Decision

DCC Price Control: Regulatory Year 23/24

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Contact:	Arno Vanden Eynde
Team:	DCC Oversight and Regulatory Review
Email:	DCCregulation@ofgem.gov.uk

Overview:

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

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

In November 2024, we ran a consultation on our proposals following a review of the report and information submitted by DCC in July 2024 for the Regulatory Year from 1 April 2023 until 31 March 2024.

This document sets out our decisions and the reasons for them on the costs DCC reported under its Price Control for the Regulatory Year 2023/24 and its application to adjust the Baseline Margin and External Contract Gain Share values under the Licence.

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

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Executive Summary

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

These are our[1] final determinations for the DCC Price Control for the Regulatory Year 2023/24 (RY23/24). Our decisions reflect our conclusions on the economic and efficient level of costs incurred in RY23/24 and in the cost forecasts; DCC's performance under the Operational Performance Regime (OPR) and Baseline Margin Project Performance Adjustment scheme (BMPPA); and adjustments to the Baseline Margin (BM) values set out in the Licence and the External Contract Gain Share (ECGS) term. Our final determination follows from our initial assessment and November 2024 consultation on DCC's costs and performance.

Cost Assessment

Overall, DCC's total reported costs for RY23/24 are £683m. This is a 15% increase in total costs compared to last year's forecasts, as approved as part of our decision on the RY22/23 Price Control. Over the Licence term (RY13/14 – RY25/26), total costs are now forecast to be £5.904bn, 7% greater than last year's forecast.

After considering all consultation responses, including from DCC, **we have determined a total of £20.185m, split between £15.157m Internal Costs (including the associated Shared Service Charge) and £5.028m External Costs, incurred in RY23/24 as Unacceptable**.[2] Our determination on Unacceptable Costs comprises:

- A portion of **External Costs** associated with the following: a change request raised for ECoS monitoring solution and integration, SMETS1 service stabilisation, defect fixes within the implementation of an updated version of Great Britain Companion Specifications (GBCS), increased chargers for SMETS1 interim DCO contract, the procurement of a replacement DCC Service Management System and delays in the TAF programme.
- In **Internal Costs**, inefficiencies in External and Internal Services, as well as costs incurred as a result of inadequate planning, scoping and resourcing, the Business

[1] The terms 'we', 'us', 'our' refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.
[2] As per Licence Condition 37.8(a) of the Smart Meter Communication Licence (or 'DCC Licence'). [Smart Meter Communication Licence]

Accuracy Programme (BAP), contractor benchmarking and the application of Shared Service Charges. There are also Unacceptable Costs based around the lack of clarity over forecasts, in particular forecasts related to the Network Evolution and the internal resource cost centres.

In our decision, we have also considered additional evidence provided by DCC as part of their consultation response to justify the costs associated with our proposed disallowances. We partially reduced the disallowance amount from our consultation position where further satisfactory evidence was received. This is for example the case for a proportion of the External Costs associated with the Enduring Change of Supplier Programme (ECoS) and FOC service stabilisation; as well as a portion of the costs associated with payroll costs. In addition, we have also determined a total of £33.734m (RY24/25) and £32.075m (RY25/26) in forecast Internal Costs (including the associated Shared Service Charge), and £4.486m (RY24/25) and £4.944m (RY25/26) in forecast External Costs as Unacceptable. In addition, we have also decided to disallow all forecast costs (£29.934m in total, of which £8.438m of Internal Costs and £21.496m of External Costs) associated with the Switching programme for RY24/25 onwards. DCC has not sufficiently justified these costs, and we consider these costs are not certain enough to include in DCC's future Allowed Revenue.

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

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. This is also the second year it is being assessed by the SMETS1 BMPPAS.

We have reviewed all responses and are adjusting our position which corresponds to a Baseline Margin reduction of **£2.220m,** and comprises:

- A reduction of £0.410m because of DCC's performance in customer engagement, corresponding to a total score of 2.08 awarded (out of a possible 3) for the customer engagement incentive

- A reduction of £0.426m due to DCC's performance under the contract management incentive, corresponding to a score awarded of 2.05 (out of a possible 3). DCC's contract management performance was assessed by an independent auditor against a modified version of the National Audit Office (NAO) contract management framework, as well as the scope set out in the OPR Guidance[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 (BMA)

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

This year, DCC has applied for a £31.537m adjustment to its BM for increases in the volume and complexity of work, changes to timescales, or increased cost certainty of activities. We have reviewed all consultation responses and have decided to change our consultation position and direct an adjustment of **£11.256m** out of DCC's application to reflect:

- Our assessment of DCC's resubmitted application regarding its core resource costs
- The price control decisions on Unacceptable Costs
- Part of DCC's application, where we have not seen sufficient evidence of a material change that could not have been foreseen, or which the driver does not appear to meet the conditions in the Licence

External Contract Gain Share (ECGS)

The DCC Allowed Revenue formula includes an ECGS term that allows for an upward adjustment to DCC's revenue in recognition of a reduction in External Costs that DCC helped achieve. Between RY15/16 (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).

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

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

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 maintain our consultation position, which is to accept DCC's ECGS Adjustment application in full.

Switching Programme

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

The is the first year in which DCC's performance for Switching is being assessed under the Switching Incentive Regime (SIR). We have reviewed all responses and are maintaining our consultation position which comprises disallowing all the operational performance element of the SIR (£0.3m) and awarding an overall score of 2.25. This corresponds to a total reduction of £0.310m.

Allowed Revenue Decision

Our decisions on the various components outlined above results in a total Allowed Revenue over the entire Licence period of £6.47bn (including Pass-Through Costs). Please see Appendix 1 for Allowed Revenue as proposed by DCC and the impacts of this year's decision.

Introduction

Context

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

1.2 DCC was awarded the Smart Meter Communication Licence[4] in 2013 to undertake this activity. Under this Licence, DCC is entitled to an Allowed Revenue which is the total amount of revenue determined on an accrual's basis in relation to each Regulatory Year in accordance with the Principal Formula set out at Part C of Condition 36 (Determination of the Licensee's Allowed Revenue) after the deduction of Value Added Tax (if any) and any other taxes based directly on the amount concerned.

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

1.4 In determining the Licensee's Allowed Revenue, the Authority is under a statutory duty to do so in a manner that it considers best furthers our principal objective[5] - namely, when carrying out its functions in such a way as to protect the interests of existing and future consumers. In addition, and specifically when determining the Licensee's Allowed Revenue, it must have regard to, amongst other things, the need to secure that the Licensee is able to finance the activities which are the subject of the obligations imposed under the relevant Acts and the Licence.

1.5 Under this legislative and regulatory framework,[6] we have a role in ensuring that DCC's costs are incurred economically and efficiently. We review DCC's costs and

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

performance after the end of the Regulatory Year in which the costs were incurred, as well as forecast costs that DCC deem certain enough to include in its forecast Allowed Revenue. This approach is referred to as an 'ex-post' price control. DCC must submit price control information by 31 July following each Regulatory Year in line with the Regulatory Instructions and Guidance (RIGs)[7]. Price Control reporting covering the Regulatory Year from 1 April 2023 until 31 March 2024 was submitted on 30 July 2024.

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

1.7 All other costs incurred by DCC in relation to the provision of the service are either Internal Costs, Pass-Through Costs,[8] or costs associated with the Centralised Registration Service.[9]

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

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

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

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

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

Related Publications

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

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

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

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

1.15 Last year's decision document is at: DCC Price Control Decision Regulatory Year 2022/23

1.16 This year's consultation document is at: DCC Price Control consultation: Regulatory Year 2023/24

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

Our decision-making process

1.18 The DCC Price Control process should be viewed in the wider context of helping to achieve Ofgem's key priorities and principal objective:[10]

- Working with government, industry and consumer groups to deliver a net-zero economy, at the lowest cost to consumers
- Stamping out sharp and bad practice, ensuring fair treatment for all consumers, especially the vulnerable
- Enabling competition and innovation, which drivers down prices and results in new products and services for consumers

1.19 As required by the DCC Licence[11], our assessment of DCC's costs is carried out by comparing DCC's incurred costs and revised forecast with DCC's Licence Application Business Plan (LABP) and the previous year's forecast. Our guidance

[10] See Our Role and Responsibilities: Our role and responsibilities | Ofgem
[11] Licence Condition 37 of the Smart Meter Communication Licence

document[12] sets out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient.

1.20 We published a consultation in November 2024[13] with our detailed proposals concerning RY23/24 and conducted a stakeholder meeting on the consultation in December 2024. This document sets out our decisions on DCC's:

- Incurred and forecast External Costs for RY23/24 (Section 2)
- Incurred and forecast Internal Costs for RY23/24 (Section 3)
- Performance under the Operational Performance Regime (OPR) (Section 4)
- Application for an adjustment to its Baseline Margin and External Contract Gain Share (Section 5)
- Switching Programme, Costs and Performance (Section 6)

1.21 We received six responses to the November 2024 consultation. There was one confidential response. All non-confidential responses are published on our website.[14] We have fully considered all responses received to our consultation. We have summarised the key points received from the responses and provided an explanation of the reasons for our decisions. If a point is not included in our summary, this does not infer that this information was not taken into account in our decision.

