24 itself), we advised DCC that, in its RY23/24 Price Control submission, it would have to re-submit its case for zero-weighting SRV8.11 for that year.

5.5 DCC has resubmitted its case for zero-weighting SRV8.11 in its RY23/24 Price Control submission. Its arguments are as follows:

- The success rate of, and time taken for, the delivery of SRV8.11 messages is not fully within DCC's control, as actions by DCC's customers when sending the message through the network (such as sending repeat messages when one has not succeeded after a given period of time) can delay messages further

[45] SRV8.11 is a message type primarily sent at the beginning of a smart meter installation to add a device to a Home Area Network (HAN). DCC is incentivised to ensure SRV8.11 messages are delivered within a Target Response Time (TRT) of 30 seconds.
[46] The full background on SRV8.11, and our views on the issue, can be found in paragraphs 5.13-5.41 of our RY22/23 Price Control Consultation.
[47] Revised OPR Guidance decision March 2024 | Ofgem

- DCC's systems were not designed to guarantee performance at a disaggregated level as it would result in a significant amount of redundant capacity across the network for most of the time
- SRV sizes have increased materially since the response times were established back in 2013, and targets and systems have not been updated to reflect this change
- OPR measures should be aligned to service provider contracts to ensure that DCC has commercial leverage and to align incentives with service providers

DCC's submission (overall system performance)

5.6 The total Baseline Margin (BM) at risk against system performance in RY23/24 is £6.258m, equally split across the three weighted measures (detailed in Table 5.1 above). Excluding the performance of the SRV8.11 sub-measure within the Install & Commission measure, DCC met all Target Performance Levels (TPLs) across all three weighted measures in all regions. Table 5.2 below summarises DCC's overall system performance for RY23/24:

Table 5.2: DCC's submitted OPR system performance values

OPR measures	BM at risk (£m)	BM reduction (£m)	Targets [minimum – target] (%)	DCC's performance
SUM1	2.086	0	99.50-98.00	Penalty Mechanism A: 99.93%
SUM2 (Dormant)	0	0	96.00-99.00	Not reported
SDM1	2.086	0	96.00-99.00	Penalty Mechanism B: - North: 99.30% - Central: 99.96% - South: 99.97%
SDM2	2.086	0	96.00-99.00	Penalty Mechanism A: 99.85% Penalty Mechanism B: - North: 100.00% - Central: 99.75% - South: 99.75%
SDM3 (Dormant)	0	0	96.00-99.00	Not reported
Total	**6.258**	**0**	**-**	**-**

Our view

5.7 With regards to SRV8.11, we accept DCC's arguments as to why its performance should again be zero-weighted for RY23/24. Chiefly, we accept DCC's argument that SRV8.11 is not fully under its control, that there is not a practical way to assess and determine how much is under its control, and it would therefore not be fair for DCC to lose margin because of SRV8.11 underperformance. This position is consistent with the positions we have already taken with respect to its weighting for RY22/23 and for RY24/25 onwards in our RY22/23 Price Control Decision and 2024 OPR Guidance Decision respectively.

5.8 **Our minded-to position is, therefore, for DCC to retain the full margin (£6.258m) associated with system performance for RY23/24.**

Contract Management

Context

5.9 RY21/22 was the first year in which DCC's contract management performance was financially incentivised under the revised OPR. DCC's performance is assessed by an independent auditor using the National Audit Office (NAO) Framework, in line with scope and terms of reference set out in the OPR Guidance.[48] RY23/24 marks the third year of the audit.

5.10 The scope of the audit covers DCC's contract management of its Communication Service Providers (Arqiva and VM02), Data Service Providers (CGI) and the three SMETS1 Service Providers who have incurred the highest costs over RY23/24. The audit also assesses DCC's procurement and re-procurement activities in RY23/24 under DCC's Network Evolution programme, including procurement of 4G Comms Hubs and Networks, re-procurement of Data Service Provider (DSP) and Smart Metering Key Infrastructure (SMKI). The scope of the audit also assesses adherence to the SEC Modifications (SEC Mods).

5.11 The final audit report was provided to Ofgem on completion in July 2024.

Audit report

5.12 The audit report, referred to as 'report', sets out the auditors' finding of DCC's performance against each supporting question under the NAO framework. Under the incentive, a score is awarded of 0,1,2 or 3 to each of the individual questions (as set out in Table 5.3). An overall score of **2.33 out of 3** was awarded to DCC by the auditor. Based on further analysis of the information

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

available to us we are minded to reduce the score to **2.14 out of 3** due to DCC's procurement approach and failure to improve the performance of its Suppliers.

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

1. Commercial strategy

Key question

Is there an overarching commercial strategy, with a clear rationale for the approach being taken?

Supporting questions	Score
1.1. Is there a clear and consistently held view of what the contract is producing, the type of commercial relationship desired, the basic contract structure and how it will be managed?	**3**
1.2 Has there been an assessment of strategic drivers, including policy drivers, and the internal and external environment?	**2**
1.3 Has the commercial strategy been based upon the assessment of strategic drivers and the internal and external environment?	**2**

2. Capability & governance

Key question

Does DCC have the capability needed to manage the contract and is it developing capability for the future?

Supporting questions	Score
2.1 Does DCC have the necessary capability, skills and systems?	**3**
2.2 Does DCC understand its future needs and is it working towards meeting them?	**2**
2.3 Has DCC deployed its capability in a balanced way across the lifecycle and is commercial capability effectively integrated with the business?	**2**

3. Market management & sourcing

Key question

Has sourcing supported the commercial strategy and followed recognised good practice to optimise VFM?[49]

Supporting questions	Score
3.1 Has market management driven long term value for money?	**1**
3.2 Was there a defensible process that resulted in the selection of a capable supplier?	**2**
3.3 Was there optimum use of competitive pressure?	**2**

4. Contract Approach

Key question

Does the balance of risk and reward encourage service improvement, minimise perverse incentives and promote good relationships?

Supporting questions	Score
4.1. Is there an appropriate allocation of risk between DCC and the supplier?	2
4.2. Are there incentives to encourage the supplier to act in the interest of DCC?	3
4.3. Are suitable mechanisms established to drive the desired relationship?	2

5. Contract management

Key question

Is the service being managed well, with costs and benefits being realised as expected?

Supporting questions	Score
5.1 Do DCC and the supplier have comprehensive knowledge of service performance?	**3**
5.2. Are the suppliers delivering in accordance with the contracts, and are they actively managed by DCC to meet or exceed requirements (including delivering accurate, timely Impact Assessments)?	**1**
5.3 Is DCC meeting its obligations?	**1**

[49] VFM = Value for Money

6. Contract lifecycle

Key question

Will the service continue to demonstrate VfM through its lifecycle?

Supporting questions	Score
6.1. Does the contract continue to support DCC's strategic intent?	**3**
6.2. Are VFM mechanisms used to ensure the contract continues to deliver VFM over its life?	**2**
6.3. Is change controlled and well managed and does the contract remain current?	**1**

7. Transition & termination

Key question

Is DCC ready for the end of the contract?

Supporting questions	Score
7.1 Has market management been undertaken to support new contracts?	2
7.2 Has the end of the contract been managed effectively to allow re-bid or handover?	3
7.3 Are insights from the operation of the contract brought to bear in developing the new contract?	3

Total Weighted Score 2.14

5.13 The report in general notes the quality of DCC's documentation for contract management and procurement as being consistent with good industry practice. It also notes that staff competency is of sufficient quality and that both the commercial and procurement teams possess sufficient resource and skillsets.

5.14 DCC has implemented several processes to help monitor supplier performance and track associated risks. This includes: a Third-Party Risk Framework (TPRM) approach, a Contract Management Handbook, a Commercial Risk Management Handbook, and the implementation of digital tools and processes.

5.15 The auditor however found that, whilst DCC has taken steps to improve supplier performance, two suppliers are still showing as requiring improvement for a third year in a row.

5.16 The auditors also found that DCC continues to underperform on timelines for its SEC Modifications and meeting the Impact Assessment deadlines.

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

Findings and recommendations from the auditor in regard to procurement and re-procurement

5.18 DCC may benefit from earlier engagement with DESNZ and SECAS during the programme work, which in turn could assist in arriving at a firm set of business requirements in shorter timelines than observed presently. Therefore, early engagement, particularly in relation to re-procurement of contracts, should be a priority for DCC in the next audit period. By prioritising early engagement, it would prevent simultaneous running of procurements and strategy delivery.

Findings and recommendations from the auditor in regard to Contract Management

5.19 The auditor noted:

- DCC should continue to upskill the existing contract management team with new tools and working practices
- Focusing on stakeholder engagement will create value and unlock additional benefits such as more aligned objectives, better service outcomes, and stronger partnerships
- A comprehensive review of the current delegated authority framework is necessary. This review should ensure that all delegations of authority are appropriately aligned with the organisation's strategic goals, risk management policies, and regulatory requirements
- DCC would be well placed to investigate FFDL amid discrepancies between the department and suppliers[50]
- DCC should maintain regular reviews of risk allocation to ensure any risk remains appropriate as circumstances change
- Conducting regular reviews of incentive criteria and monitoring performance outcomes will ensure the continued success and relevance of DCC's incentive framework

[50] Fixed First Discuss Later

Findings and recommendations from the auditor in regard to SEC modifications

5.20 The report noted that, whilst there has been some evidence of improvement over the past 12 months, DCC is continuing to fail to meet the required timescales for Preliminary and full Impact Assessments. As with the last two audits, the auditor has again raised that the timescales of the SEC modifications (SEC Mods) are potentially restrictive as they do not take account of situations where the assessments may not be achievable within the timeframe.

5.21 The auditor also noted that there is still opportunity for DCC to improve the sharing / reporting of improvement performance of the SEC Modifications with interested parties.

5.22 Finally, the auditor also recommended that a meeting between SEC, DCC and Ofgem, to discuss the findings and recommendations outlined in the report, would be beneficial to address the issues that had been identified.

Our view

5.23 Having assessed the audit report as well as additional information provided by DCC to us over the course of RY23/24, together with information shared with us by the SEC Panel and DESNZ, we are proposing to adjust the auditor's scores of **2.33** to a minded-to award score of **2.14 out of 3 to DCC**. This corresponds to a reduction of **£0.383m** of DCC's margin from a possible **£1.341m** available.

5.24 Whilst we consider the majority of the scores awarded by the auditor to be an accurate reflection of DCC's performance, we felt that it was appropriate to reduce the score in some areas given DCC's approach in managing the performance of its service providers as well as DCC's regular use of direct awards. We agree with the auditor that DCC has made improvements by implementing processes to manage the performance of its service providers, however, we have not received evidence that the intended outcomes of these processes have been achieved yet. Our decision to propose a reduced score in some of the areas is further supported by the fact that many of the findings of this year's audit are similar to those of the RY22/23 audit and have not been fully addressed in RY23/24.

5.25 One of the areas we are concerned with is DCC's continued use of awarding direct awards notwithstanding the default obligation under the Licence requiring a competitive procurement.[51] The Licence expects DCC to drive a fair and

[51] Licence Condition 16

effective procurement process, and consequently, this should be treated as the primary expected vehicle to deliver value for money. Given DCC's lack of improvement to use market engagement to drive value for money and ensure 'optimum use of competitive pressure', we are proposing to reduce the scores for questions 3.1 and 3.3.

5.26 We are also concerned with the ongoing issues with supplier performance as, for the third year in a row, some of them are continuing to show in the Annual Service Report (ASR) as requiring improvement. Whilst we understand that the auditor has noted the processes which DCC has taken to improve supplier performance (like implementing contract management approach, commercial risk handbook, putting suppliers on improvement plans etc), we are proposing to reduce the scores on the basis that some of the results have yet to materialise. As these processes have been newly implemented, we will not be able to see the improvements in supplier performance be fully realised until the next audit. Based on the fact that, at present, the ASR is still showing that some suppliers need improvement, along with the findings of the auditor's report and our own internal assessment, we are proposing to reduce the scores for question 4.1 from 3 to 2.

5.27 The auditor further noted that, although a moderate number of suppliers are meeting the demands of their contracts, there is little to no evidence of suppliers exceeding expectations. The auditor also mentioned that there are suppliers who have failed to meet the desired performance levels. As mentioned above, DCC has taken steps to improve supplier performance, however, based on the fact two of the suppliers have been performing poorly for the past two years and are continuing to show poor performance, we are proposing to reduce the score for question 5.2 from 2 to 1.

5.28 We consider that the audit report sets out a comprehensive overview of DCC's contract management activities in RY23/24. We expect DCC to take reasonable steps to address the issues and recommendations presented, including through further engagement with industry, DESNZ, the SEC Panel and any other relevant stakeholders.

Customer Engagement

Context

5.29 This is the third year in which DCC's customer engagement will be financially incentivised under the revised OPR. DCC's performance in this area has been assessed based on qualitative submissions received from both DCC and SEC

panel. The assessment covers three sections: timing and frequency of engagement; quality of information provided by DCC; and accountability of customer views.

5.30 The three sections under customer engagement each have three assessment questions with relative weightings. The individual weighting for each assessment question is calculated as one third of its section weighting, with the overall score calculated using a weighted average of the scores specified for each question. For full details on the scoring methodology please refer to our guidance.[52]

5.31 To inform the scoring, we received submissions from both DCC and SEC Panel on DCC's performance during RY23/24 against the criteria set out in the March 2023 OPR Guidance document. We considered both the submissions and evidence provided to assess DCC's customer engagement performance in RY23/24.