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

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

1.24 For further context to these decisions please read this document alongside our November 2024 consultation on the RY23/24 Price Control.

[12] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[13] Ofgem (2024), DCC Price Control consultation: Regulatory Year 2023/24. www.ofgem.gov.uk/sites/default/files/2024-11/DCC_Price_Control_Consultation_Regulatory_year_23_24.pdf
[14] Ibid.

Decision-making stages

Date	Stage description
06/11/2024	Stage 1: Consultation open
03/01/2025	Stage 2: Consultation closes (awaiting decision), Deadline for responses
15/01/2025	Stage 3: Responses to Consultation reviewed.
28/02/2025	Stage 4: Consultation decision and responses published.

General feedback

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

Q1. Do you have any comments about the overall quality of this document?

Q2. Do you have any comments about its tone and content?

Q3. Was it easy to read and understand? Or could it have been better written?

Q4. Are its conclusions balanced?

Q5. Did it make reasoned recommendations?

Q6. Any further comments

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

2. External Costs

Most responses to our consultation were supportive of our proposals on External Costs. Stakeholders generally agreed with our positions on proposed cost disallowances in the context of, in many cases ongoing, concerns around DCC's contract management, engagement with customers and the quality of DCC's forecasting and reporting. DCC disagreed with our proposals and submitted further evidence and clarifications in support of its arguments.

Following consideration of all representations, we have decided to amend some of our positions, while maintaining others. First, in respect of the ECoS monitoring solution and integration of cyber security we have reduced our proposed disallowance by £0.507m (c.15%) in relation to costs associated with part of the Change Request we deem justified, acknowledging DCC's evidence of the programmes necessity but highlighting our significant concerns in relation to contract management and customer engagement. Secondly, we reduced our proposed disallowance of SMETS1 stabilisation work to £0.505m. Thirdly, we decided not to proceed with our proposed disallowance of the device swap out costs; however, we are concerned that DCC's lack of clear engagement and poor contract change management contributed to the resulting nugatory spend and decided to adjust DCC's contract management scores in two areas. Finally, we reduced our proposed disallowance in relation to operational issues and defect fixes within the implementation of an updated version of Great Britain Companion Specifications (GBCS) to £0.129m. We have maintained our consultation position disallowances in relation to increased chargers for SMETS1 interim DCO contract, the procurement of a replacement DCC Service Management System, delays in the TAF programme, and forecast costs.

Altogether we have determined that £5.028m of External Costs incurred in RY23/24 and further £9.430m in forecast External Costs in RY24/25 and RY25/26 have been Unacceptable and shall be removed from DCC's Allowed Revenue.

Questions posed at consultation

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?**
2. **What are your views on our proposed cost disallowance of up to £0.600m in relation to SMETS1 service stabilisation?**
3. **What are your views on our proposal to disallow up to £2.481m of costs incurred on the device swap-out project?**

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?**
5. **What are your views on our proposal to disallow all costs of the procurement of a replacement DCC Service Management System (DSMS)?**
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)?**
7. **What are your views on our proposed cost disallowance of £0.740m related to delays in the TAF programme?**
8. **What are your views on our proposal to disallow £11.347m in forecast FSP External Costs?**
9. **Do you have any other views on External Costs?**

Q1 ECoS Monitoring Solution and Integration

***Proposal at consultation**: Disallow all costs associated with a Change Request (CR) for the ECoS monitoring solution and integration that DCC sought to justify this year (£3.434m). We proposed this on the grounds that it had not been established that the programme of work was necessary. DCC did not produce evidence of a regulatory requirement, a gap analysis or performance issues.*

***Decision**: Revise the proposed disallowance to account for additional evidence provided by DCC; accept a proportion of costs associated with the CR. Disallow £2.917m.*

Respondents' views (other than DCC)

2.1 Overall, three stakeholders agreed with our consultation position, one neither agreed nor disagreed, and two others did not specifically comment on this position.

2.2 One stakeholder, who supported our decision, considered that the solution should have been included in the original design of the contract.

2.3 Three stakeholders highlighted that the lack of transparent engagement with funding DCC users was of significant concern.

2.4 The neutral stakeholder indicated that the SEC Security Subcommittee (SSC) was 'made aware' of the improvements to the ECoS monitoring solution, specifically that DCC would benefit from monthly Threat Reports as a result of the integration of data feeds from ECoS into the Security Operation Centre (SOC) and Technical Operation Centre (TOC). However, they highlighted that the costs and benefit analysis was not discussed so they were not in a position to determine whether the cost had been fairly incurred.

DCC's response

2.5 DCC disagreed with our proposal. Its arguments centred on three key points:

- The programme of work was necessary
- The CR was necessary to implement the programme of work
- There was not a cheaper alternative, so the costs were economic and efficient

2.6 First, DCC argued that the work was necessary and in line with DCC's regulatory requirements as it allows DCC to deliver a reliable, efficient and secure ECoS system by the integration of data feeds from ECoS into the DCC's SOC and TOC. The programme achieves this by reducing the time to identify failures from 40 minutes (under the old solution) to near real-time, creating a better understanding of potential cyber-attacks through "cross-correlation", allowing for proactive threat hunting, and better detection of bad actors on Private Key Transfer activities. DCC also stated that the changes were necessary as they were required by changing industry standards on security monitoring. Furthermore, DCC provided evidence that it raised the integration of ECoS with DCC TOC and SOC at SSC meetings where no objections were recorded.

2.7 Second, DCC stated the only way to achieve this additional functionality was through a CR as the Service Provider had already been competitively procured and the original contract signed. DCC stated it would not be possible or efficient to re-tender this element separately.

2.8 Finally, DCC stated that even if the requirement had been included in the original contract, it would not have been cheaper to procure. This is because any additional requirements would have led the ECoS monitoring solution Service Provider to increase their bid to reflect the greater scope. Furthermore, the competitive procurement showed that no other supplier would have delivered the entire cost of the ECoS solution at a lower price to the selected service provider. Lastly, in negotiating the CR, DCC claims to have minimised the spend from £9.6m to £3.4m.

Reasons for our decision

2.9 Following careful consideration of stakeholders' representations and evidence provided by DCC, we have decided to change our consultation position and **allow £0.507m** in relation to costs associated with part of the CR that DCC **justified in RY23/34, resulting in £2.917m being deemed as Unacceptable costs and removed from the Allowed Revenue**. Below we state the reasoning for our decision.

The necessity of the programme

2.10 Our consultation position was based on the principle that if a piece of work, even within a larger programme forming a part of DCC's Mandatory Business, is not justified as necessary then no costs could be deemed economic or efficient.

2.11 We acknowledge the evidence that DCC has provided regarding how the new cyber security functionality enhances its ability to provide a secure service, and that it was implemented to meet changed industry standards on security monitoring.

2.12 We also acknowledge that the SSC confirmed that DCC had discussed the integration of ECoS with DCC's SOC and TOC and that SSC acknowledged the benefits of improved security monitoring.

2.13 Therefore, we accept that enhanced monitoring and cyber security functionality could be considered necessary and within DCC's SEC and Licence obligation to provide a secure service. However, we still have significant concerns about this CR; specifically due to:

- A lack of customer engagement to establish whether customers considered the work necessary and the costs economic; and
- DCC's poor contract management meant costs were not incurred economically and efficiently.

Lack of customer engagement

2.14 It is important to note that the CR *improved* the existing monitoring solution. DCC stated it reduced the time taken to identify failures from 40 minutes to near real time and provided a better understanding of cyber-attacks. However, there was an existing monitoring solution already in place.

2.15 In our Price Control Guidance,[15] we set out that for costs arising from decision of DCC's internal governance we expect robust evidence of how DCC has taken customer views into account. This includes consultation on the merits of adding additional functionality and costs to existing contracts.

2.16 We expect evidence of the following which has not been provided:

- Customer input was sought and gained in advance of key decision points
- Customers were provided with information at a level of detail (including costs and benefits) that enabled them to develop an informed view, for example through sharing draft business cases or impact
- Customers were consulted on options and cost/service trade-offs
- Decisions which took customer views alongside other factors into account, for example showing how and why initial proposals were amended or the reason the views were not reflected in final proposals

2.17 Customers were not presented with the reasons why real-time monitoring and enhanced integration of data-feeds would be beneficial. There was no costs and benefit analysis provided to customer for them to decide between the trade-offs of the functionality versus the costs. Customers were not given the opportunity to consider options or advised on the appropriateness of the changes proposed and the likelihood of performance improvements being realised. It is still unclear whether the programme of work was necessary from a customer perspective.

Concerns in area of contract management

2.18 Upon reviewing the procurement documentation for the original ECoS monitoring solution, we have significant concerns over the process and scope of the procurement. This includes that DCC did not clearly scope and establish the technical requirements in the contract which led to duplication between the scope of the original contract and the scope of the CR.