DCC and SEC submission

Timing and frequency of engagement

5.32 DCC understands that the strength of its decisions depends on regular and timely engagement with customers. It has established a range of engagement mechanisms to enable customers to feed in views at appropriate points and with appropriate frequency.

5.33 DCC notes that it actively engaged with customers during RY23/24, ensuring it sought customer feedback at appropriate times during each stage of the programme delivery. Following trials in 2022, DCC has arranged a cycle of monthly meetings with the Chairs of SEC sub-committees to provide early sight of programme engagement. DCC states that these meetings highlight engagement three months ahead to gather feedback, support and provide assurance that the right committees and customer groups are being engaged at the right time. DCC also mentioned that they have worked with SECAS to develop a shared industry calendar to bring together details of upcoming engagements

5.34 DCC cited specific examples such as the re-procurement of the DSP, the delivery of the Scaling and Optimisation programme, and the Future Connectivity Strategy, which it believed were prime examples of how it enabled customers to feed in views. DCC mentioned how it used the Programme Assurance Policy

[52] Ofgem (2023), OPR Guidance

(PAP), which it developed with SEC Panel in 22/23, as well as the Business Case process as models to engage with customers across the programme lifecycles.

5.35 DCC also made reference to its RY23/24 Business and Development Plan (B&DP). DCC stated to have captured insights at two customer workshops where it discussed their views, inputs, areas of concern and how they should prioritise, and it ran a further drop-in session during the consultation period.

5.36 DCC stated that it provided sufficient notice of their regular consultations with customers having a minimum of 20 days to contribute their views and run additional customer sessions ahead of, or during the consultation window, where it is beneficial. DCC state 97% of Major Incident communications were delivered within Service Level Agreement (SLA) in RY23/24.

5.37 Overall, DCC considers that it had made concerted efforts to enable customers to feed in their views at appropriate points and frequency in RY23/24 and have met the higher standard. Based on this, DCC proposed an average score of 2.66 for this assessment section.

5.38 According to the submission by SEC Panel, they received a varied level of customer engagement from DCC. They stated that it is not always clear from DCC what the impacts are of its consultations and there is limited visibility of background work for parties to understand progress.

5.39 SEC stated that general information updates were typically delivered well through SEC forums, however DCC's performance was not consistent. They made reference to information on expiry dates for dual band comms hubs not being properly communicated to parties and noted that the Test Automation Framework and Future Service Management programme updates from the DCC to SEC sub-committees were poorly timed.

5.40 SEC made reference to a consultation on proposed changes to power outage alerts where parties were not provided with sufficient time to produce a response.

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

Quality of information provided by DCC

5.42 DCC is aware of the need to deliver high quality information to its customers. SECAS rated DCC with an average quality score of 98% for RY23/24 across all Sub Committees indicating that the majority of DCC's papers were readable and comprehensible. DCC believes it has met the required standard and has

consistently produced information that is of sufficient quality for broader engagement.

5.43 DCC provided an example of a range of new ways used in RY23/24 to provide more detailed cost information. It has agreed a new approach to increase SEC Panel visibility of commercial arrangements and invitation to tender evaluations as part of the DSP core and system integrator procurement process as well as worked with incumbent service providers to put in place appropriate Non-Disclosure Agreement and classified sub-committee session appropriate to enable them to share a greater level of cost detail.

5.44 DCC also advised that it had implemented changes to increase the range of information shared with customers, including direct engagement with customers and / or through SEC sub-committees, sharing unredacted SOCs and OBCs with SEC Panel and presenting customers' needs and costs to SEC Panel at the end of each engagement phase.

5.45 DCC stated that it had tailored information to compliment customers' own metrics and business processes by providing a combined monthly operational update for OPSG from May 2023 and have held dedicated incident-themed workshops with customers to provide more information on DCC's approach to incident categorisation and handling. DCC also introduced a SEC Mod to measure its performance against the end-to-end business process, which it stated will identify the internal and external issues causing failure.

5.46 Overall, DCC considers that its information is of a quality standard and proposed an average score of 2.33 for this assessment section.

5.47 SEC mentioned that the quality of information provided by DCC to Panel, Sub Committees and SEC Parties varies. They noted that requests for actions from the security sub-committee were not forthcoming on some occasions and provided an example of Order Management System updates, which have been unclear from DCC in terms of quality of information and required detail.

5.48 SEC acknowledge that DCC have been willing to establish new arrangements via SEC Panel Sub-Committee Chairs by scheduling monthly programme and engagement meetings. However, SEC mentioned that further work is needed to provide greater visibility of these meetings to SEC Panel and SEC Parties.

5.49 SEC noted concerns surrounding transparency of costs with DCC, particularly around the sharing of Outline Business Case Information. SEC also provided an example of the 3G sunsetting impacts and decisions, which was requested to be

made by DCC users from the DCC with limited information to aid the decision-making process.

5.50 SEC made reference to communication from DCC not being tailored towards DCC customers, as it can contain too much technical detail. SEC provided the example of the Major Incident reports, which includes many acronyms and can be difficult to understand.

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

Taking account of customer views

5.52 DCC explained that it had utilised various engagement methods to help stakeholders understand which issues they are able to contribute views towards. DCC published 25 consultations and facilitated 36 workshops which covered regulated and non-regulated areas of its work. One example evidence by DCC is the Business Disaster Recovery Testing consultation which provided the opportunity for customer views to be considered. DCC noted they provided clear explanation of how customers views would be taken forward.

5.53 DCC advised that it had implemented a range of new ways in RY23/24 to provide more detailed cost information to customers such as providing the SEC Panel with visibility of DSP Core and DSP SI commercial arrangements as well as providing cost ranges of shortlisted options in the OBC for their S&O programme.

5.54 DCC also advised that it has also set up an internal Demand and Capacity Assurance Group (DCMAG), which reviews DCC's information and data gathered from bilateral meetings with customers to develop a demand forecast that continues to be shared with industry on a quarterly basis and support solutions needed to manage demand and capacity issues.

5.55 DCC noted that it regularly seeks feedback from customers to inform decisions across strategic, operational and programme related topics.

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

5.57 SEC acknowledged that, in general, DCC seeks to ensure customers understand issues.

5.58 One SEC party commented that "DCC did not always make clear the DCC User role which is impacted." Another respondent commented that "DCC's responses to consultations typically do demonstrate where/why customers views have been taken into account or alternatively have been discounted."

5.59 Several respondents noted concerns throughout the Regulatory Year with the DCC Quarterly Finance Forum (QFF), with one respondent commenting that DCC programme business cases were presented at DCC's QFF as a *"fait accompli"* and cited that the Business Accuracy Programme was subject to limited scrutiny during its scoping and development.

5.60 SEC stated that DCC do not always make clear how it has used and incorporated the feedback it has received, particularly within their consultation decisions. One respondent stated that "they did not feel they understood how the views provided to DCC had shaped the next steps from the DCC."

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

Our view

5.62 It is apparent that DCC is progressing in its customer engagement strategy with positive examples stated in its submission. We appreciate that DCC has provided some examples of facilitating customer views at appropriate times and being proactive to establish new arrangements via SEC Panel Sub-Committees, however there are raised examples of DCC not providing timely and clear updates to SEC sub-committees and poor communication across different forums.

5.63 DCC has made improvements in customer engagement via working with SEC sub-committees. However, there have been some examples of inadequate engagement practices around FSM programme and Test Automation Framework updates to SEC sub-committees.

5.64 We recognise DCC provided examples of taking into account customers' views, however there are mixed opinions from customers on the extent to which their views have shaped the next steps from DCC.

5.65 We note that DCC has arranged new ways to provide more detailed cost information to its customers. Whilst this information is shared in the monthly programme and engagement meetings between Sub Committee Chairs, SEC Panel Chair and DCC programme and stakeholder engagement representatives, it is recognised that work is needed to provide greater visibility of these meetings to SEC parties.

5.66 Overall, we consider that DCC has made sufficient efforts to engage and seek views from stakeholders, but there needs to be greater consistency with its quality of customer engagement and ensuring customers understand how their views have informed its decision-making. Based on the submissions received,

our minded-to position is to award an overall score of 2, corresponding to a Baseline Margin reduction of £0.448m from a possible £1.33m available. A breakdown of the scores is provided in Table 5.4 below.

Table 5.4: Customer engagement assessment criteria

Assessment Questions	Ofgem Score	SEC Score	DCC Score
Timing and frequency of engagement			
1. Has DCC enabled customers to feed in views at appropriate points and with appropriate frequency in decision-making cycles?	2	2	3
2. Has DCC provided appropriate notice and allowed sufficient time for customers to contribute views?	3	2	3
3. Has DCC provided general information to customers in a timely manner and with sufficient frequency? (Including general updates, reactive engagement on unplanned issues)	2	2	2
Average score	2.33	2	2.66
Quality of information provided by DCC			
4. Has DCC provided its customers with sufficient quality of information to allow them to feed into a decision-making process? (e.g. clear costs and benefits and/or consequences of decisions)	2	2	3
5. Has DCC provided sufficient quality of information in its broader engagement (e.g. general updates, reactive engagement etc) for customers to understand the issues and the actions DCC is taking?	2	2	2
6. When engaging with customers, has DCC ensured to engage with relevant audiences, and tailored the information appropriately?	2	2	2
Average score	2	2	2.33

Taking account of customer views			
7. Has DCC ensured its customers understand on which issues their views will inform decision-making?	2	2	3
8. Have DCC's decisions demonstrated that customer views have been taken into account?	2	2	2
9. Has DCC clearly explained how customer views have informed its decision making, and where relevant why DCC has disagreed with customer views?	2	2	2
Average Score	2	2	2.33
Final weighted score	**2.11**	**2**	**2.47**

6. Baseline Margin and External Contract Gain Share

Section summary

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

DCC applied for an adjustment of £31.537m for RY23/24 to RY25/26. We are minded to reject part of the application for some of the grounds and activities, reducing the Baseline Margin Adjustment to £4.918m. In addition, DCC cannot receive a Baseline Margin Adjustment on Internal Costs that are not economic and efficient. We calculate the effect of our proposed Internal Cost disallowances to be £2.919m. **We therefore propose to amend DCC's Baseline Margin Adjustment application and allow £1.994m**.

DCC applied for an adjustment to its ECGS of £4.991m across for RY23/24. This adjustment relates to the continuation of re-financing arrangements, the financing of Communication Hubs (CHs), and the operation of DCC's in-house test lab service. **We propose to accept DCC's ECGS adjustment application in full**.

Questions

Question 18: What are your views on our assessment of DCC's application to adjust its Baseline Margin?
Question 19: What are your views on our assessment of DCC's application to adjust its External Contract Gain Share?

Baseline Margin Adjustment

Context

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

6.2 The BMA mechanism was included in the Licence in recognition of the uncertainty of the nature and risks of DCC's Mandatory Business over the Licence term. The adjustment mechanism is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business – including the volume, characteristics, risks and timescales of these activities. Greater detail of the conditions and requirements for a Baseline Margin Relevant

Adjustment can be found in the RIGs, and the processes and procedures document.[53]

DCC's application

6.3 Alongside its RY23/24 Price Control submission, DCC has applied for a £31.537m Relevant Adjustment to its Baseline Margin for work performed (or forecasted) in RY23/24, RY24/25, and RY25/26. This represents a significant increase compared to prior years' applications. For context, in RY22/23, DCC applied for £24.02m; and in RY21/22, DCC applied for £13.27m.

6.4 It is important to note that DCC also applies for negative adjustments to its Baseline Margin as part of its application to correct for over-estimates or underspend against prior applications. This means the gross value of DCC's application is higher than £31.537m.

6.5 DCC has identified 13 grounds for a BMA this year. 12 have been included in previous years' BMA applications and are associated with existing drivers: increased cost certainty, technology-driven change, supporting a changing business, operational change, and changes to DCC's supply chain structure. One new driver was raised in this year's application: 'Regulatory Requirements'. Within this driver, one new ground was raised: Licence Renewal. The drivers and grounds under which DCC has applied for a BMA this year are summarised below.

Table 63.1: Activities and their corresponding drivers identified in the Baseline Margin Application

Change Driver	Grounds (resource and non-resource)	Driver first raised
Certainty	SMETS1	RY16/17
	Network Evolution	RY19/20
	ECoS	RY18/19
	Facilitating Additional Relevant Service Capability	RY18/19
	MHHS	RY20/21
	People Transformation	RY17/18

[53] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, Section 4: Baseline Margin Adjustment. DCC Price Control Guidance: Processes and Procedures 2022 | Ofgem

Change Driver	Grounds (resource and non-resource)	Driver first raised
Technology Driven Change	Security Driven Change	RY17/18
	Technology Transformation – General	RY17/18
Supporting a Changing Business	Support – Resourcing Planning and Management	RY17/18
	Increase in Customers	RY17/18
Operational Change	Ops – Service Standard Expectations	RY18/19
Change to DCC's Supply Chain Structure	Increase in Commercial Activity	RY18/19
Regulatory Requirements	Licence Renewal	RY23/24

'Certainty'

6.6 DCC is applying for a BMA through 6 different, pre-existing grounds under the Certainty driver: 'SMETS1', 'Network Evolution', 'ECoS', 'Facilitating Additional Relevant Service Capability', 'MHHS', and 'People Transformation'.