2.19 DCC is responsible for managing its service providers to derive value for money for its customers. If work relating to cyber security, monitoring and integration had been included under the original contract, then DCC should have effectively exercised its contract management function and held the service provider to account for delivery of functions already included in the contract. As such we

[15] Ofgem (2022), DCC Price Control: Processes and Procedures – Guidance, paras 2.78-2.81 www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

reject in the main DCC's second argument that the only way to achieve this functionality was through a CR.

2.20 The scope of the CR was to deliver seven solution areas, five of which were chargeable to DCC and two at the contractor's cost. We compared the five areas against the original contract and found in all but one area that there was a high likelihood that requirements were either duplicative, or the original contract was unclear about which provider should have been delivering the solution.

2.21 Therefore, we have decided to allow costs in relation to only Solution Area A as this appears to be a new functionality not in scope of the original contract. This means that **we will allow a total of £0.507m comprising of £0.373m in relation to design, build and test, and £0.134m in relation to operational chargers.**

2.22 The design, build and test costs and operational charges of the rest of the solution areas have been disallowed and removed from DCC's Allowed Revenue due to the significant risk in these areas that consumers have paid twice for the solution. **We thus deem the remaining £2.917m to be Unacceptable Costs and determine that these be removed from DCC's Allowed Revenue.**

DCC's counterfactual

2.23 We also reject DCC's counterfactual that if the scope of the CR had been included in the original contract it would not have been cheaper to procure. If the requirements had been properly set under the tender processes, a different provider may have won the bid, so it is not possible to compare like for like. Furthermore, if the majority of this CR was not required because the scope was covered by the original contract, it is immaterial that DCC made savings as part of its negotiations with the SP over the CR.

Conclusion

2.24 On this occasion, we are not satisfied that DCC was able to fully deliver value for money through this process.

2.25 Given the evidence we have seen regarding poor procurement practices, contract management and customer engagement, we will continue to closely monitor this area in future price control assessments. We expect DCC to display better transparency and clear RIGs reporting about further work aligned to this CR. Failure to do so may result in compliance action.

Q2 SMETS1: service stabilisation

Proposal at consultation: *Disallow* ***£0.600m*** *comprising 50% of costs of maintenance releases, operational incidents and device recovery changes, totalling £0.487m; and all costs expended on enduring certificate rotation and payments for legacy work, totalling £0.113m.*

Decision: *Disallow* ***£0.505m,*** *allowing £95k in costs of a preliminary impact assessment (PIA) spent on enduring certificate rotation solution.*

Background

2.26 Similar to previous years, the SMETS1 programme has experienced technical issues requiring interventions by DCC and relevant External Service Providers (SPs), resulting in a large number of fixes to uplift and maintain performance. DCC's Annual Service Report showed a continued poor performance by two SPs responsible for the Final Operating Capacity (FOC) cohort. DCC sought to justify costs across the following areas: maintenance releases; capacity improvements; device recovery; enduring certificate rotation; payments for legacy work; and operational incidents.

2.27 We consulted on accepting the costs required to deliver operational capacity improvements; however, we proposed to disallow:

- 50% of costs of maintenance releases, operational incidents and device recovery changes as, based on available evidence, we were not satisfied that DCC has struck the right balance in risk sharing by fully accepting these costs = **£0.487m**
- 100% of certificate rotation solution costs and payments for legacy work as these solutions were either not suitable or authorised and abandoned without delivering any benefits = **£0.113m**

Respondents' views (other than DCC)

2.28 Most respondents agreed with our proposals. Several remarked on the longer-term issues of the SMETS1 programme, one respondent highlighting a case of several thousands of FOC devices which did not function in smart mode for over a year.

2.29 Respondents were of the view that costs arising from inefficiencies or because of a failure of DCC or its SPs should not be borne by customers and ultimately consumers. A couple of respondents disagreed with our proposal to disallow 50% of costs, arguing for a full disallowance instead with one noting the full costs to stabilise the Dual Control Organisation (DCO) should be disallowed to encourage DCC to pursue cost recovery from its SPs.

2.30 A couple of respondents welcomed the reintroduction of service credits to the FOC SPs, although one noted that DCC only did so at the insistence of the SEC Operational Group.

2.31 One respondent expressed concern over further costs being incurred in future Regulatory Years, calling for additional scrutiny.

DCC's response

2.32 DCC disagreed with our proposals, addressing each in turn as follows.

Maintenance releases, operational incidents and device recovery

2.33 DCC argued that customers would not have received better value for money had DCC struck a different balance of risk with its SPs. DCC explained that its approach to contracting has relied on a limited "polluter pays" principle whereby SPs, where at fault, are only liable for direct costs of remedying an issue, but not for consequential downstream impacts on other parties. DCC argued that including liabilities for consequential damages into its contracts would have increased the operational costs of those contracts as SPs would have charged risk premium. Referring to our proposed disallowance amount, it asserted that 'if the broader definition of the "polluter pays" principle was applied to the entire External Costs contract base, suppliers would only need to [marginally] increase their bids for it to have been cheaper to use the narrow version of the "polluter pays" principle.' On balance, DCC believed that passing the consequential costs to its customers has been the more economic and efficient option.

2.34 DCC also noted that it is unable to retrospectively introduce these clauses into its existing contracts but it has sought to include them in its newer procurements.

Certificate rotation

2.35 DCC explained that the costs incurred on certificate rotation were expended on a Preliminary Impact Assessment (PIA) necessary to identify whether a more economical solution was needed. The PIA did identify a cheaper solution and DCC duly moved away from the original solution

2.36 DCC argued that as a result of carrying out this PIA it avoided c.£2m for the more expensive contract. As such, DCC asked for this disallowance to be rescinded.

Opt-in opt-out (OIOO)

2.37 DCC explained that the OIOO solution is to enable smart meters to opt in or out of the collection of half-hourly reads. An element of it developed a fault and DCC paid its SP for a fix. DCC disputed the cost with the SP but claims it was impossible to prove contractual liability, although it accepts that it may have been possible to better define the scope of the project upfront.

Reason for our decision

Maintenance releases, operational incidents and device recovery

2.38 We have said in previous years[16] that DCC customers should not pay for poor performance or delivery of DCC's SPs where issues are within DCC's or its SPs' control or where DCC should be recovering such costs under its contract – passing costs to customers must be demonstrably the only or the most economic and efficient option. Last year we made a decision on the same matter of costs related to service failure/poor delivery on the basis that (a) singular or shared responsibility can be determined, and (b) DCC has not showed it had acted in line with risk sharing principles. The same **two** grounds of **(1) determining responsibility,** and **(2) contractual risk sharing provisions** apply this year.

Determining responsibility

2.39 We consider that in this instance the issues were within the control of DCC and its SPs.

- *Maintenance releases:* DCC itself was able to assign the root cause to a SP in all instances of failures requiring fixes through the use of maintenance release.
- *DCO operational incident and device recovery:* As we said last year, the set-up of the DCO solution has been the responsibility of DCC who carried out the initial testing and assured its outcome, whereas the subsequent implementation has been the responsibility of the SPs under DCC-negotiated contracts. DCC and the SPs share in the responsibility for addressing incidents and dealing with issues such as rollback failures requiring device recovery exercise.

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

Risk sharing and contractual provisions:

2.40 First, we note that the costs under our disallowance proposal in relation to operational incidents and device recovery are *direct* costs, rather than *consequential* costs. DCC's contracts include provisions that require SPs to provide fixes at own cost and permit DCC to seek financial remedy under various circumstances. We have not seen evidence of DCC effectively utilising them in these two areas. The existence of a wider "polluter pays" clause is therefore irrelevant.

2.41 Secondly, we accept that the passthrough costs of maintenance releases have been consequential in nature. However, we do not agree that passing these costs to consumers is demonstrably the most economic and efficient option. Additional costs of fixes and maintenance have been a feature of the SMETS1 programme for a number of years. For example:

- In RY20/21, DCC incurred and passed on £5.53m in change and project requests on account of delays to FOC System Integration Testing execution as a result of a high number of defects.[17] We said that we were concerned about the level of risk borne by DCC's customers for issues in programme delivery and urged DCC to strengthen its contingency-planning and demonstrate more robust risk sharing.[18]
- In RY21/22, DCC incurred and sought to pass on at least £3.74m in maintenance release uplifts for FOC.[19]
- In RY22/23, DCC sought to justify further £2.36m in maintenance release and design change costs.[20]
- In RY23/24, we identified further £1.96m in stabilisation costs, including direct and consequential costs.

2.42 In our view, DCC has not followed best practice to robustly protect its position on ensuring that commercial risks are passed through the contractual supply chain; the SMETS1 contracts are an example of this. However, we note that DCC took some steps to adjust the contractual framework from at least RY22/23 with a

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[17] Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, A1.28-A1.30. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202021
[18] Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, 2.43. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021.
[19] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22, 2.31. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-202122
[20] Confidential document "SMETS1 FOC Costs by MR APv2" submitted to Ofgem on request on 20/09/2023

view to addressing this concern. Although we recognise that the apportionment of risk between parties will depend on the merits of each case, we are not satisfied that the acceptance of all consequential costs has struck the right balance. Given the disaggregated nature of the SMETS1 solution, DCC should have appropriate contractual provisions in place to effectively mitigate the risk of these issues and their downstream impacts. In the absence of evidence of risk sharing, we conclude, as we did in our RY22/23 decision, that risk should be shared at minimum equally. In line with our consultation proposal, we therefore determine that **£0.487m in costs of maintenance releases, operational incidents and device recovery are Unacceptable Costs** and are to be excluded from DCC's Allowed Revenue for RY23/24.