6.7 DCC first applied for a BMA for the SMETS1 programme in RY16/17. This ground relates to business-as-usual (BAU) work on the SMETS1 service. In RY23/24, work in this area fell into three workstreams: Maximising Migrations, Device Swap Out, and FOC Stabilisation. The basis for application is largely in line with those in previous years. DCC is applying for an adjustment over the next 3 years of £1.654m due to new activities and increased certainty with this ground.

6.8 DCC first applied for a BMA for Network Evolution Programme (NEP) in RY19/20. The programme is aimed at supporting the long-term enhancement of DCC platform, simplifying the network's design with greater resilience and enabling faster and more cost-effective change. DCC has applied for a BMA on activities within the following Network Evolution sub-programmes: DSP, DSMS, Communication Hubs & Networks (CH&N, PKI Enduring Services, and Test Automation. The basis for application is largely in line with previous years. DCC is applying for a BMA of £6.121m over the next three years due to increased certainty for this ground.

6.9 DCC first applied for a BMA for the Enduring Change of Supplier (ECoS) Programme in RY18/19. DCC has applied for a BMA on resource and non-

resource costs. In terms of non-resource costs, activities include test assurance and change and project requests for the ECoS Service Providers. DCC's application under this ground totals £0.063m over the next three years.

6.10 DCC first raised the 'Facilitating Additional Relevant Service Capability' driver in RY18/19. Like last year, DCC's application under this ground is further divided into three sub-grounds: 'Brabazon House/Test Lab Operator', 'Other accommodation', and 'Other activities facilitating additional relevant service capability'. The first sub-ground relates to activities at Brabazon House, which hosts DCC's Test Labs and the Technical Operations Centre (TOC). The second sub-ground relates to non-Test Lab-related accommodation costs, including Project Gold, a refurbishment and workspace improvement project. The third sub-ground, which was also raised last year, relates to a number of additional resource and non-resource activities stemming from:

- Significant increase in the demands on project, programme and portfolio management activities arising from DCC providing a range of new capability and Programme services
- Work to analyse potential cost savings on resources within DCC through piloting Managed Service Provider activities and offshoring of certain functions
- Material changes to the nature of the testing activities that DCC is now required to perform
- System engineering and other technical device on the design of amendments to DCC's systems
- Additional obligations on DCC arising from BEIS taking powers under LC13 to require DCC to develop HMT Green Book compliant business cases[54]
- Additional activities to manage capacity on the network arising from a significant increase in the size and type of messages traversing DCC's systems, that were not provided for in the original Licence Application Business Plan, or in prior BMA applications.

6.11 DCC is applying for a BMA on both resource and non-resource costs over the next 3 years under this ground, totalling £17.303m. This is a significant increase on last year's BMA application of £5.040m under this ground.

6.12 DCC first applied for a BMA for the Market-wide Half-Hourly Settlement (MHHS) Programme in RY20/21. The application was based on the grounds that DCC is

[54] LC13: Arrangements relating to the Transition Objective

expected to play a central role in the MHHS solution, as its network would need to be able to accommodate the increased volume and regular retrieval of meter data. In RY23/24, activities under this programme related to DCC supporting its System Integration Testing (SIT) and Migration phases, as well as the planning of the delivery of additional programme requirements. DCC is applying for a BMA £0.107m across the next 3 years under this ground.

6.13 DCC first applied for a BMA under the 'People Transformation' ground in RY17/18. This ground relates to the activities of DCC's People team, which in RY23/24 included pay and reward work as well as welfare and additional staff training. DCC is applying for a BMA of £0.099m across the next 3 years under this ground.

'Technology Driven Change'

6.14 DCC is applying for a BMA under the 'Technology Driven Change' driver through 2 previously approved grounds, both first raised in RY27/18: 'Security Driven Change' and 'Technology Transformation – General'.

6.15 The 'Security Driven Change' ground relates to activities enabling the transformation and enhancement of DCC's security model. In RY23/24, DCC achieved full resourcing to provide 24/7 monitoring of the DCC network for security events and added the ECoS service provider to its security event log feeds. In RY24/25, DCC anticipates adding further external service providers to its event monitoring systems. DCC is applying for £1.221m over the next 3 years under this ground.

6.16 The 'Technology Transformation – General' ground relates to costs for sourcing cloud skills to support commercial, legal regulatory and technological developments. DCC argues that these skills are necessary to ensure consistent use of cloud solutions. In RY23/24, DCC continued work on developing the use of cloud solutions in these areas and is applying for a BMA £0.580m over the next 3 years under this ground.

'Supporting a Changing Business'

6.17 DCC is applying for a BMA under the 'Supporting a Changing Business' driver through 2 previously approved grounds, both first raised in RY17/18: 'Resource Planning and Management' and 'Increase in Customers'.

6.18 The 'Resource Planning and Management' ground relates to establishing and improving processes focused on the delivery of greater business accuracy, controls, and compliance. DCC state that in RY23/24 it mobilised its Business Accuracy Programme to improve and streamline its planning, forecasting and

reporting processes. DCC also reported non-resource costs arising from the use of external experts to review these systems and deliver improvements to them. DCC is applying for a BMA £1.909m across the next 3 years under this ground.

6.19 The 'Increase in Customers' ground relates to work DCC delivered to improve customer onboarding and offboarding processes to and from its systems as well as work on charging its growing range of customer types more effectively (specifically 'Other Users'). DCC is applying for a BMA of £0.228m under this ground.

'Operational Change'

6.20 DCC is applying for a BMA under the 'Operational Change' driver through 1 ground: 'Service Standard Expectations'. This ground was first raised in RY18/19 and relates to investments in DCC's operational capacity. DCC states that the introduction of new services such as the Network Evolution, ECoS and MHHS Programmes – and the challenges and complexities that these bring in terms of operational requirements – are different to those for its existing services (eg SMETS1, SMETS2, and Switching). In addition, due to these complexities, engagement between DCC and its customers has become more technical and frequent.

6.21 In RY23/24, DCC's work focused on assessing the efficacy of its in-life supplier management processes and developing and implementing improvements to them, following feedback from its customers that these processes were less efficient than desired. DCC is applying for a BMA of £0.324m across the next 3 years under this ground.

'Changes to DCC's Supply Chain Structure'

6.22 DCC is applying for a BMA under the 'Changes to DCC's Supply Chain Structure' driver through 1 ground: 'Increase in Commercial Activity'. This ground was first raised in RY18/19 and relates to the activities of DCC's Commercial function, which is responsible for the commercial management of DCC's External Service Providers, including contract and supplier relationship management, contractual frameworks, and procurement of new service contracts.

6.23 DCC's application this year relates to both BAU activities, such as contract changes, sourcing activities, and extension of the DSP contract; and new work, such as its improvement programme which has delivered enhanced digital capabilities, a new benefits and savings programme, and a material controls process to promote best practice with regards to the management of contracts

and supplier performance. DCC is applying for a BMA of £1.254m across the next 3 years under this ground.

'Licence Renewal'

6.24 DCC is applying for a BMA under a new driver, 'Licence Renewal', through one new ground, 'Regulatory Requirements'. This driver (and ground) relates to work DCC has performed on the following activities driven by the expiry of the current DCC Licence in September 2027:[55]

- The transition to an ex-ante price control model
- The Business Handover Plan (BHP), which sets out how DCC will transition its Authorised Business to the successor DCC Licensee
- The tracing and mapping of operational dependencies and contractual relationships DCC shares with its parent company, Capita
- The design of "DCC2" (ie the successor Licensee)

6.25 DCC argues that the above workstreams represents a material increase in volume and complexity of its work as:

- The work was not envisaged in the LABP and has not been previously funded.
- The work to design a new regulatory framework is extremely complex, with expert advice required to deliver a large number of policy papers and analysis.

6.26 DCC is applying for a BMA of £0.424m under this ground.

Our view

6.27 We consider that the conditions for DCC to make a Relevant Adjustment to its Baseline Margin have been met for some of its application. However, DCC has not provided sufficient evidence to support the full amount for which it has applied. Additionally, we have significant concerns with the DCC's application regarding its resource costs.

'Facilitating Additional Relevant Service Capability'

6.28 As mentioned above (in paragraph 6.11), DCC's application for a BMA under the 'Facilitating Additional Relevant Service Capability' ground has increased significantly from RY22/23, from £5.040m to £17.520m. The vast majority of

[55] In September 2024 we published our decision to extend the current Smart Meter Communication Licence by 2 years, from September 2025 to September 2027. The details behind our decision can be found here: Decision on the continuation of the Smart Meter Communication Licence and the rate of Shared Service Charge and Baseline Margin | Ofgem

this increase is driven by the resource cost component, from £2.658m to £14.226m.

6.29 DCC explained in its application that changes to its internal time sheeting system (which now allow it to allocate resource to a given project on a more granular level than in prior years) have affected the functionality of the model it uses to calculate its BMA application and allocate the application to the relevant drivers and grounds. To accommodate these functionality issues, DCC has allocated the entirety of its core resource BMA application (ie, the portion of its resource costs not directly tied to a programme such as SMETS1, ECoS, MHHS, or Network Evolution) to the 'Facilitating Additional Relevant Service Capability' ground in its model.

6.30 We have numerous concerns with this approach. Firstly, it detaches the resource costs for which DCC is applying for a BMA from the true activities that its staff are actually working on. Historically, DCC's BMA application for resource costs is spread across several grounds as, in reality, there are several different drivers and motivations for the work its staff are doing. For example, in its RY22/23 application, DCC applied for a BMA on resource costs through 12 different grounds. 4 of these grounds related to specific programmes, meaning DCC's core resource application was spread across 8 different grounds.[56] DCC's application approach this year means we cannot accurately assess whether its core resource application warrants a Relevant Adjustment, as we cannot be sure that the grounds under which they have been applied for are genuine.

6.31 Secondly, this approach means that the potential *true* drivers and grounds for the costs in question – used elsewhere in DCC's BMA application for non-resource costs – have been under-utilised, which understates the amount of money and resource that DCC has spent on work with grounds that we would otherwise consider as valid for a BMA. The grounds and drivers which we are minded to accept (which we cover later in this section) likely have significant resource cost attached to them that could be eligible for a BMA, which has been mis-allocated in DCC's application.

6.32 Thirdly, the ground that DCC has chosen to apply its core resource BMA application under – 'Facilitating Additional Relevant Service Capability' – is one for which we have rejected significant portions of past BMA applications, including as recently as RY22/23. For context and completeness, we will

[56] See table 6.1 in our RY22/23 Price Control Consultation for a summary of DCC's BMA application for that year.

summarise our rationale behind our rejections against this ground in RY22/23 in the following paragraphs.

6.33 In our RY22/23 consultation, we rejected £0.49m of DCC's BMA application under the 'Facilitating Additional Relevant Service Capability' ground. This related specifically to activities raised under 1 of the ground's 3 sub-grounds, 'Other Activities Facilitating Additional Relevant Service Capability'. DCC stated that the costs it was applying for a BMA under this sub-ground fell into six categories:

- [Costs driven by a] significant increase in the demands on project, programme and portfolio management activities arising from DCC providing a range of new capability and programme services
- Work to analyse potential cost savings on resources within DCC through piloting Managed Service Provider activities and offshoring of certain functions
- Material changes to the nature of the testing activities that DCC is now required to perform
- System engineering and other technical device on the design of amendments to DCC's systems
- Additional obligations on DCC arising from BEIS taking powers under LC13 to require DCC to develop HMT Green Book compliant business cases
- Additional activities to manage capacity on the network arising from a significant increase in the size and type of messages traversing DCC's systems, that were not provided for in the original Licence Application Business Plan, or in prior BMA applications.

6.34 DCC justified this application on both the basis that these costs represented a material increase in both the volume and complexity of its work. We accepted DCC's justifications via the 'increase in complexity' criterion, which were that it was not provided ex-ante funding allowances to recognise the complexity of running a multi-programme business. Furthermore, it was also not funded for investing in taking analytical and remedial action arising from significant changes in the expectations on the system, and specifically message size in CSP North, which has resulted in extra costs as DCC proactively takes steps to improve performance for customers.

6.35 We proposed, and ultimately decided, to reject the BMA applied for on all the activities above except for those related to 'managing capacity on the network' (the final bullet point above), as we considered that only these activities related

to the valid justification DCC provided around the 'increase in complexity' criterion for a BMA.

6.36 This year, DCC has re-used both the descriptions of the activities included under this sub-ground (ie the bullet points above), as well as its arguments around how these costs represent an increase in the volume and complexity of its activities.

6.37 Given that there is no change in DCC's description of the activities within, or justification of, this sub-ground for this year, we again propose to **reject all of DCC's *non-resource* BMA application under the 'Other Activities' sub-ground except for activities related to "managing capacity on the network", which amounts to a proposed reduction of £2.907m over the next 3 years**. This is consistent with our proposal from RY22/23.

6.38 However, we cannot ascertain the portion of DCC's £14.226m *resource* BMA application under the 'Facilitating Additional Relevant Service Capability' ground that it intended to justify under the 'Other Activities' sub-ground. Further to this, given our concerns with the accuracy of DCC's resource BMA application under this ground (as described in paragraphs 6.28-6.31), **we propose to reject the positive portion of DCC's resource application under this ground in full, amounting to a reduction of £21.115m over the next 3 years.** Note that this figure represents the gross positive value of this portion of DCC's application, excluding any negative BMA applications.