2.43 For the avoidance of doubt, and as set out in our RY22/23 decision, it is for DCC to decide how it structures it contracts. Nonetheless, we welcome that DCC has decided to enhance liability provisions in its newer contracts. We will continue to engage with DCC further on this issue, particularly in respect of the 4G Comms Hubs & Network programme and re-procurement of the Data Service Provider (DSP).

Certificate rotation

2.44 We accept DCC's explanation that the expenditure was justified in the wider context of identifying a solution that would best deliver value for money. We agree that carrying out a PIA to determine the scope and cost of proposed procurement or contractual change is good practice, so long as the cost of PIA itself is proportionate. In this instance we are satisfied that the use of a PIA at the cost was on balance economic and efficient. We have therefore decided not to proceed with our disallowance proposal in this area.

Opt-in opt-out (OIOO)

2.45 DCC itself accepts that the cost arose as a direct result of a fault in the solution of its contracted SP and that a better upfront scoping could have enabled DCC to better enforce its contract. As discussed above in relation to the ECoS monitoring solution and integration CR, we are concerned that poor scoping and definition of requirements have again led to avoidable costs.

2.46 We also observe that in its Price Control submission DCC noted that "the OIOO solution was never ratified by [DESNZ] and as a result the piece of work was cancelled in an incomplete state."

2.47 For these reasons we have decided to maintain or consultation position and determine that **£0.018m of the associated costs are Unacceptable** and will be excluded from DCC's Allowed Revenue for RY23/24.

Q3 SMETS1: Device swap-out

Proposal at consultation: *Disallow* ***up to £2.481m*** *in costs incurred beyond a proof-of-concept stage.*

Decision*: Not to proceed with the disallowance proposal; adjust DCC's OPR Contract Management Scores in relevant areas.*

Background

2.48 Device swap-out is a functionality enabling the exchange of smart metering equipment on premises. It was not initially available for SMETS1 meters but following DCC's consultation in 2022, one large supplier expressed interest in the solution for its FOC meter cohort.

2.49 DCC progressed work on device swap-out in 2023 including the solution design, PIT (Pre-Integration Testing), SIT (System Integration Testing) preparations and building of a feature switch. In July 2023, DCC was notified by the interested customer of its withdrawal from further development.

2.50 DCC had incurred £2.877m in costs for pre-July 2023 design, build and test and subsequent "unpicking" of the code from the service provider's environment. These costs have been confirmed as entirely sunk. We proposed to disallow the costs incurred on activities post-Proof of Concept (PoC) stage due to a lack of evidence of engagement with the sole customer on the scope and therefore a lack of justification for any further work.

Respondents' views (other than DCC)

2.51 Four respondents, who chose to comment on this proposal, agreed with our minded-to position.

2.52 The sole interested customer stated that the PoC stage of DCC's design identified that the solution was unworkable and it was at that stage that they reviewed the business case and decided to withdraw from the development. Their respondent also provided additional evidence including:

- Their view of the timeline of key events
- A copy of the high-level design document received from DCC in May 2023
- Correspondence with DCC following their notification of withdrawal in July 2023

2.53 Other respondents expressed concerns over the socialisation of the nugatory spend among all paying customers and DCC's contract management approach, with payments made without a contractual change being finalised and signed.

DCC's response

2.54 DCC disagreed with our proposal and submitted additional evidence in support of its four main arguments:

- First, DCC was required to deliver the device swap-out solution due to obligations within the Smart Energy Code. It consulted with industry to ascertain the interest and received a confirmation from DESNZ in January 2022 that there was a positive business case for the service.
- Secondly, DCC consulted with industry on the charging mechanism for the solution which received mixed responses. DCC referred the matter to DESNZ who stated that it would not intervene and that industry parties could raise a SEC modification to change the charging approach, which did not happen.
- Thirdly, DCC was directed by DESNZ to produce a Joint Industry Plan (JIP) for developing the service and engaged in industry forums (including the Testing Advisory Group, or TAG, and Industry Managers Forum, or IMF) as well as directly with the customer on the design of the service.
- Fourthly, DCC stopped all the work as soon as it was notified by the customer of their withdrawal.

2.55 DCC argued that it had acted in accordance with its obligations and asked that the disallowance be rescinded in full.

Reason for our decision

2.56 For clarity, we do not dispute the basis on which DCC initiated the device swap-out project, nor do we dispute that DCC halted the project post-July 2023. We accept that DCC consulted with industry to ascertain the demand for the solution and that there existed a positive business case for at least one customer on the basis of which DCC delivered a PoC. We saw evidence of DCC requesting confirmation from the customer in writing on whether they wished DCC to deliver the PoC (but only the PoC), which was received. Our key concerns have been that:

- DCC did not explain whether and how it had engaged with the sole customer on the scope of the solution <u>beyond</u> the PoC, including any engagement on costs.

- DCC paid for the key aspects of the low-level design and testing before finalising the negotiations with the main SP and signing a change authorisation note (CAN).

2.57 Upon review of DCC's additional evidence, we have decided not to proceed with the proposed disallowance for the following main reasons:

- First, we accept that DCC did engage with industry on the approach to delivering the solution after the JIP was updated with a go-live date that set a deadline for the delivery. This included a full approach to testing which was presented to TAG in May 2023. We have seen no evidence of any objections raised in the industry forums.
- Secondly, we understand that the customer withdrew upon re-evaluating their business case with a greater knowledge of the high-level design of the solution. Nevertheless, we also note that they did confirm their participation in requisite testing activities as late as June 2023, including support for September 2023 User Integration Testing (UIT).

2.58 We therefore recognise that it was reasonable for DCC to proceed with the work.

2.59 Nevertheless, we are concerned that DCC's lack of clear engagement and poor contract change management contributed to the resulting nugatory spend:

- The email correspondence from DESNZ regarding the costs and benefits, which DCC relied on, is dated January 2022 whereas much of the expenditure was incurred for work in the first half of 2023. DCC should have engaged directly with the sole customer on the scope <u>and</u> costs and receive a clear agreement to proceed through successive design stages. The evidence submitted to us by the customer shows that they were not aware of the scale of costs which DCC was incurring for the work carried out on their behalf.
- DCC did not provide satisfactory explanation for its repeated use of the temporary funding vehicle of Early Engagement Instructions and payments made to the SP in the absence of a signed CAN. We have repeatedly questioned DCC about the use of the EEIs (or similar instruments) and warned DCC in our Price Control consultations and decisions since RY19/20 about the risks involved. The independent contract management auditor likewise highlighted these risks to both DCC and the SPs in its RY22/23 report.

2.60 We are unable to quantify the impact of these aggravating factors on the total costs. In our RY20/21 decision, we set out that in such cases we may instead adjust DCC's OPR scores, depending on the circumstances of the case.[21] We consider that in this instance DCC's actions have constituted clear failings under the modified NAO framework used for DCC's contract management incentive. We have therefore decided to reduce DCC's scores under the contract management OPR incentive as follows:

- In domain #6 (Contract lifecycle), under supporting question 6.3. "Is change controlled and well managed and does the contract remain current?" we have decided to reduce DCC's score by 1. The change control process DCC followed in respect of the main CR was insufficient. Changes were not formally written into the contract despite work being delivered and funded by DCC.
- In domain #4 (Contract approach), under supporting questions 4.1 "Is there an appropriate allocation of risk between DCC and the supplier?" we have decided to reduce DCC's score by 1. DCC left itself (and by extension its funding parties) exposed to the impact of change in circumstances, in this case the customer withdrawal, bearing the full risk of nugatory spend which materialised.

2.61 The impact of these revisions on DCC's overall margin position is limited in the context of the overall nugatory spend. However, we expect DCC to reflect on the following lessons learned from this project which are that:

- DCC does not absolve itself of its responsibility to engage with its customers by relying on brief email correspondence with any party, including DESNZ, and has a clear record of engagement with customers on the scope and costs/benefits of work it delivers on their behalf at all stages.
- DCC's governance framework may require a revision to ensure more effective oversight of the decision-making for the delivery of Mandatory Business. This should include documenting the following matters: (1) ensuring that any projects are based on regulatory, policy or customer requirements; (2) management controls are in place to regularly review assumptions and check if the selected delivery route for any mandated work continues to provide value for money and is aligned to expectations.
- Contractual changes are managed such that DCC does not expose itself to undue risks by upfront payments for delivering work still under negotiations.

[21] Ofgem (2022), DCC Price Control Decision Regulatory Year 2020/21. paragraphs 3.66-3.77. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021

As we previously commented, resorting to EEIs or similar instruments should be an exception, not a standard practice.

2.62 While on this occasion we have decided not to exclude costs from DCC's Allowed Revenue, we will enhance scrutiny to DCC's processes in the areas highlighted above going forward.