6.39 Should DCC wish to potentially reduce the scale of this reduction, we invite it to re-submit the resource component of its BMA application under this ground with its activities allocated to more appropriate grounds, alongside sufficient justification as to how these costs meet the Licence Condition (LC) criteria for a BMA.

6.40 Lastly, DCC has re-applied for a BMA on some activities under the 'Other Accommodation' sub-ground within this ground, which we rejected last year. **We propose to reject the BMA application associated with these activities, which amounts to a reduction of £0.125m over the next 3 years.**

'Licence Renewal' ground

6.41 Regarding the new ground, 'Licence Renewal', raised by DCC this year, we do not consider it to meet the Licence's criteria for a BMA. This is because, in our view, DCC has not been able to demonstrate a material increase in volume

and/or complexity of its activities, nor do we consider DCC to have met the application window requirement for a BMA.

6.42 DCC's application under this ground relates to 4 workstreams (described in paragraph 6.24 above). We cover each in turn below:

- Transition to *ex-ante* price control: while work on the transition to an ex-ante price control has been conducted within the context of the DCC Review, which also concerns Licence renewal, we disagree that this work specifically relates to Licence renewal. The transition to an *ex-ante* price control model is intended to take place within the course of the current DCC Licence (ie before September 2027). Therefore, we do not consider this work relevant to the grounds under which it has been raised. The drivers behind the transition are improvements to business planning and forecasting, which are enduring elements of work we expect from DCC already. Furthermore, we do not consider DCC has met the application window requirement for this portion of its application, as work on the transition to an ex-ante price control model began in RY20/21 following the publication of our Call for Evidence to feed into Phase 1 of the DCC Review in February 2021.[57] Similarly, Phase 1 of the DCC Review Consultation was published in September 2022, ie RY22/23.[58] We therefore do not consider that the grounds here were first identified in RY23/24.
- BHP: DCC argue that *"the work required to support Ofgem* [with regards to Licence Renewal] *was not envisaged in the LABP"*. However, the requirement for the development and review of the BHP has existed in the Licence since it was first awarded to DCC. LC43.19 requires an annual review of the BHP, which DCC has conducted since the first year it was first awarded the Licence. While DCC's growth beyond what was forecast at the time of the LABP may mean that more work is required to review the BHP, the underlying principles of a robust and well-reviewed BHP have not changed since its inception.
- Tracing of Capita dependencies: we consider this activity part of the BHP, as comprehensive knowledge of Capita's ongoing activities within the DCC network will be required at the time of the handover of the Licence. DCC's work on this is provided to us through subsidiary documents of the BHP. Furthermore, every Capita dependency in the network will have been

[57] Call for evidence: Review of the DCC licence arrangements | Ofgem
[58] DCC review: Phase 1 Consultation | Ofgem

decided by DCC's own actions; there are no Licence obligations for DCC to use resources from its parent company.

- The design of "DCC2": while the specificities of the work performed by DCC (as well as Ofgem and other industry stakeholders) on the design of the successor Licensee will not have been known at the time of the LABP, we do not consider that this work would have ever been envisaged as not involving input from the incumbent Licensee. Similarly, as discussed above in relation to the claim for work on a transition to an *ex-ante* price control, we believe DCC has missed the application window for this work, given work to review the DCC Licence began in RY20/21.

6.43 **For the reasons above, we are minded to reject the application of a BMA under the grounds of 'Licence Renewal', on the basis we do not consider it to meet the Licence's criteria for a BMA. This amounts to a proposed reduction of £0.424m over the next 2 years.**

Cost variances below £150k

6.44 Similar to last year, DCC has applied for a BMA on over 100 non-resource activities with immaterial (<£150k) costs. We rejected all BMA applied for on these activities as the activities themselves had not been justified elsewhere in DCC's submission, stating that, while we typically do not expect justification of activities with cost variances below £150k as part of the price control process, we do expect justification of the cost variance of any activities on which DCC is applying for a BMA.59As with last year, DCC explained that it has expanded the scope of its BMA application (by including activities with immaterial or small cost variances) in order to meet the Licence requirement of applying for a BMA on activities within the first RY that the grounds for the BMA are identified *(*ie meeting the application window). However, DCC has not provided any further justification on the cost variances behind the vast majority of these activities**. We are therefore minded to reject the positive BMA application for all non-resource activities with unjustified cost variances below £150k, which amounts to a proposed reduction of £1.818m over the next 3 years.** However, DCC is able to re-apply for a BMA on these activities in future years. DCC state in their application that "*Ofgem rejected all DCC's applications for expenditure items below £150k in RY22/23, citing immateriality. This contradicts Ofgem's own guidance, and the Licence."* To clarify, and re-iterate

[59] See paragraph 6.31 of our RY22/23 Price Control Consultation: DCC Price Control decision: regulatory year 2022 to 2023 | Ofgem

what we have stated above, we did not (and do not this year propose to) reject this portion of DCC's BMA application because it related to immaterial cost variances, but rather because these variances had not been justified, which, if DCC is applying for a BMA on them, is necessary.

Other proposed reductions and proposed Baseline Margin Adjustment

6.45 DCC cannot receive a BMA on costs, incurred or forecast, that are not economic and efficient and have been disallowed as Unacceptable Costs as part of the price control process**. We calculate the effect of our proposed cost disallowances on DCC's BMA application to equal a reduction of £2.919m over the next 3 years.**

6.46 Additionally, DCC has applied for a BMA on 12 other non-resource activities which we rejected last year across the following grounds: 'SMETS1', 'Increase in Commercial Activity', 'Resourcing Planning and Management', Security Driven Change', and 'Tech Trans – General'. **We propose to reject any BMA applied for through these activities, amounting to a proposed reduction of £0.194m over the next 3 years**.

6.47 Due to the ex-post nature of the Price Control, the Baseline Margin Adjustment is recovered by DCC two RYs after the RY in which the work on which it is based was performed. The years to which are proposing to make the adjustment is made to are RY25/26, RY26/27, and RY27/28.

6.48 Taking all of these disallowances and rejections into account, **we propose to reduce DCC's Baseline Margin Adjustment application by £29.543m, therefore amending the final BMA to £1.994m,** which would be applied between RY25/26 and RY27/28 as shown in table 8.4 below.

6.49 We note that the overall proposed BM Adjustment is negative for RY25/26 and RY26/27. This results from a combination of the relatively large proposed rejection of margin applied for under the 'Facilitating Additional Relevant Service Capability' ground as well as further reductions in margin that have resulted from previously forecasted costs (for which a BMA was previously awarded) not materialising. For clarity, this does *not* represent a reduction to any margin DCC has already earned, but rather the margin to be put at risk against DCC's various performance adjustment schemes in these respective RYs.

6.50 When determining any Relevant Adjustments to DCC's Baseline Margin, the Licence Condition 36.A10 (b) requires us to have regard to DCC's expected rate of return on its activities over time. As in previous Price Controls, we considered a 15% margin acceptable for RY23/24.

6.51 **For RY23/24, we continue to award a margin level of 15%.**

Table 6.2: Proposed Baseline Margin compared to Baseline Margin as of the RY22/23 Price Control Decision

Baseline Margin (£m)	RY25/26	RY26/27	RY27/28	Total
Baseline Margin as of RY22/23 Decision	6.754	4.239	0.000	**10.993**
Adjusted by RY23/24 application (Difference from RY22/23)	15.468 (8.714)	11.839 (7.600)	15.224 (15.224)	**42.530** **(31.537)**
Adjusted by RY23/24 Consultation proposal (Difference from RY22/23)	5.839 (-0.916)	3.600 (-0.639)	3.548 (3.548)	**12.987** **(1.994)**

Figure 6.1: Comparison between DCC's application and our proposed adjustment

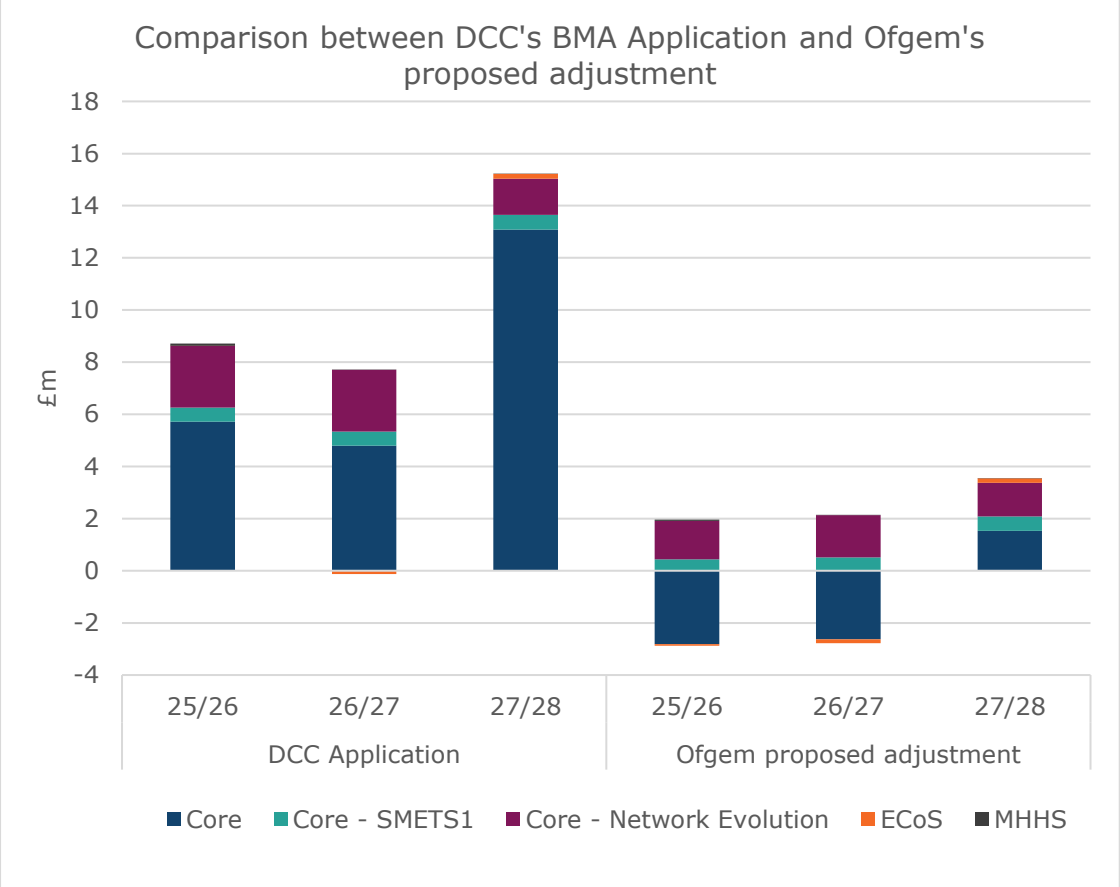


figure 6.3: Data table

Driver	Application			Proposal		
	25/26	26/27	27/28	25/26	26/27	27/28
Core Drivers	5.715	4.797	13.080	-2.817	-2.637	1.529
Core - SMETS1	0.540	0.539	0.575	0.439	0.515	0.555
Core - Net Evo	2.367	2.375	1.380	1.476	1.614	1.289
ECoS	0.003	-0.122	0.182	-0.060	-0.137	0.171
MHHS	0.089	0.011	0.007	0.047	0.006	0.004
Total	**8.714**	**7.600**	**15.224**	**-0.916**	**-0.639**	**3.548**

External Contract Gain Share

Context

6.52 The formula for DCC's Allowed Revenue includes an External Contract Gain Share (ECGS) term, which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the FSP contracts.[60] This is so that DCC has an incentive to seek and achieve cost savings in the FSP contracts. This term is zero unless DCC applies for a Relevant Adjustment to this term.

DCC's application

6.53 DCC has applied for a £4.991m Relevant Adjustment to its ECGS term for RY23/24 on the basis of £13.28m in savings to industry as a whole and £8.318m being returned to customers. This year's application is based on the same activities that were approved last year and in RY21/22.

6.54 DCC has applied for a Relevant Adjustment in relation to the ongoing savings generated by previously agreed re-financing arrangements with the two CSPs. These savings stem from previously renegotiated and approved interest rate reductions. As with previous applications, and in accordance with our Price Control guidance, DCC's application only includes savings for milestones that have already been achieved and therefore where the interest rate at the time of achievement was known.[61] DCC estimate these renegotiations have resulted in a further saving of £0.088m across both (CSPs) from RY23/24 to the end of the contracts. DCC is applying for a Relevant Adjustment of £0.033 on the basis of these savings (a 37.5% share), with the remaining £0.055m (62.5%) being returned to customers.

6.55 In RY19/20, DCC successfully managed to secure a substantive reduction in interest rates for the financing of Trance 2 Comms Hubs which has continued to generate savings in each RY since. DCC has again applied for a Relevant Adjustment related these savings. DCC estimate the savings generated by its interest rate refinancing to be £6.633m across both CSPs in RY23/24. DCC is applying for a Relevant Adjustment of £2.499m on the basis of these savings to industry (a 37.5% share), with the remaining £4.134m (62.5%) being returned to customers.