Q4 SMETS1: Increased charges for interim DCO contract

Proposal at consultation: *Disallow* ***£0.437m*** *of operational costs incurred in RY23/24 and the following forecast costs: £1.722m in RY24/25, £2.085m in RY25/26, £2.424m in RY26/27 and £2.759m in RY27/28.*

Decision: *Our proposals remain* ***unchanged.***

Background

2.63 In RY22/23 DCC entered into an interim emergency contract with Capita for the provision of DCO hosting service to safeguard continuity of service in the wake of a subcontractor market exit. We assessed DCC's procurement of this contract as part of the RY22/23 Price Control. We did not find all costs economic and efficient but allowed DCC to recover justified costs for the duration of the interim solution until April 2024, whereafter we decided to only accept costs at the level of the original solution.[22]

2.64 In its RY23/24 submission, DCC reported further increase in operational costs, which were 61.5% above the baseline of the original solution of April 2023, and 13% higher that DCC's own forecast. DCC also sought to justify project costs, principally for technical (security/ software) upgrades. We proposed to disallow a portion of the operational costs which went above justified levels of January 2023.

Respondents' views (other than DCC)

2.65 All respondents who commented on this issue agreed with our proposals, although one pointed out that they were unable to comment on specific costs due to lack of visibility of the details in DCC's price control submission.

2.66 One respondent noted that given the recent procurement, DCC should have appropriately scoped the contract and its costs in detail. Similarly, another echoed the concern about the inclusion of additional baseline charges that DCC should have been aware of at the time of contract signature.

[22] Ofgem (2024), DCC Price Control decision: regulatory year 2022 to 2023, 2.1-2.36. www.ofgem.gov.uk/decision/dcc-price-control-decision-regulatory-year-2022-2023

DCC’s response

2.67 DCC disagreed with our proposal. DCC said that the increase in charges above inflation was not additional but “reflected what was agreed as part of the service”, which, DCC asserted, was procured competitively. DCC submitted data on the operational charges paid from January 2023 to October 2024. This confirmed increases in charges between January 2023 and April 2023 from £0.177m to £0.193m per data centre per month, with indexation of 8.7% applied in August 2023 and billed back to April 2023.

2.68 DCC restated its justification of project costs describing further operational requirements needed to enhance and future-proof the DCO hosting service. DCC explained the change requests raised with Capita, arguing that these were not a part of the original contract and the need for the changes only became apparent after the DCO service started operating and could not have been foreseen. DCC said that a disallowance should not be “set arbitrarily at 100%” but reflect the value the changes delivered.

Reason for our decision

2.69 First, we accept DCC’s explanation in support of the project (change request) costs. However, this does not have bearing on our consultation proposal which focused on operational charges only.

2.70 Regarding the operational charges, we note DCC’s additional evidence which shows *how* the charges increased; nonetheless, DCC did not explain *why* it had agreed to include the increases in baseline charges in its contract. We have further confirmed that:

- The costs of the original solution are a fair and valid comparison for Capita’s charges.
- The January 2023 to April 2023 increases were additional baseline charges needed to bring the solution to at least the same standard as existed under the previous contract.
- The current charges are not transparent, and significant savings can be achieved by moving away from the incumbent.

2.71 We did accept last year that DCC had been constrained in its options to move away from the original provider to ensure business continuity and prevent significant disruption to the smart metering service. However, we reject DCC’s claim that the service was competitively procured as the contract was negotiated with, and awarded to, Capita directly (as we discussed in detail in our last year’s consultation and decision). The evidence shows that the current contract does not deliver good value for money. Despite providing equivalent service to the previous subcontractor, Capita's charges have been significantly more expensive with additional costs incurred above and beyond DCC's last year's justification without a clear explanation. Therefore, we do not deem these costs to be economic and efficient, and maintain our consultation proposal to:

- **Disallow £0.437m** of the operational costs in RY23/24 above the contractual indexation. For clarity, this is not a "100% disallowance" as DCC asserts, but a proportion calculated as the difference between DCC's Price Control reporting, and the baseline charges justified as of January 2023 adjusted for inflation at 8.7%.
- Reduce DCC's allowable forecast costs to that level with an allowance for indexation in RY24/25. Table 2.1 below sets out the impact of our decision on DCC's Allowed Revenue per RY.

2.72 We are further concerned that the requirements were not properly scoped and defined in the contract, despite being understood at the time given DCC had opted for a "lift and shift" solution provided by Capita. This resulted in the need for additional project costs via change requests.

2.73 We are disappointed that DCC is yet to procure an enduring solution. We will closely scrutinise any further costs incurred in RY24/25 in next year's Price Control. We expect DCC to move at pace to competitively procure a compliant enduring solution which provides good value for money. We also expect DCC to effectively manage its existing contract, including challenging any further requests for additional investment from Capita to maintain an interim service.

Table 2.1: Disallowance per RY

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

Q5 DSMS: nugatory spend

Proposal at consultation: *Disallow **£0.300m** in costs of exploratory work*

Decision: *Our proposal remains **unchanged***

Background

2.74 In 2023, DCC started a programme of work to replace its Service Management System (DSMS) as the existing contract was coming to an end in 2024. DCC reported expenditure of £0.300m on a project request for "[DSMS] discovery and service enabling work" raised with one of its incumbent SPs.

2.75 We proposed to disallow these costs on the grounds that the procurement process had not been carried out on a competitive basis in line with the Licence requirements under LC 16. We saw no evidence of benefits being delivered as DCC halted the project after we informed DCC of our view that its selection process was not compliant.

Respondents' views (other than DCC)

2.76 The respondents who commented on this issue agreed with our proposal on the basis that the process did not adhere to the Licence conditions. A couple of stakeholders suggested that DCC's Internal Costs associated with this activity should also be considered for a disallowance.

DCC's response

2.77 DCC admitted that the contract was not competitively awarded. However, it argued that the exploratory work was not without any benefits. Specifically, DCC claimed it had "prompted DCC to set up the Service Management Working Group to actively engage and solicit user or practitioner input from a good representation from across industry, to ensure the requirements used in the competitive procurement exercise were aligned with the needs of industry users." According to DCC this led to the competitive tender, once initiated by DCC, being better scoped.

2.78 DCC also said that it has since strengthened its internal processes so that competitive procurement is always undertaken.

Reason for our decision

2.79 It is welcome that DCC sought customer input and engagement on the scope and requirements of the service. However, we do not accept DCC's argument that ascertaining customer views ahead of the procurement of a customer-facing service can be considered a material benefit of the work carried out and funded under this project request. Indeed, effective customer engagement is an expected part of any procurement which DCC undertakes, as is ensuring that tender requirements are properly understood and scoped.

2.80 As we have seen no further evidence of additional benefits delivered through this work, we maintain our consultation proposal to disallow the costs of this procurement in full and exclude them from DCC's Allowed Revenue for RY23/24.

2.81 We note respondents' suggestion to consider the impact of this procurement on DCC's Internal Costs. We have considered this as part of our broader assessment of Internal Costs associated with the Network Evolution Programme (see Q10 in chapter 3 below).

Q6 SMETS2: GBCS 4.1 SIT, UIT and Pilot Support

Proposal at consultation: *Disallow **£0.515m**, or 50% of the total costs of change, assuming an equal split between SECMP0007 activities and unjustified work remedying operational issues, incidents and defects.*

Decision: *Disallow 50% of the costs of defect fixes, allow costs of resolving operational issues with comms hubs (assuming an equal split between both)*

Background

2.82 DCC raised a CR for the implementation for an updated version (v4.1) of Great Britian Companion Specifications (GBCS). The scope comprised of delivering mandated over the air firmware updates to PPMIDs and HCALCS under SECMP0007 as well as changes to address operational issues associated with re-joining gas meters, defect and production incident fixes.

2.83 We proposed to accept the costs associated with SECMP0007 delivery but disallow the costs of operational issues, defect and incident fixes which DCC did not justify. In the absence of further evidence, we calculated the proportion to be **£0.515m,** or 50% of the total costs assuming an equal split between SECMP0007 activities and the remaining activities.

Respondents' views (other than DCC)

2.84 Those who commented on this proposal agreed with our consultation position.

2.85 One respondent said that as the defects appear to have arisen in a developed solution, any additional costs should be borne by the responsible SP(s). They were of the view that DCC should be maximising the use of its contractual provisions to hold the SPs to account, instead of relying on customers to fund programme overruns.

2.86 Two respondents argued that, although defect masks for releases are agreed by the Testing Advisory Group (TAG), this does not mean that the TAG agrees that the defects should be rectified and paid for by DCC customers. One of the respondents specifically stated that "the agreement is purely that following consideration of the severity of the defects, the DCC should be allowed to exit the specific testing gate as the defects are not (in many cases) viewed as being critical." The respondent was of the view that where defects arise due to a design error, DCC should cover the costs of remediation. Where defects arise due to an incorrect design implementation by a SP, that SP should bear the costs.

2.87 One respondent noted our proposal to disallow 50% of the CR costs. They were of the view that this was reasonable in the absence of evidence regarding specific costs.

DCC's response

2.88 DCC disagreed with our proposal.

2.89 First, DCC argued that all of the defects related to technical activities which were required in order to maintain compliance with the SEC and were part of the BAU process for releases. DCC clarified that the scope of the CR comprised:

1. "SECMP0007 – Delivering mandated over the air firmware updates to PPMID
2. Comms Hubs changes to address operational issues associated with re-joining Gas Smart Metering Equipment (GSME)
3. Tosh[iba] Defects – Silab stack 6.7.10 is to be used, 15 defect fixes along with 1 production incident fix
4. WNC Defects – Silab stack 6.7.10 is to be used, 11 defect fixes along with 1 production incident fix
5. EDMI Defects – Sensus WAN SDK that improves Firmware download performance, 25 defects fixes"

2.90 DCC also clarified that all costs were incurred for the CSP-C&S SP, with items 3-5 relating to equipment provided by manufacturers within the company's supply chain.

2.91 DCC explained that it is economic and efficient to bundle a number of smaller changes (including any required fixes) and deliver defect fixes through a wider release because:

- It avoids multiple releases during the year.

- It allows software upgrades to be delivered at minimal incremental cost into a larger release.

2.92 Secondly, DCC argued that the defect mask (the acceptable levels of defect fixes) had been approved by the TAG and that a cost disallowance would undermine the TAG's authority in this area.

2.93 Thirdly, DCC reiterated that it was impossible to quantify the proportion of costs related to individual elements within a wider release but that the costs of defect fixes were likely "a very small proportion of the total". Therefore, DCC was of the view that a 50% disallowance proposal was excessive.

Reason for our decision

2.94 We sought further evidence from the Test Advisory Group to help inform our decision. The TAG clarified that it is not within its remit to "decide or approve the contents of any given release, but [to] provide governance over the scope and results of testing." It also explained that defect masks apply to PIT and SIT test phases but not to Production issues. Nevertheless, the TAG also pointed out that its terms of reference have recently been expanded to include review of testing scope. In relation to the two separate areas, we found the following:

- Comms Hubs changes (issue #2) sought to address operational issues which had arisen as a consequence of a change introduced via a previous version of GBCS v3.2. This was intended to improve the way smart metering devices securely re-joined to the Home Area Network (HAN) but also impacted some energy supplier processes for installation of GSME. The Government ran a consultation in August 2021 to resolve this by inclusion of the comms hub changes in the GBCS v4.1 update. DCC delivered this as part of the wider release.[23]

- The defect fixes (issues #3-5) related to remedy of 64 low severity defects on Toshiba, WNC and EDMI devices. These were presented to the TAF in an appendix to the test approach document and were noted by the TAG and were noted by the Group at the time, however, as the defects had been discovered in Production, they were outside the remit of the TAG.

[23] BEIS (2021), BEIS Consultation on Changes to the GB Companion Specification to address operational issues associated with re-joining Gas Smart Metering Equipment (CRPs 613 and 649). Accessible on the SEC website here: https://smartenergycodecompany.co.uk/beis-consultation-on-changes-to-the-gb-companion-specification-to-address-operational-issues-associated-with-re-joining-gas-smart-metering-equipment-crps-613-and-649/

2.95 In light of the additional evidence, we have decided not to proceed with our proposed disallowance of costs associated with the comms hubs operational changes. We recognise the expectation placed on DCC to deliver these changes and we accept that DCC was not responsible for the impact of the initial GBCS v.3.2 changes on supplier processes which necessitated further changes under GBCS v4.1.

2.96 However, we remain of the view that the costs of the defect fixes have not been fully justified. We understand the decision to include these fixes within the wider release; however, we have not seen sufficient justification for DCC's decision to pass the costs of these fixes to customers in full, rather than assigning the root cause and identifying the responsible party within its supply chain. As noted by a number of respondents, a review of the defect mask or test approach by the TAG does not absolve DCC from ensuring that the costs of implementation are economic and efficient. In line with our reasoning in respect of SMETS1 service stabilisation costs (see 2.39-2.44), in the absence of any evidence of appropriate risk sharing, we are of the view that risk should be shared at minimum equally and therefore determine that 50% of the costs of defect fixes under this CR, calculated to be **£0.129m, are Unacceptable and shall be removed from DCC's Allowed revenue in RY23/24.**

2.97 We welcome the change in the TAG's ToR such that the group now also reviews the scope of testing to be done. However, we are concerned that the governance process does not provide sufficient oversight of cost impacts and that the commercial assurance of DCC's External Service Provider contracts is not sufficiently robust, resulting in a lack of transparency of costs of change and implementation. We will engage further with DCC on this issue, including the governance process that it follows. We would expect DCC to produce a plan to reduce the impacts of defects and issues, at minimum by monitoring their frequency and costs and discussing these within suitable industry forums with customers.

Clarification on the proportion of Unacceptable costs

2.98 We have repeatedly sought information on the scope of the individual items within the overall CR, but DCC was unable to provide this. In the absence of that information, we assumed an equal split between SECMP0007 (item #1) and the remaining issues (comms hub changes and defect fixes). Within those, we assumed an equal split between changes to the comms hub operational issues (item #2) and defect fixes (items #3-5). The proportion of costs we deem not to be economic and efficient in this case is therefore 12.5% of the overall CR value (or 50% of the 25% assigned to the defect fixes).

Q7 TAF programme delays

Proposal at consultation*: disallow the total costs associated with delays: £0.740m.*

Decision*: remains unchanged from the consultation.*

Respondents' views

2.99 Four stakeholders supported our consultation position, two did not provide comment, and DCC disagreed with the proposed disallowance.

2.100 Those who supported the disallowance said contributing factors that lead to the delays were reasonably foreseeable, had been flagged as potential issues, and appear to have been within DCC's control to resolve.

2.101 DCC stated that the reason for the delay was due to the heavier than expected weight of the robotics which was a low probability event and, therefore, not necessarily foreseeable.

Reasons for our decision

2.102 We do not accept that the weight of the robotics was an unforeseeable event. Furthermore, stakeholders understood that different reasons for the delays were provided to SEC Panel Test Assurance Group, such as the overheating of the lab and overwhelming of the lab's power supply and that these were flagged before the work began.

2.103 Given the reasons for the delays were in our view foreseeable, they should have been in DCC's control to resolve. Therefore, we maintain the consultation position of 100% disallowance in relation to costs associated with delay: £0.740m.

Q8 Forecast external costs

Proposal at consultation*: disallow and remove from DCC's forecast £11.347m, comprising of forecast costs associated with a cloud-based testing environment for CSP-Central and CSP-South.*

Decision*: remains unchanged from consultation.*

Respondents' views

2.104 All four stakeholders, who responded to this consultation question, supported our proposals.

2.105 Stakeholders expressed concerns over DCC's poor forecasting and justification for costs, activities and specific delays.

2.106 DCC did not address this question in their consultation response other than in relation to the general comments DCC made about forecasting disallowances that the nature of DCC's expenditure means that there is an inherent level of uncertainty in its forecasting.

Reasons for our decision

2.107 In the absence of any justification from DCC, we are proceeding with our consultation position and determine that £11.347m of External Costs are to be excluded from DCC's forecasts from RY24/25 to RY26/27.

2.108 We are disappointed that DCC did not provide any response to our proposals to disallow forecast External Costs. We share stakeholders' concerns around DCC's lack of justification for its forecasting.

2.109 Where DCC wishes to re-justify any previously disallowed forecast costs in future Regulatory Years, we expect to see full justification and evidence that the costs meet the required certainty and efficiency thresholds, and other principles as set out in our guidance.[24]

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

Q9 Other views on External Costs

Respondents' views

2.111 Several respondents expressed general concerns about the year on year increases in External Costs and the effectiveness of DCC's cost control:

- One respondent raised concerns about industry exposure to costs resulting from the poor performance of DCC and/or its SPs, especially where multiple issues combine, giving examples of poor contract management, dependency on contractors and lack of evidence of efficient procurements.
- One respondent welcomed our scrutiny of DCC' External Costs and suggested our findings in relation to change management should also be applied to the contract OPR management incentive.

2.112 Several respondents also raised concerns about DCC's ability to accurately forecast its costs:

[24] 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

- A couple of respondents referred to the issue we had commented on in our consultation, in relation to the disparity in costs between FIA for SEC modifications and actual costs of modifications.
- One respondent commented specifically that they have little confidence in DCC's SMETS2 CSP cost forecasts.[25]

2.113 A couple of respondents highlighted the need for better forecasting ahead of a move to an *ex-ante* cost control regime

2.114 A stakeholder also commented on the impact of the Licence expiry and associated business handover activities on DCC's costs, questioning whether there was sufficient time for prospective applicants for the Successor Licence to influence DCC's Business Handover Plan before it is approved by Ofgem.