6.56 DCC has also applied for a Relevant Adjustment for the savings made from its in-house test lab service. The provision of testing services originally sat within

[60] The terms and conditions through which DCC is able to apply for an adjustment under the ECGS is set out in Condition 39 of the Smart Meter Communication Licence.
[61] DCC Price Control Guidance: Processes and Procedures 2022 | Ofgem

the FSP contracts. The design, build and operation of the in-house test lab service since 2018 has made it possible for DCC to provide a fully integrated end-to-end test facility that better meets its customers' needs, at a cost cheaper than the testing services that were initially provided by the FSPs. DCC estimate the savings generated by its in-house test lab functionality (as opposed to that which would have been provided by the FSPs) to be £6.558m. As with the other elements of its application, DCC is applying for a Relevant Adjustment equivalent to 37.5% of this saving (£2.459m), with 62.5% (4.099m) being returned to customers.

6.57 DCC provided justification of its proposed distribution of the savings, which included benchmarking against comparable gain share arrangements in other regulated industries. Its proposed distributions are consistent with those which it applied for last year.

Our view

6.58 In line with our previous decisions, we are minded to accept DCC's proposed Relevant Adjustment related to the continuation of re-financing arrangements. We consider the Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence.

6.59 In line with last year's decision, we are minded-to accept the Relevant Adjustment related to the financing of Tranche 2 CHs. We consider that DCC's application is duly made and that DCC has provided sufficient evidence that it was instrumental in the arrangement. DCC's application justified saving from the refinancing and financing arrangements would not have been achieved without its involvement.

6.60 In line with previous year's decisions, we are minded-to accept the Relevant Adjustment related to the realised savings made from DCC's in-house test lab service. We consider this Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence. We acknowledge that DCC has followed our guidance that ECGS applications should be made on the bases of certain savings.

6.61 **We therefore propose to award DCC the full Relevant Adjustment it has applied for in RY23/24 of £4.991m.**

7. Switching Programme

Section summary

This section provides our assessment of DCC's costs associated with its roles in the Switching Programme and under its live Switching operations (18 July 2022 onwards) in RY23/24. We also provide our assessment of its forecast costs in RY24/25 and RY25/26. We find that the costs incurred in RY23/24 are economic and efficient. We propose to disallow DCC's forecast costs through to the end of the Licence term, which totals £29.953m (Internal costs of £8.438m and External Costs of £21.496m due to cost uncertainty and insufficient justification). Please note that by "Licence term" we mean up to and including RY25/26. In September 2024, we published our decision to extend DCC's Licence by two years to September 2027. However, as the additional regulatory years had no baseline (approved forecasts), they are excluded from this year's reporting.

This section also covers DCC's submission of its performance under the Switching Incentive Regime (SIR), which includes System Performance and Customer Engagement Incentives. Under the SIR, we are proposing to disallow all of DCC's margin associated with system performance for RY23/24. For the customer engagement incentive, we received submissions from both DCC and REC Panel on DCC's performance during RY23/24. After assessing both submissions, we are minded-to award a score of 2.25, corresponding to a reduction of DCC's BM of £0.310m.

Consultation Questions

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

Question 21: What are your views on our assessment of DCC's performance under the Switching Incentive Regime?

Switching Costs

Context

7.1 The Switching Programme was established to improve consumers' experience of switching between energy suppliers, resulting in faster and more reliable switching.

7.2 DCC played a central role in delivering the new Switching systems, which went live on 18 July 2022. DCC continues to play a key role in live operations under the new Switching arrangements through the provision of the Central Switching Service (CSS), the Certificate Authority (CA) and the Switching Operator (SO) services.

7.3 The costs and performance incentive mechanisms associated with DCC's roles in the Switching Programme and in live operations are dealt with separately from the rest of DCC's business. All Switching costs must be justified as the Business Plan was not competitively tendered, and therefore cannot be considered innately economic and efficient.

7.4 Switching has no agreed baseline, and as a result, all incurred costs are reported as variances

DCC's justification

7.5 DCC incurred total costs of £14.815m in RY23/24, comprising £4.873m of Internal Costs and £9.888m of External Costs. This represents a reduction from the RY22/23 figure of £21.392m (£5.106m of Internal Costs, £16.286m of External Costs) reflecting the move from the DBT phase into live operations.

7.6 The majority of the Switching Internal Costs were payroll related, with some costs attributed to External Services and some to Service Management, representing DCC's provision of the Switching service desk. Internal Costs are forecast to reduce in RY24/25 and remain steady into RY25/25, reflecting a reduction in resource required from early life support into steady state operations of the new Switching arrangements.

7.7 There was one material Change Request (CR) amounting to £3.1m reported against the External Cost figure of £9.88m. The scope of the CR was for the service provider to introduce a Continuous Improvement Team as a result of DCC's assessment of BAU resourcing requirements for Registration and Address Services for the period 1 November 2022 through to 31 December 2023.[62] DCC explained that it actively challenged the level of proposed FTEs whilst also challenging the respective grading of staff against the prescribed rate card.

7.8 DCC did not initially provide documentation around CR4967 but submitted information on request. As part of our assessment, we had concerns regarding the CR being signed in May 2023, following the resource already being in place.

7.9 During the clarification process, DCC stated that a change of leadership part way through negotiations and the intervening Christmas period resulted in a delay to CR4967 being signed.

Our view

[62] CR4967

7.10 We consider that DCC has appropriately justified all Internal Costs incurred in RY23/24 as economic and efficient. We are therefore not proposing any disallowances.

7.11 We are minded to accept DCC's External Costs, however we have concerns regarding the CR being signed after the work had already begun. We would like to remind DCC to follow best practice in contract management to ensure that it derives value from these contracts at all times, effectively manages change, and delivers value for money for its customers and consumers.

7.12 **In line with previous years, we propose to disallow all forecast Internal and External Costs for Switching for RY24/25 and RY25/26 amounting to £29.953m in total, due to uncertainty and insufficient justification**. DCC presents its cost forecasts to the REC code manager shortly before the start of the financial year, and the code manager must then review the DCC budget. Only at the point of REC approval of the budget would we have sufficient certainty and clarity over DCC's Switching costs to be able to approve forecast costs.

Switching Performance

Context

7.13 From 1 April 2023, DCC has its Switching baseline margin incentivised against the Switching Incentive Regime (SIR). We published our decision to introduce the SIR in January 2023.[63]

7.14 The SIR places 80% of DCC's switching margin at risk against its operational performance and 20% against customer engagement in its roles as provider of the Central Switching Service (CSS), the Certificate Authority (CA) and the Switching Operator (SO) services.

7.15 During the RY, DCC will collect its entire allowed margin as standard from Retail Energy Code Company (RECCo), alongside its costs through the monthly CRS Provider invoicing process. DCC may incur Performance Charges as determined by its performance against its service levels under the REC CRS Provider Performance Charges framework. This process is governed entirely within the REC.

[63] Our January 2023 decision to establish the switching Incentive Regime is accessible at: https://www.ofgem.gov.uk/sites/default/files/2023-01/Ofgem Decision - DCC Switching Incentive Regime1674651228949.

7.16 Following the end of the RY, DCC must submit information as specified by the RIGs, which reports the values of Performance Charges it bored as a result of missed service levels throughout the RY. As provided for in the Retail Energy Code (REC), DCC may also submit evidence to the Authority concerning any missed service levels it considers were not necessarily within its control.

7.17 Alongside this submission, Ofgem takes a submission from both the REC Code Manager and DCC with regard to DCC's customer engagement performance. Further details can be provided in the SIR Guidance.[64]

Operational Performance

7.18 During the consultation on SIR in November 2022, DCC expressed its concern with the scheme proceeding as proposed whilst the REC change proposal (CP) is still in progress.[6566] This CP was raised by DCC on 28 January 2023 and proposed changes to the Service Level Agreements (SLAs) in the REC. DCC considered that its margin should only be put at risk once a new mutually agreed set of SLAs had been agreed.

7.19 As noted in the decision on the SIR, we considered that the SIR could proceed with the SLAs as drafted, and did not need to be delayed until the SLAs were resolved. DCC was involved in the original conception of the SLAs to support the procurement process as well as with the incorporation of the SLAs into the REC as part of the REC v3 release.[67] DCC has been required to comply with these SLAs since July 2022 when the new Switching arrangements went live. It should also be noted that the discussions around using the SLAs in a financial incentivisation scheme had been ongoing for some time.

7.20 For RY23/24, DCC reported a 100% margin reduction for operational performance for the switching service.

DCC's justification

7.21 As part of this year's Price Control submission, DCC put forward arguments that it was unrealistic to meet the metrics covered under the incentive scheme and the targets associated with these, which requires DCC to achieve 100% performance.

[64] Link here to SIR Guidance
[65] Link here to consultation on proposals to introduce SIR
[66] CP R0092
[67] Link here to SIR decision

7.22 DCC stated that it is not economic or efficient to invest customers' money to meet the 100% targets for all system related service levels and will not result in additional benefit to end consumers. DCC also stated that certain service levels are not fully within their control to achieve and should therefore be excluded from the regime.

7.23 As mentioned, DCC raised R0092 'DCC Service Level Agreements for the Switching Incentive Regime' in January 2023, and has been working with Code Manager, Ofgem and industry colleagues through an extensive solution development phase to ensure the DCC service levels are fit for purpose.

7.24 The REC Code Manager raised an alternative proposal in January 2024.[68] The Authority approved this on 22 July 2024.

7.25 DCC argued that the current service levels, and the service levels under R0092A are not fit for purpose and state that, while the implementation of R0092 would not have guaranteed DCC would achieve all service levels every month, it did propose challenging yet achievable levels.

7.26 DCC has requested that Ofgem consider what their performance would have been should the measures under R0092 have been in effect from 1 April 2023 and for any lost margin to be reconsidered.

Our view

7.27 After consideration of the evidence submitted by DCC, we are minded-to disallow all of the performance element of DCC's margin. This corresponds to £0.3m.

7.28 In relation to the arguments provided by DCC, we understand that DCC can provide evidence to the Performance Assurance Board (PAB) in relation to those instances whereby failures to meet the SLAs are caused by user endpoints and are outside of its control.

7.29 We encourage DCC to keep working with REC to address its concerns regarding the current SLA's and implement a solution.

Customer Engagement

Context

7.30 DCC's customer engagement is assessed using a defined set of qualitative criteria to produce an overall score. The criteria cover taking account of

[68] R0092A

customer's views, providing timely and quality information; providing quality support, and transparency of costs.

7.31 The three sections under customer engagement each have three assessment questions, with relative weightings applied. The individual weighting for each assessment question is calculated as one third of its section weighting, with the overall score calculated using a weighted average of the score specified for each question. For full details on the scoring methodology please refer to our guidance.[69]

7.32 To inform the scoring, we received submission from both DCC and REC on DCC's performance during RY23/24 against the criteria set out in the SIR Guidance. We considered both the submissions and evidence provided to assess DCC's customer engagement performance in RY23/24.

DCC and RECCo's submission

Taking account of customer views

7.33 DCC stated that it has adapted a regular forum set up by Ofgem to create the Switching Operator Forum (SOF). This forum provides an opportunity for DCC to engage with their stakeholders and discuss and address switching matters more quickly.

7.34 As part of the REC CP R0092 to revisit the DCC service level agreements, DCC was involved in multiple working groups with RECCo and industry in 2023 to explain how the switching service operates and how its performance is measured.

7.35 Overall, DCC considers that it has made efforts to take into account customers views in RY23/24. It proposed a sore of 2 for this assessment question.

7.36 Feedback from REC Parties indicate that they have to be persistent to both their views are understood and will be considered by DCC. Parties expressed concerns with the level of detail in the information shared, particularly around Major Incidents.

7.37 Parties recognised that DCC has worked to improve customer engagement through collaborative working with REC code manager, however improvements could be made in ensuring a clear terms of reference for the SOF are communicated to their customers.

[69] Link here to SIR Guidance

7.38 As a result of the above views, RECCo proposed an average score of 2 for this section.

Providing timely and quality information

7.39 DCC stated that it has a series of obligations under the REC to ensure timely and quality information is provided for customers, which includes utilising service status dashboards along with service bulletins to keep parties informed.

7.40 DCC provided an example of certificate replacement activity where it provided written communications and a tracking tool to industry as well as presented at the SOF and REC Issues Group to explain the activity.

7.41 DCC mentioned that it presents a tailored plan on a page and detailed benefits of the items that will be deployed via the SOF meetings.

7.42 Overall, DCC considered that the information that it provides is of a quality standard. It proposed an average score of 2 for this assessment section.

7.43 REC parties meanwhile advise that there is a reluctance for DCC to share service bulletins via their own Service Portal, particularly around major incidents and the certificate replacement activity, as well a reluctance to use its Switching Portal to host customer facing messages, with delayed updates and lack of visibility causing issues for users.

7.44 There are concerns again raised from REC parties about the maintenance of DCC's contact list with ServiceNow, as customers have reported that DCC's updates and responses to tickets have been cumbersome.

7.45 REC parties advised that operational changes have been delayed on occasions as a result of impact assessments being provided to the Code Manager outside of the REC SLAs or incorrect information and wrong supporting documents being included.

7.46 REC parties stated that DCC has missed opportunities at SOF and its Service Now Platform to provide a view of the planned pipeline of changes in the upcoming quarter and year and releases as well as any of their Operational updates or UIT testing related to those changes. This would provide customers with a wider view of any impacts.