2.115 DCC did not provide any additional views in response to this question.

Our views/actions in response to stakeholder comments

2.116 We understand stakeholders' concern about the increase in DCC's External Costs over time. For transparency, we have included in figure 2.1 below a view of how DCC's External Costs have changed. It is important to note that the primary driver of the cost increase has been the procurement of new contracts, most recently to deliver the 4G Comms Hubs & Network programme. We continue to scrutinise both the costs of new procurements as well as costs resulting from change management. We share stakeholder's concerns about the level of customer exposure to the latter, particularly as pertains to appropriate risk sharing and holding poorly performing SPs to account. As set out in paragraphs 2.26-2.47, we found a portion of DCC's costs expended on the SMETS1 FOC stabilisation to be Unacceptable for those reasons. Similarly, we decided to reduce DCC's contract management score under the OPR incentive (as discussed in paragraphs 2.59-2.60) as a result of insufficient change control in developing the device swap-out solution. We will continue to scrutinise these areas and expect DCC to ensure that these issues will not materialise in future programmes. Equally, we will continue to scrutinise any new procurements or inclusion of new requirements into existing contracts. It is crucial that DCC both consults properly with its customers on the scope and costs of new requirements and defines these clearly upfront when engaging with Service Providers.

[25] DCC's Price Control submission showed a negative variance of -£39.2m in RY24/25, followed by a positive variance of £52.7m in RY25/26. See Ofgem (2024), DCC price control consultation: regulatory year 2023 to 2024, figure 3.3. www.ofgem.gov.uk/consultation/dcc-price-control-consultation-regulatory-year-2023-2024

2.117 We agree with respondents that accurate forecasting will be fundamental for the success of an *ex-ante* cost control regime. In our recent consultation on the future process for Determination of Allowed Revenue[26] (part of our ongoing review of DCC's regulatory arrangements), we set out several proposals to assure DCC's forecasting, including:

- An obligation to consult with a dedicated customer challenge group on a costed business plan prior to the Price Control submission to Ofgem.
- The publication of a Business Plan Guidance setting out requirements on the expected evidence in support of DCC's forecasts.
- The inclusion of measures on the quality of the submitted Business Plan against our guidance, and subsequent delivery to that Plan, into a future DCC remuneration policy.
- The continuation of the *ex-post* assessment until the end of the current Licence as a backstop should DCC's forecasts prove inaccurate or DCC deviates from them.

2.118 We note stakeholder feedback in relation to the cost disparity in the SEC mod *governance*. We understand this is largely driven by the lack of visibility of post-PIT testing activities, including Regression Testing costs. As noted in our consultation, we welcome DCC's commitment to improve cost estimates and visibility and expect changes to be implemented as soon as possible. We may revisit this issue in the next Price Control.

2.119 Finally, we note the comments in respect of end-of-licence activities. We want to minimise any *risk* of disruption to DCC's service during the Business Handover Period (which we expect to occur throughout 2026) and unnecessary costs being incurred. To that end, we require from DCC a compliant Business Handover Plan (BHP),[27] including a forecast of costs over the business handover period. The BHP will include the term of reference of a newly constituted Joint Handover Steering Group with an independent chair and a third-party assurance, which will oversee the handover activities and should include representatives from industry as well as the Successor Licensee.

[26] Ofgem (2024), DCC Review Phase 2: Determination of Allowed Revenue. www.ofgem.gov.uk/consultation/dcc-review-phase-2-determination-allowed-revenue
[27] Under LC 43

Figure 2.1: DCC's total External Costs per RY

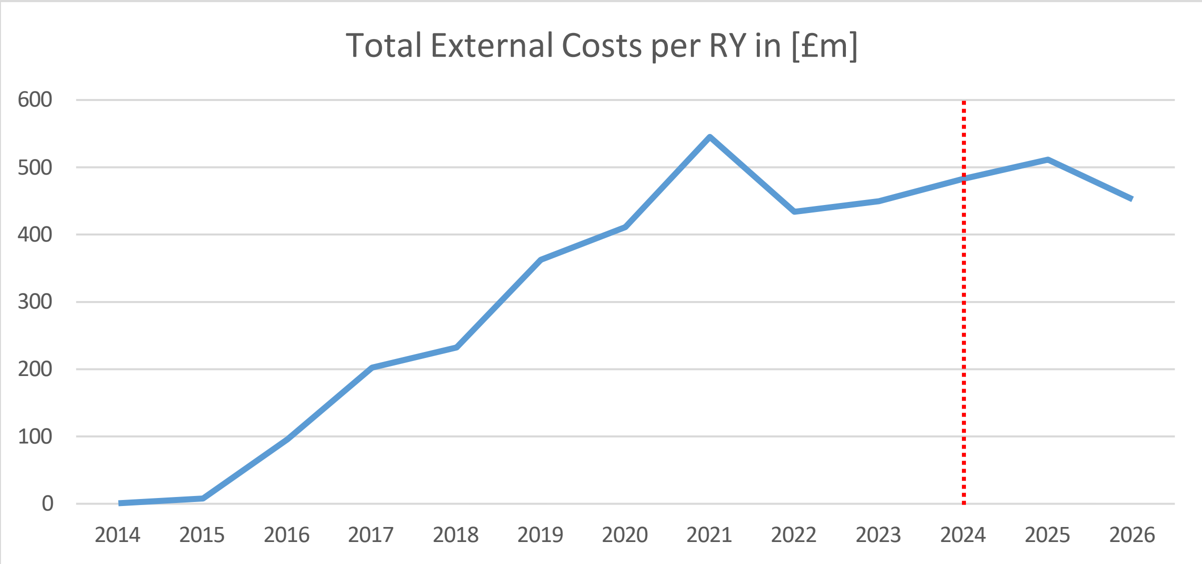

Figure 2.1: Input table

RY	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	**2024**	*2025*	*2026*
EC	0.8	7.7	96.0	202.2	232.3	362.5	411.1	545.2	433.7	449.4	**483.0**	*511.6*	*452.3*

3. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY23/24. We have reviewed all responses and determined a total of £15.157m incurred Internal Costs for RY23/24 (including the associated Shared Service Charge) as unacceptable. Our decision is based on various costs related to inefficiencies in resourcing activities, as well as inefficiencies in External and Internal Services, the Business Accuracy Programme (BAP), the application of Shared Service Charge, contractor benchmarking as well as costs incurred because of inadequate planning and scope.

We have also decided to maintain our position on DCC's forecast costs over RY24/25 and RY25/26 due to a lack of clarity and certainty over forecasts, and in particular forecasts associated with the Network Evolution and SMETS1 programmes, as well as with the Corporate Management, Security, Service Delivery and Operations cost centres.

Questions posed at consultation

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?**
11. **What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?**
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?**
13. **What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?**
14. **What are your views on our proposal to disallow forecast cost variances in RY24/25 and 25/26; and all baseline forecast costs for RY26/27 onwards?**

Q10 Payroll cost disallowances for internal costs

Proposal at consultation: *Disallow a total of £5.031m incurred payroll costs across three cost centres: Service Delivery, Operations and Network Evolution.*

Decision: *Adjust our position to allow the same costs for the 4G Communications Hubs and Networks Programme, as incurred in RY22/23 (£5.363m), and disallow the variance (£2.064m) but maintain our position for the remaining cost centres. This corresponds to a total disallowance of **£3.805m** with a total reduction of **£1.226m**.*

Respondents' views

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

3.2 One respondent suggested for Ofgem to propose a 100% disallowance for the entire increase in RY23/24 costs.

3.3 Two respondents did not provide their views on proposed incurred disallowances.

3.4 DCC did not agree with our consultation position on Network Evolution costs. DCC explained that Ofgem cannot disallow costs simply based on costs not falling within the reported forecasts. DCC agreed that the types of activities flagged in their RY22/23 submission are consistent, however the level of resourcing effort is not consistent with the forecast from their RY22/23 submission. DCC stated the reasoning for the variance in costs is based on the fact that the CH&N programme is currently in the 'post contract award delivery stage, which is more resource intensive and required the establishment of a delivery team. DCC has also provided further evidence of a breakdown of the roles working on the CH&N programme.

3.5 For Service Delivery, DCC noted a calculation error in the variation from last year and so the proposed disallowances should have been £1.614m rather than 1.624m as consulted upon. DCC provided further explanation that a new time-sheeting tool in April 2023 has meant the RY23/24 costs are allocated on a different basis to RY22/23. DCC states that the reasoning for the increase in the Professional Services Practice (PSP) function is due to the transfer of half of the Portfolio and PMO Transformation staff who were assigned to the Finance function in RY22/23.

3.6 Under the Operations cost centre, DCC stated that they must be able to conduct investigatory activities in relation to fibre connectivity. However, given DCC is not planning further work following the trial, DCC accepts Ofgem's position in relation to this cost disallowance.