7.47 As a result of the above views, RECCo proposed an average score of 2 for this section.

Providing quality support

7.48 DCC explained that the service desk proactively contacts relevant parties for incidents that are nearing their service levels and conducts weekly incident management reviews with key service providers to review any priority incidents and to share best practice.

7.49 DCC also advised that it has improved engagement with REC Code Manager and REC parties regarding the release process to ensure impactful engagement outcomes are achieved.

7.50 DCC further provided an example of how it led a lessons learned exercise following an incident to learn from the management of the incident and improve their service.

7.51 Overall, DCC has awarded themselves a score of 2 out of 3 for providing quality support.

7.52 REC parties explained that the updates which DCC provides at the SOFOF are high level and do not focus on the cause or resolution required, resulting in opportunities being missed to enhance solutions and support their customers. Parties have suggested that DCC could consider an alternative approach of highlighting the impact to their customer and end consumers as well as offering efficient ways to mitigate these impacts.

7.53 REC parties acknowledged that incident volumes have reduced significantly in early 2023, however state that there is no clear understanding of DCC's forward looking targets in terms of volumes of switching incidents or age profile for those affected by the incidents.

7.54 REC parties have mentioned that DCC would also benefit from sharing the successes and challenges from their internal process of contacting suppliers to address issues and resolve incidents at the SOF.

7.55 RECCo recommended an average score of 2 for this assessment section.

Transparency of costs

7.56 It is apparent that DCC is progressing in terms of providing quality and transparent information around the costs of providing its services. DCC explained that it engages with RECCo during the year on its CRS budget, holding a six-monthly review session with RECCo to answer queries and any clarification questions.

7.57 DCC also stated that in the half-year review and full budget submission, it provides information relating to internal costs, external costs and margin and

has been transparent in answering queries relating to contact values as well as responded to queries as quickly as possible.

7.58 As a result of the above, DCC has awarded themselves a score of 3 for transparency of costs.

7.59 Feedback from REC parties explained that DCC has provided the right level of detail within its budget submission to RECCo and has engaged in the spirit of transparency and in a collaborative manner, providing explanatory information and answering queries.

7.60 RECCo raised concerns about delays to the impact assessment process last year, which led to delays in progressing a Change Proposal, and reiterated the importance of DCC undertaking impact assessments of forward solutions at the relevant points.

7.61 RECCo recommended an average score of 3 for this assessment section.

Our view

7.62 DCC is progressing in its customer engagement strategy with positive examples stated in its submission. We appreciate that DCC has provided some examples of facilitating customers views at appropriate times and via the Switching Operator Forum, however there are raised examples of DCC missing opportunities to update customers at the SOF, poor communication across different channels and DCC's updates at the SOF being too high level.

7.63 DCC has demonstrated that it has provided transparent cost information through its engagement with RECCo. However, concerns have been raised about delays to the impact assessment process by DCC.

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

7.65 We also note a difference in quality of information provided by DCC. Whilst the service desk proactively contacts relevant parties that are nearing their service levels and conducts weekly incident management reviews as well as lessons learned exercises, there are delayed updates and lack of visibility on DCC's own service portal. There have also been concerns raised about DCC's maintenance of the contacts list governance with its service portal as well as its updates via the SOF being unclear in terms of how it impacts the CSS platform, DCC's customers, their switching volumes and end-consumers.

7.66 Overall, we believe DCC has made sufficient efforts to engage and seek views from stakeholders, but there needs to be greater consistency with its quality of customer engagement. Based on the submissions received, our minded-to position is to award an overall score of 2.25, corresponding to a BM reduction of £0.018m from a possible £0.365m available. A breakdown of these scores is provided in Table 7.1 below.

Table 7.1: Customer engagement assessment criteria

Assessment Questions	Ofgem Score	REC Score	DCC Score
Taking account of customer views			
Have DCC's decisions demonstrated that customer views have been taken into account? Has DCC clearly explained how customer views have informed its decision making, and where relevant why DCC has disagreed with customer views?	2	2	2
Providing timely and quality information			
Taking into consideration the processes listed below: • Has DCC provided timely and quality information for its customers? • Maintenance of service status dashboards • Provision of service bulletins for Market Participants • Maintenance of the knowledge database for Market Participants • Provision of information regarding future planned Operational Switching Service Changes	2	2	2
Providing quality support			
Has DCC provided adequate support to market participants in fulfilling Service Requests and in	2	2	2

managing the resolution of Switching Incidents raised?			
Transparency of costs			
Has DCC met expectations in terms of providing quality and transparent information in a timely manner around the costs of providing its services?	3	3	3
Final weighted score	**2.25**	**2.25**	**2.25**

Appendices

Appendix 1 – External Costs Assessment

A1.1. In this Appendix to Chapter 3 (External Costs), we provide further context for the drivers of new material costs which DCC justified through its submission – we focus on the change and project requests (CRs/PRs) with value over £1m which DCC progressed within the SMETS2 and SMETS1, and ECoS Programmes.

A1.2. Table A1.1 below provides an overview of DCC's main contracts relevant to our assessment of DCC's External Costs.[70] DCC's main role is to effectively manage these contracts to derive value for money and quality service for its customers.

Table A1.1: Overview of DCC's contracts with External Service Providers

Capacity	Role	Provider	RY of contract
Fundamental Service Providers			
Data Service Provider	DSP	CGI	13/14
SMETS2 Communications Service	CSP-N	Arqiva	13/14
	CSP-C	Telefonica	13/14
	CSP-S	Telefonica	13/14
SMETS1 service providers			
Initial Operating Capability (IOC)	S1SP_1	CGI IE	18/19
Middle Operating Capability (MOC)	S1SP_2	Secure	18/19
Final Operating Capability (FOC)	S1SP_3a	Trilliant	18/19
	S1SP_3b	DXC	18/19
Dual Control Organisation (DCO)	S1_DCOa	Capgemini	18/19
	S1_DCOb	CSW	19/20
	S1_DCOc	Capita	22/23
SMETS1 Communications Service	S1_CSP1	Vodafone	19/20
	S1_CSP2	Telefonica	19/20

[70] Please note that service providers for the Switching Programme are omitted from this overview as switching costs are assessed separately from both external and internal costs.

Capacity	Role	Provider	RY of contract
ECoS service providers			
Technical Application Service		CSW	21/22
Hosting Services and Service Management		Accenture	21/22
CH&N service providers			
Component Integration		Accenture	22/23
Device Manager		Accenture	22/23
4G Comms Hubs		Toshiba	22/23
Wide Area Network (WAN)		Vodafone	22/23
Integration and Assurance		Critical	22/23
Subscription billing [for DM hosting]		Capita (interim) IBM (enduring)	23/24
TAF service providers			
Test Automation and Robotics Framework Programme		HCL	22/23

Key material variances

SMETS2

A1.3. DCC's Fundamental Service Providers (FSPs) comprise the Data Service Provider (DSP) and two Communication Service Providers (CSPs), operating across three communication regions; together, they provide the core communication infrastructure for smart metering across GB and enable DCC users to send and receive messages to and from smart meters. The FSP contracts were procured by the government on a competitive basis and are managed by DCC.

A1.4. In RY23/24 DCC incurred £340.1m in total FSP costs. DCC justified 13 new material CRs/PRs with a total value of £34.09m across the following areas: testing, scaling & optimisation in the North, tech refresh, SEC release and other activities.

Testing

A1.5. DCC justified 2 CRs and 3 PRs relating to testing which was the largest proportion of the newly justified SMETS2 costs.

A1.6. CR5194 related to DSP User Integration Testing (UIT) to support industry testing and ensure defect fixes before the live environment. DCC revised the cost and scope of the UIT services based on reviews of effort and work done provided monthly by the service provider. These reviews resulted in a 12% reduction in the monthly charge.

A1.7. DCC reported 1 CR and 1 PR which related to the testing activities required to support the Great Britain Companion Specification 4.1 release. CR4727 related to mass 'over the air' upgrade of installed communications hubs. DCC reviewed the impact assessment costs and achieved a 29% reduction by identifying an unnecessary testing cycle. PR7295 was raised for System Integration Testing (SIT) of SEC mandated security changes to be implemented within the comms hub firmware. The PR was justified in last year's price control and the costs incurred match those forecast for RY23/24. DCC contracted on a time and materials (T&M) basis, allowing it to track costs each month and stay within budget.

A1.8. PR7272 is a continuation of another PR which was issued in 2022 for production support testing and integration testing with all service providers. DCC reviews and revises the scope and price annually. PR7272 covered the period from April 2023 to March 2024. The original PR was used as a benchmark for pricing. DCC achieved savings of 41% (adjusted for indexation) attributable to FOC stabilisation programme and planning of maintenance releases.

A1.9. PR7726 related to the extension of testing environments for CSP-C&S. Service providers are required to maintain both testing stream. One (SIT-A) is required for production fixes on fail support and to support the delivery of planned future releases. The other (UIT-B) is required to enable customers to test the current and the next release in parallel. This PR extended the on-premise solution for the testing while DCC develops a cloud solution. The extension was from 1 August 2023 to 31 January 2024. As there was no change in requirement, the costs were in line with the existing contract and subject to some indexation.

Scaling and optimisation in the North

A1.10. DCC justified 1 CR and 2 PRs in relation to the scaling and optimisation in the North project. PR7762 and PR7907 accounted for the majority of the costs incurred (80%). This work enabled the service provider to start mobilisation to uplift the Regional Network Interface (RNI) and replace the Network Management System (NMS). The scale testing that was conducted confirmed the capacity limit of the network and that the

transition to the RNI was necessary. The work also delivered on supporting the future scale while re-architecting the network for better stability and upgrading existing systems. CR4866 related to increasing the number of radio frequency channels in order to meet growing network capacity demands.

A1.11. DCC explained it secured value for money by managing FTE costs and continuously reviewing and challenging costs and resource estimates. DCC also negotiated an overall price cap for the entire programme of work to provide assurance that costs will not be subject to further increases. This has ensured an estimated savings of £11.4m.

Tech refresh

A1.12. DCC reported 1 CR and 1 PR associated with tech refresh for the extension of the DSP contract to 2024. The DSP hardware needs to be replaced, and DSP has recommended re-architecting to provide cost efficiencies from new technology and solutions. The scope of the change included purchase of new equipment, scoping efficiencies that will be delivered and forecasting ongoing use costs of hardware items. DCC managed costs by reducing the number of licences required, correcting prices of the service providers infrastructure team and reducing working capital charges.

A1.13. PR7700 was raised to upgrade the storage infrastructure supporting the Storage Area Network Solution. This included procurement of replacement hardware, software and associated maintenance agreements. DCC reduced infrastructure costs by 8% through renegotiation of procurement quotes which also reduced third party risk contingency by 20%. This resulted in overall savings of 3%.

SEC Release

A1.14. DCC reported one CR relating to the SEC release to implement SECMP0007 (firmware updates to IHDs and PMMIDs). This involved consequential changes to the previously agreed programme of work and pricing relating to over the air firmware updates. DCC reviewed the proposed level of FTEs, challenged the grading of staff against rate cards, and scrutinised costs such as applied indexation. DCC was able to secure a 15.4% reduction in costs.

Other activities

A1.15. DCC has previously raised CR4470 for the consolidation of DSP leadership and PMO support resources in one central funding starting from November 2021. This removed the risk of double charging for these resources and secured a 20% reduction in the rate of these resources. Costs in RY23/24 were in line with last year's forecasts.

A1.16. PR7529 provided cover for the service provider to continue to work on the design and build of the GBCS v4.2 changes (these changes are a SEC mandate to deploy new firmware to all communication hubs to ensure compliance and benefits of additional functionality). The scope of the PR was to mobilise and commence delivery activities, provide DCC with a draft testing approach, and to provide device, programme management and governance support across the project. DCC validated the amount of FTE effort with its technical teams to ensure value for money.

A1.17. Table A1.2 below provides an overview of these newly SMETS2 justified PRs/CRs.

Table A1.2: Overview of newly justified material SMETS2 CRs/PRs

PR/CR #	Description
Testing	
CR4727	GBCS 4.1 SIT, UIT and Pilot Support
CR5194	Testing services: Changes to CR4191 for Contract Year 23/24
PR7272	May 2023 Production Support Testing: April 22 – March 25
PR7726	SIT A and UIT B Extension Aug 23 - October 23 & Nov 23 - Jan 24
PR7295	GBCS 4.1 - SIT and UIT Cover
Scaling and optimising in the North	
CR4866	Radio Frequency (RF) Channel Expansion for Bulk Messaging Channels ARQCAN132
PR7762	CSP-N Scaling & Optimisation Phase 2 - Breakdown of Costs for RNI Uplift (Accelerated) up to December 23
PR7907	Advance work on CR4895 (RNI Uplift) re CSP.N Scaling & Optimisation project
Tech refresh	
CR4349	DSP Extension Tech Refresh Implementation 1 April 2022 to 31 March 2023
PR7700	CGI Tech Refresh 2.0, Storage and Senetas (SafeNet) Fibre WAN Encryptor
SEC Release	
CR4452	SEC Releases - Compliance with Updated Tech Spec drafts to be designated in November 2021 (Primarily SECMP0007 delivery)
Other activities	
CR4470	Consolidated Funding for Core Leadership and PMO Support Teams

PR/CR #	Description
PR7529	GBCS 4.2 Design and Build (linked to CR4279)

SMETS1

A1.18. The purpose of the SMETS1 programme is to integrate first generation smart meters into the DCC service to ensure their interoperability. Under an agreed plan, the enrolment and adoption of the SMETS1 meters happens in three releases – Initial (IOC), Middle (MOC) and Final (FOC) Operating Capability – with each release delivering a capability for a different type of meter installed by energy suppliers. The SMETS1 service went live in July 2019, initially for IOC meters. DCC then consulted on revisions to the Joint Industry Plan (JIP) to deliver solutions for the MOC and FOC cohorts. The capability to migrate and operate some MOC devices went live in August 2020. In RY20/21 and 21/22 DCC made progress towards delivering the solution for FOC, however the programme suffered delays due to testing issues and a replan had to be agreed at the end of 2020. Throughout RY21/22, DCC worked on a revised plan and phased commissioning approach with the first phase of the FOC capability commissioned in February 2022. In RY22/23, DCC worked to optimise the solution, including delivery of fixes and design changes. DCC also procured a new service provider (DCOc) under an emergency interim contract to provide hosting service as a replacement for a subcontractor who existed the market.

A1.19. In RY23/24, key activities included:

- Maximising Migrations
- Final Operating Capability (FOC) Stabilisation Service
- Device swap-out
- Technical upgrades

A1.20. DCC justified 6 new material CRs/PRs with a combined value of £7.67m, raised with DSP/S1SP_1 and reported a number of smaller CRs/PRs progressed with the three DCO providers for technical updates and service uplift.

DSP/S1SP_1 changes

A1.21. CR4864 was raised to continue DCC's migration capability until March 2024. This was necessary as migrations within the IOC cohort had not completed and the service had to be in place until a Decommissioning Timetable was approved by the Secretary of State. DCC argued that it had achieved value for money by extending at "static rates" with a reduction in real terms. Furthermore, as the service stopped by end-May 2023, DCC executed its termination rights resulting in actual charges being 66% lower than the

Final Impact Assessment (FIA). The largest portion of the costs related to Smart Meter System Operator (SMSO) charge which DCC became responsible for from August 2022.

A1.22. CR4634 provided a cover for a tech refresh to upgrade DSP software. DCC sought to achieve value for money through unchanged fixed operational charges, reduction in labour costs and re-use of technical hardware, securing c.9% cost reduction on FIA.

A1.23. CR4563 covered an upgrade to Hardware Security Modules (HSMs) as support for the existing version terminated by end-2022. DCC explained how it challenged the service provider on labour costs, third party costs and other expenses, resulting in savings of c.7%.

A1.24. PR7508 consolidated system regression testing carried out by the DSP in its system integration capacity, with estimated savings of 48% for RY23/24 delivered by removing the costs quoted in individual changes and replacing them with charges for an agreed team.

A1.25. PR7538 provided cover for post Pre-Integration Testing (PIT) activities for the June 2023 SEC release between January and July 2023. DCC negotiated a 17% saving by reduction of expenses and updates to assumptions around test volumes and resourcing.

A1.26. PR7810 covered testing preparation and execution for June 2024 SEC release between November 2023 and August 2024. DCC secured a price reduction of c.4% by challenging the service provider on effort estimates for the PIT environments and design teams, and by leveraging synergies with November 2024 release.

DCO upgrades

A1.27. DCC reported a host of smaller changes raised with the DCO service providers to deliver a suite of technical upgrades to the solution. As DCC is currently in the process of reprocuring all three DCO contracts, we questioned DCC on the value of these additional investments. DCC explained that it had carried out upgrades to components only where this was absolutely necessary to ensure safe service continuation. DCC also explained that these upgrades were open source and that the assurance and validation were provided by DCC's Chief Technology Officer. DCC provided evidence of negotiations with relevant parties on commercial terms and costs of the upgrades. Altogether, these upgrades resulted in c.£4.1m in costs in RY23/24. Table A1.3 below provides an overview of those changes.

A1.28. In addition, PR7655 provided cover for support required from the DCOa provider from March to May 2023 for service uplift and management of the solution delivered by DCOc who replaced DCOa's subcontractor for hosting. In RY22/23 DCC explained that

these charges resulted from a shift from an integrated contractor-subcontractor environment to a solution involving two separate SPs. Specifically, DCC set out the following drivers: Service Uplift and Management (2 FTEs) to monitor and ensure performance of the new SP, the loss of Control Plane software, and functional differences resulting in increased incidents and operational issues. These costs were deemed acceptable for the duration of the interim solution only.

Table A1.3: Overview of newly justified SMETS1 CRs/PRs

PR/CR #	Description
DSP/SP_SP1 changes	
CR4864	SMETS 1 - Requesting Party extension
CR4634	Tech Refresh - Identity Management (IDM) Software Upgrade
CR4563	HSM Upgrade Implementation
PR7508	SI - System Regression as a Service
PR7538	June'23 SIT Execution Cover (CR4844)
PR7810	June '24 SEC System Release SIT Preparation Activities & Systems Integration and Operations Board Attendance
DCO upgrades	
CR4439, PR7754	DCO Java & Thorntail replacement (Quarkus)
PR7749, CR5121, CR5037	DCO Red Hat Enterprise Linux (RHEL) upgrade
CR4950, PR7695	DCO/CP JVM Upgrade
PR7598, CR4966, PR7611	SQL Stage 1 + 2
CR5035, PR7601	Network Switch
PR7667, PR7594 CR4952 PR7595	Mirantis upgrade
PR7655	DCO Service / Resource Uplift

ECoS

A1.29. The purpose of the Enduring Change of Supplier (ECoS) Programme is to provide an enduring process to facilitate the switching of ownership certificates on devices such as smart meters between suppliers when an energy consumer switches supplier. The solutions developed under the ECoS Programme replace the prior, temporary Transitional Change of Supplier (TCoS) processes.

A1.30. The ECoS Programme is delivered via two service providers, both of whom were appointed by DCC in 2021. One service provider is responsible for the design/build/test phase of the Programme (plus ongoing support), while the other provides hosting services and service management once the Programme is live.

A1.31. In last year's price control, DCC justified a revised go-live date of June 2023 (originally intended June 2022) which resulted in costs to the hosting and management service providers under CR4560. The costs incurred this year related to the deferred milestone payments of the final design, build and test stages and settlement of the retention payment.

A1.32. CR4889 combined three CRs which were related to adding new and additional functionalities to technically integrate the ECoS party with the technical operation centre, security operation centre, and the data science and analytics service. This was part of DCC's cyber security work to get better exchange of service performance, business transition and data through secure methods. DCC reduced costs by consolidating the changes to achieved economies of scale and better control of the delivery. DCC also removed the need for support from a contractor as DCC intends to bring some of the procured services in-house. This resulted in a saving of 7.8% in relation to the initial price of the combined CR, and an estimated 64% if the contracted solutions had been delivered separately.

Table A1.4: Overview of newly justified ECoS Programme CRs

CR	Description
CR4560	New ECoS go-live date
CR4889	Proposed new design – monitoring solution and TOC/DS&S/SOC CRs

4G CH&N

A1.33. Within the 4G CH&N programme DCC reported 2 new material CRs and 1 PR, raised with the DSP provider.

A1.34. CR4583 covered support for necessary SIT and UIT and transition to operation for the programme. DCC provided evidence of negotiations with the service provider to revise quoted costs and drive savings by challenging the volume profiles for testing, descoping of activities where requirements were not clear, reviewing third party costs and use of milestones. DCC reported achieving savings of c.14% on the initial IA.

A1.35. PR7383 covered system integration activities including SI Leadership, SI Environments Management and SI Release Management services. DCC again described its approach in negotiating with the service provider over a number of iterations of the

IA. Savings totalling 14% were achieved by the removal of overtime, reduction in technical readiness testing activities, and review and changes to resource profiles.

A1.36. CR4090 covered changes to the DSP interfaces. DCC explained that this was the first change raised with DSP to build and operate the 4G solution. The CR captured modified gateway interface changes required to enable 4G CH providers to connect to DCC, relevant testing activities, as well as support for test set-up test environments. DCC explained that it sought to include protections against overruns and delays caused by the SP which resulted in additional risk premium being charged by the SP; however, in DCC's estimates this provided value for money based on an analysis of the impacts delays would have on the overall programme costs. Even with the premium included, DCC reported a price reduction of 25% compared to the SP's first cost submission.

A1.37. Altogether these changes will cost c.£12.6m, however, only £1.3m were incurred in RY23/24 as the costs are spread out over a number of RYs.

Table A1.5: Overview of newly justified 4G CH&N programme CRs/PRs

CR	Description
CR4583	CH&N SI Services & Support for Dual Band Delivery (Dis-aggregated Solution)
PR7383	SI, SI Environment & Release Management Services for CH&N
CR4090	DSP Interfaces

TAF

A1.38. The Test Automation and Robotics Framework (TAF) Programme was new in RY22/23. Its purpose is to improve defect identification during System Integration and User Integration testing phases (SIT & UIT), reducing the impacts on customers arising from changes implemented in the DCC system.

A1.39. A single service provider is responsible for the provision of the Programme, delivering both cloud-based software and robotics elements, as well as incident resolution and maintenance services. DCC remains responsible for the provision of test laboratories, internet connection, and meter sets.

A1.40. Over RY23/24, DCC have been finalising the design and build of the TAF infrastructure. Go-live is planned for January 2025. There were no material CRs or PRs in RY23/24.

Appendix 2 - Internal Costs Assessment

A2.1. DCC's internal Baseline costs are reported by cost centre. DCC reports separately on Additional Baseline and New Scope costs.[71] Table A2.1 gives an overview of the types of costs associated with each cost centre.

Table A2.1: Overview of costs associated with each cost centre

Cost Centre	Functions Include
Corporate Management	• Strategy and Regulation • Corporate Affairs • Stakeholder Engagement • Business Improvement and Internal Audit • Accommodation and Test Labs • Price Control support for DCC
Commercial	• Commercial Operations • Procurement • Vendor Management • Contract Management • Relationship management of contracts in DCC's strategic supply chain • Meet Price Control needs.
Finance and People	• Financial Reporting, including producing statutory accounts, Price Control data and managing annual audit. • Commercial Finance activities, including responsibility for producing and managing financial plans and forecasts of the business. • Regulatory Finance and Pricing activities, including preparing and publishing annual charging statements and indicative budget documents. • Finance Transformation and Business Operations, including responsibility for ensuring DCC reporting system is maintained and modified, and introducing systems to automate financial processes.

[71]Additional baseline refers to any costs that are associated with requirements that the Licensee was expected to deliver at the time of the licence award but were not fully costed in the LABP. New scope refers to activity associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence award. The Centralised Registration Service is considered new scope.

Cost Centre	Functions Include
	• People team, including ensuring DCC attracts and acquires the talent and expertise required. • Legal, including supporting DCC with in-house Legal resource and managing relationships with external law firms
Operations	• Delivers reliable and repeatable service, at scale. • Reports operational performance to DCC's Customers and Regulatory Parties • Supports DCC's focus on customers, including customer relationship management and service desk. • Supports the prioritisation of activity and development effort for DCC through customer insight, process measurement and Industry engagement. • Improves the solutions proposed by DCC through early and effective engagement in the design process. • Protects the margin and reputation of DCC through a focus on service.
Design and Assurance	• Designs the Enterprise Architecture for the DSP re-procurement and Network Evolution comms Hubs. • Works with DCC customers to improve existing ways of working and maximise benefits to be delivered by NEP. • Reviews existing practices, technology and tooling and defines new ways of working to incorporate technology that maximises testing efficiency and quality of deliverables. • Responsible for the design of technical solutions that address new SEC Modifications and Customer-led changes. • Responsible for ensuring DCC executes key services and operates to the standards required by DCC's licence and customers. • Delivers quality and consistency in Design and Testing Services
Security	• Assures the security of all DCC systems.

Cost Centre	Functions Include
	• Ensures the platform and new programmes being added to it are secure and meet with Licence and code requirements. • Addresses the changing threats to the systems through a risk-based approach in line with industry and regulatory guidance. • Provides security assurance to the regulators and DCC customers. • Information governance and data protection
Service Delivery	• Accountable for programme delivery, and professional practices of Business Analysis, Test Assurance and Programme and Project Management that support delivery of the change portfolio for DCC. • Delivers DCC's inventory of Programmes. • Improves Service Delivery Practice Capability and resourcing approach. • Increases the maturity and effectiveness of the business analysis capability to support the evolution of the DCC total system. • Increases the maturity and effectiveness of the Test Assurance practice. • Drives PM performance management via an engaging and supportive approach, with clarity of R&R across Programme and Practice.

A2.2. Figure A2.1 shows the variance over the Licence period in Internal Costs by cost centre compared to the RY22/23 forecast, including the Additional Baseline cost. This shows that the increase in costs over the Licence period compared to last year's forecast are concentrated in Additional Baseline, Programme and Operations cost centres.

Figure A2.1: Cost variance by cost centre - compared to RY22/23 in current year prices

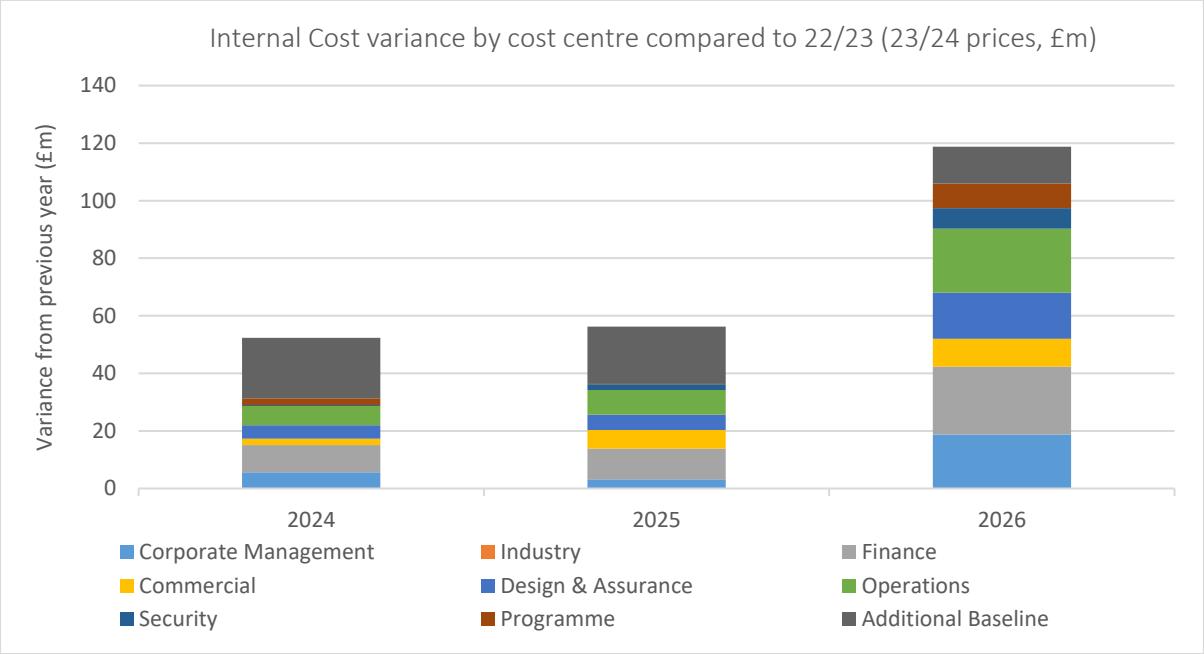


Figure A2.1: data table

Cost Centre	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Corporate management	5.64	3.19	18.73
Industry	-	-	-
Finance	9.42	10.63	23.64
Commercial	2.28	6.49	9.69
Design & Assurance	4.60	5.37	15.98
Operations	6.72	8.50	22.22
Security	0.38	2.10	7.20
Programme	2.29	0.00	8.53
Additional Baseline	21.01	20.00	12.83

A2.3. Figure A2.2 shows the variance over the Licence period in Internal Costs by cost centre compared to the LABP. This shows that the forecast cost variances over the Licence period compared to the LABP are concentrated in Additional Baseline, followed by Corporate Management, Programme, and Operations.

Figure A2.2: Cost variance by cost centre - compared to LABP in current year prices

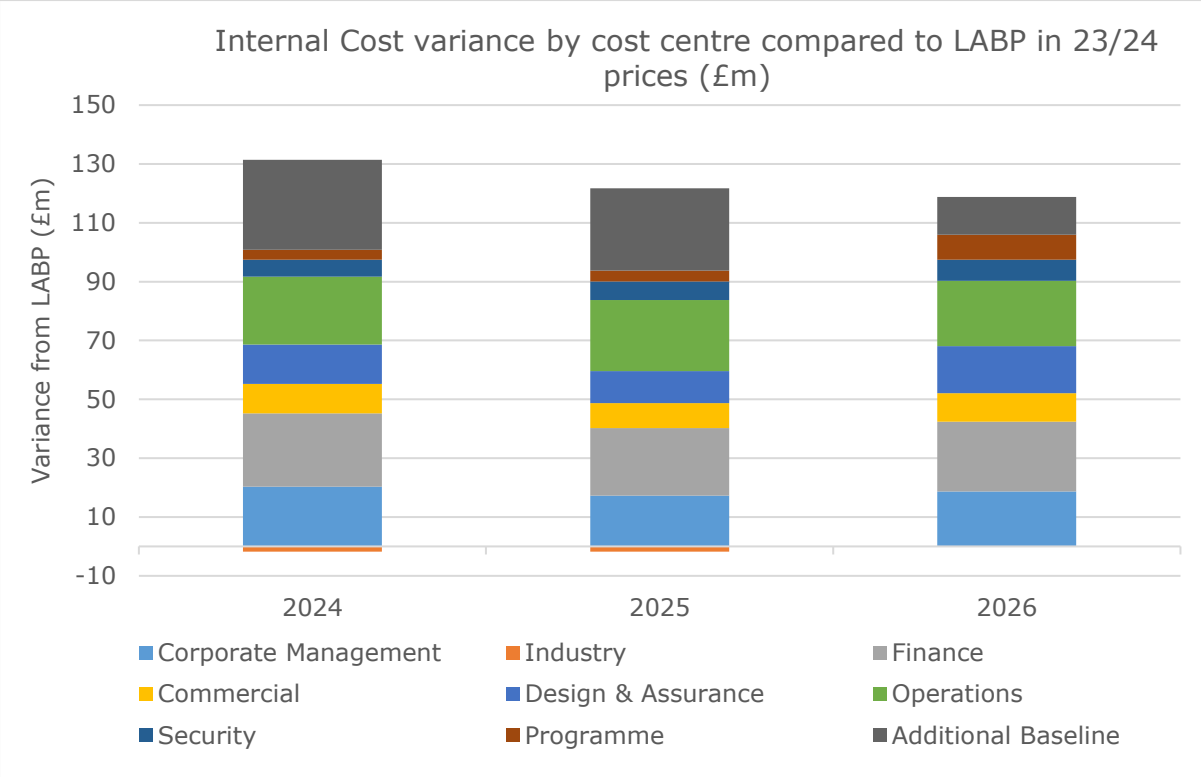


Figure A2.2: data table

Cost Centre	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Corporate Management	20.29	17.22	18.73
Industry	-1.74	-1.74	0.00
Finance	24.94	23.06	23.64
Commercial	9.97	8.42	9.69
Design & Assurance	13.43	10.94	15.98

Cost Centre	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Operations	23.11	24.14	22.22
Security	5.74	6.29	7.20
Programme	3.38	3.66	8.53
Additional Baseline	30.53	27.97	12.83

A2.4. Payroll costs are a major driver of Internal Costs across the different cost centres. Table A2.2 summarises DCC's headcount from RY22/23 to RY23/24 as measured in full time equivalents (FTEs) by cost centre. In RY23/24, there is a 5% increase in FTE compared to the RY22/23 forecast for RY23/24.

Table A2.2: FTEs by cost centre

Cost Centre	RY23/24	RY22/23 forecast for RY23/24
Corporate management	75	75
Industry	0	0
Finance	123	112
Commercial	81	42
Design & Assurance	138	110
Operations	185	154
Security	50	38
Programme	131	29
New Scope	0	120
CRS	0	0
Total	**783**	**703**

Appendix 3 – Proposed Allowed Revenue

Table A3.1. Proposed Allowed Revenue for each year to the end of the Licence term (including extension period), £m (23/24 prices)

Regulatory Year	RY23/24	RY24/25	RY25/26	RY26/27	RY27/28
LABP Allowed Revenue (23/24 prices)	**546.080**	**672.165**	**443.185**	**0.000**	**0.000**
Previous Year Allowed Revenue (23/24 prices)	**546.080**	**672.165**	**443.185**	**0.000**	**0.000**
Submitted AR RY23/24 (excludes any performance adjustments)	**637.472**	**702.059**	**660.432**	**659.246**	**661.407**
Cost Disallowances					
External Cost Disallowances					
Service stabilisation	0.600	0.000	0.000	0.000	0.000
S1_DCOc	0.437	1.772	2.085	2.414	2.759
S1_DCOa	0.300	0.000	0.000	0.000	0.000
CSP-C&S	0.515	0.000	0.000	0.000	0.000
Device swap-out	2.481	0.000	0.000	0.000	0.000
ECoS1	3.424	0.000	0.000	0.000	0.000
TAF	0.740	0.000	0.000	0.000	0.000
CSP-C&S – forecast costs	0.000	2.714	2.859	2.887	2.887
CRS External Costs (Switching)	0.000	10.386	11.110	11.562	10.964
Total External Cost Disallowances	***8.497***	***14.872***	***16.054***	***16.863***	***16.610***
Internal Cost Disallowances					
ES - Planning, Scoping & Resourcing	6.086	6.400	0.247	0.000	0.000

Regulatory Year	RY23/24	RY24/25	RY25/26	RY26/27	RY27/28
ES - Business Accuracy Programme (BAP)	4.124	0.813	0.320	0.000	0.000
PR - Programme (Service Delivery) - Incurred & Forecast Costs	1.624	1.278	5.119	0.000	0.000
PR - Future Connectivity Programme (FTTP) Resource Costs	0.117	3.937	2.297	0.000	0.000
PR - Network Evolution - Incurred & Forecast Costs	3.290	11.345	6.165	0.000	0.000
PR - Design and Assurance - Forecast Costs	0.000	1.821	5.154	0.000	0.000
PR - Corporate Management - Forecast Costs	0.000	0.663	2.869	0.000	0.000
PR - Finance - Forecast Costs	0.000	2.450	3.075	0.000	0.000
PR - Security - Forecast Costs	0.000	0.935	1.011	0.000	0.000
PR - SMETS1 - Forecast Costs	0.000	0.000	0.899	0.000	0.000
PR - MHHS - Forecast Costs	0.000	1.609	0.268	0.000	0.000
Forecast Baseline Internal Costs (includes ABL)	0.000	0.000	0.000	118.808	123.217
Benchmarking - Contractor Costs	0.506	0.000	0.000	0.000	0.000
Shared Service Charge	1.212	2.668	2.533	10.796	11.316
CRS Internal Costs (Switching)	0.000	4.513	3.925	3.980	4.094
Total Internal Cost Disallowances	***16.958***	***38.432***	***33.882***	***133.585***	***138.627***
Total Cost Disallowances	***25.455***	***53.304***	***49.936***	***150.448***	***155.237***
Performance Adjustment Reductions					
OPR	-0.644	0.000	0.000	0.000	0.000
BMPPA - SMETS1	-1.385	0.002	0.000	0.000	0.000

Regulatory Year	RY23/24	RY24/25	RY25/26	RY26/27	RY27/28
Switching Incentive Regime (SIR)	-0.310	0.000	0.000	0.000	0.000
Allowed Revenue excluding BM and ECGS Adjustments	***609.678***	***648.756***	***610.496***	***508.799***	***506.170***
Baseline Margin and ECGS Adjustments					
Baseline Margin Adjustment (23/24 prices)	0.000	0.000	-0.916	-0.639	3.549
ECGS Adjustment	0.000	0.000	4.991	0.000	0.000
Allowed Revenue including BM and ECGS Adjustments	***609.678***	***648.756***	***614.571***	***508.159***	***509.719***

Table A3.2. Total proposed Allowed Revenue across the whole Licence term (including extension period), £m

	Total across Licence term (RY23/24 prices)
LABP (23/24 prices)	**5,231.963**
Previous year (23/24 prices)	**5,231.963**
Submitted AR RY23/24 (excludes any performance adjustments)	**6,891.943**
Cost Disallowances	
External Cost Disallowances	
Service stabilisation	0.600
S1_DCOc	9.467
S1_DCOa	0.300
CSP-C&S	0.515
Device swap-out	2.481
ECoS1	3.424
TAF	0.740
CSP-C&S – forecast costs	11.347
CRS External Costs (Switching)	44.022
Total External Cost Disallowances	***72.896***
Internal Cost Disallowances	
ES - Planning, Scoping & Resourcing	12.733
ES - Business Accuracy Programme (BAP)	5.257

	Total across Licence term (RY23/24 prices)
PR - Programme (Service Delivery) - Incurred & Forecast Costs	8.021
PR - Future Connectivity Programme (FTTP) Resource Costs	6.351
PR - Network Evolution - Incurred & Forecast Costs	20.800
PR - Design and Assurance - Forecast Costs	6.975
PR - Corporate Management - Forecast Costs	3.532
PR - Finance - Forecast Costs	5.525
PR - Security - Forecast Costs	1.946
PR - SMETS1 - Forecast Costs	0.899
PR - MHHS - Forecast Costs	1.877
Forecast Baseline Internal Costs (includes ABL)	242.025
Benchmarking - Contractor Costs	0.506
Shared Service Charge	28.525
CRS Internal Costs (Switching)	16.512
Total Internal Cost Disallowances	***361.484***
Total Cost Disallowances	**434.380**
Performance Adjustment Reductions	
OPR	-0.644
BMPPA - SMETS1	-1.383
Switching Incentive Regime (SIR)	-0.310
Allowed Revenue excluding BM and ECGS Adjustments	**6455.227**

	Total across Licence term (RY23/24 prices)
Baseline Margin and ECGS Adjustments	
Baseline Margin Adjustment (23/24 prices)	1.994
ECGS Adjustment	4.991
Allowed Revenue including BM and ECGS Adjustments	**6462.211**

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".