Reason for our decision

3.7 We disagree with DCC's view that Ofgem is not entitled to disallow a cost merely because it varies from a forecast, our rationale for this position is as follows: As. mentioned in previous years, LC37.5[28] requires DCC to submit a price control report that details the comparison between the amount that was actually incurred

[28] LC37.5 – Part A: Submission of annual report on cost performance

for the relevant Regulatory Year and the amount that was estimated to be likely to be incurred in the LABP (and in all updated forecasts of expenditure submitted in accordance with LC 32[29]). LC 37.6[30] also requires DCC's submission to provide an explanation of any material variations between the incurred and forecasted costs and requires the DCC to provide a statement of any material revision it thinks is necessary to make to the LABP as a result. Our assessment of DCC's incurred costs is based on whether DCC has provided sufficient evidence to show that the costs incurred were economic and efficient. In paragraph 3.9 of the Guidance[31], it lists the ways DCC can make sure it provides good quality reporting to support cost variations. This is further complemented by the RIGs guidance[32] that states that the *"updated forecasts should reflect economic and efficient costs as submitted by DCC and reviewed by the Authority at the previous price control review."*

3.8 We note respondents' views, as per the previous year, to increase the disallowance for Network Evolution and to propose a disallowance of 100% of the increase in RY23/24 costs, as the 4G CH&N programme has been delayed by circa two years. Whilst we appreciate the views of the respondents, Ofgem has a duty to ensure DCC is being judged fairly and objectively on the evidence that it has submitted on the incurred costs. We believe, as previously mentioned, it is for DCC to provide us with evidence to show the costs incurred are economic and efficient. We will then assess the evidence provided to determine if this is the case. In this instance, DCC failed to provide sufficient evidence to show how the incurred costs for the Operations and Service Design Cost Centres as well as increased costs for the 4G CH&N Programme compared to RY22/23 were economic and efficient. We have therefore used the evidence DCC has submitted within their narrative submission in relation to scope of work as well as the number of FTE's allocated to cost centres and programmes to decide to either maintain our consultation position or adjust the disallowance of costs incurred. This is discussed further below.

3.9 In the RY23/24 Price Control submission, DCC claimed the reason for the increased costs for the Professional Service Practice sub team in Service Delivery

[29] LC 32 – Reporting of Price Control Information
[30] LC 37.6 – Part A: Submission of annual report on cost performance
[31] Ofgem (2022), Data Communications Company (DCC) Price Control Guidance: Processes and Procedures 2022. https://www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[32] Ofgem (2023), Data Communications Company (DCC): Regulatory Instructions and Guidance. www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2023

was entirely due to the new time sheeting system which was implemented during RY23/24, but the overall team size had remained consistent with previous years. This led to reported costs for RY23/24 to include some resources that were deployed on programmes. In their consultation response, DCC stated that the additional resource and £1.12m of the proposed disallowance cost is due to reassigning half of the EPMO team to Service Delivery. The residual (£0.494m) proposed disallowance is attributed to the implementation of the time sheeting system. DCC has not provided sufficient justification of the activities driving the increase in resource costs of the EPMO function. As such we maintain our consultation position to disallow costs above those incurred in RY22/23. Noting that we had a made a calculation error and that this should be £1.614m.

3.10 We recognise that virtual WAN requirements may become part of DCC's business in the future. However, work in this area is currently not part of the Authorised Business. We note that the evidence we have seen of government requests were based around exploratory work on the options to improve connectivity for remote premises in the north, which included trialling the viability of a fibre technology solution. We do not expect that responding to government requests requires dedicated product staff and can be carried out as part of BAU activity by its existing regulatory requirements. We maintain our consultation position and have decided to disallow the incurred cost of £0.117m.

3.11 Also, we did not receive any satisfactory evidence from DCC to justify the material variances on the Network Evolution programme. In its explanation, DCC provided high-level explanation into the increase in resource costs for the 4G Comms Hubs and Networks (CH&N) programme, as it has transitioned to a core delivery phase. As per our position last year, we remain concerned about the drivers that have led to material variance in resource levels in 4G CH&N programme. Whilst the level of costs increased, we have not received further explanation from DCC regarding the scope of work which is driving these increased costs. DCC provided further clarification on the activities and individual roles within their consultation response, however, we are not satisfied that there was an increase in scope which was met by a rise in FTE and therefore the increased resource within the 4G CH&N programme remains unjustified. We have used this further evidence to compare the number of individual roles in the 4G CH&N programme in RY23/24 and RY22/23 and are therefore proposing to adjust the disallowance to allow the same costs for the 4G CH&N programme, as incurred in RY22/23 (£5.363m), and disallow the variance (£2.064m).

Q11 Benchmarking

Proposal at consultation: *No proposed disallowances against DCC's permanent staff costs. Disallow £0.506m in contractor costs which fell above the benchmark and were not properly justified.*

Decision: *Remains unchanged from our consultation position.*

Respondents' views

3.12 Three stakeholders, including DCC, responded to this question.

3.13 Two respondents expressed concern around DCC's choice to exempt some roles from the benchmarking process. One stated that, even if a role is considered too niche or technical to source an appropriate benchmark, then DCC should provide a detailed explanation or supporting evidence to that effect.

3.14 DCC re-stated its view that Ofgem should consider the net position of permanent and contractor staff spend rather than isolating the marginal overspend against each role's individual benchmark. It highlighted that net contractor spend was £3.3m below its aggregated contractor benchmark.

Reason for our decision

3.15 Having considered all responses, our consultation proposals remain unchanged.

3.16 We note the concern from some stakeholders around DCC's exempting of some roles from the benchmarking process this year. As stated in our consultation, we expect to see the number of exempted roles to decrease in subsequent price control submissions.

3.17 We note that DCC intends to review its benchmark weighting for future submissions. We suggest that, as part of this work, DCC also considers what can be done to ensure fewer exemptions are made to the benchmarking process in the future, as well as the procedures it follows and evidence it provides as part of its price control submissions in instances where no suitable benchmark for a given role can be reached.

Q12 Planning, Scoping and Resourcing of projects

Proposal at consultation: *Disallow £6.086m and £6.6647m in respectively RY23/24, and RY24/25 and RY25/26, that is linked to activities that we consider not to have been resourced in the most economic and efficient way.*

Decision: *Adjust consultation position to account for additional evidence from DCC and reduce the disallowance to £5.569m, for RY23/24. No change to forecast disallowance for RY24/25 and RY25/26.*

Respondents' views

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

3.19 More generally, according to DCC, expenditure on consultants is a normal part of business activity for all organisations (including regulators) that is required for the following reasons:

- Consultants bring a cohesive set of resources to a task, rather than onboarding several independent contractors who all may have a different view of how to complete the work
- Consultants provide specialist advice and thought leadership in tandem with carrying out work, whereas contractors generally work within the remit of a given contract only
- Contractors can give notice, whereas if a consultant needs to move off the project, take leave or becomes sick, the consultancy will replace that individual
- Resourcing contractors requires more time than requesting assistance from consultancies, especially where there is a framework to call upon
- More often than is the case with contractors, consultancies with previous experience of working with DCC, bring insight, knowledge and understanding of the business to maximise positive outcomes
- Consultants can provide surge support on a targeted basis. DCC claims that a similar approach is taken by Ofgem, which has the skills internally to, for example, conduct financial and econometric analysis on network price controls but consistently hire consultants to provide additional support during peak periods.

3.20 In response to the respective areas that are subject to the proposed cost disallowances, DCC explained that it had appropriate reasons to outsource these activities. DCC provided a summary of each of these projects together with a justification for why it considered that internal resources or contractors were not suitable.

3.21 DCC also claimed that Ofgem's assumptions for calculating a counterfactual benchmark, more specifically, the appropriate mix[33] of permanent / contractor resourcing, seemed inappropriate as it leaves zero space for consultancy support. DCC noted that for:

- Eleven projects, contractors nor internal staff could realistically have been used and that engaging consultants was necessary to successfully deliver these projects. DCC proposed that in this case, the disallowance should be returned in full. To the extent that Ofgem remains unconvinced by this, DCC suggested that Ofgem's benchmark is recalculated based on contractors only
- Seven projects, there are good reasons for why internal staff could not have been used; instead, it may have been possible to consider the use of contractors. DCC proposed on that basis that Ofgem recalculates the benchmark based on a 100% use of contractors as opposed to a mix permanent and contractor staff.

3.22 DCC further reviewed Ofgem's benchmarking model that was used to calculate the disallowance costs and noted that a flat profile of resource days used across each project for each resource, regardless of grade; DCC commented that this approach is incorrect, and that not adjusting for this will skew the benchmarked costs. Finally, DCC also identified a few errors in relation to the grading and mapping of a few roles within Ofgem's benchmarking model.

Reasons for our decision

3.23 We reviewed the additional justification provided by DCC against each of the associated projects individually. However, we remain of the view that none of these projects were resourced in the most economic and efficient way, our rationale for this position is as follows.

3.24 As explained at the consultation phase as well as in previous years, we accept that there are circumstances where DCC is required to outsource certain projects where it does not hold skills in-house or where the nature of the activity is short-term. We do not believe that this should be the case for activities that are of a

[33] Our benchmarking methodology assumed that an activity should be carried out by 70% permanent staff (and 30% contractors) if that activity is of a recurring nature; however, where we consider that an activity is BAU but nonetheless less likely to recur, we have assumed that activity to be taken up by 30% permanent staff (and 70% contractors).

recurring nature, and can therefore be easily planned and forecasted, as well as for activities that we consider to be part of DCC's BAU operations.

3.25 Each of the respective projects that were subject to this year's disallowance in this area encompasses activities that we expect DCC to be carrying out on a day-to-day basis; these include support to key business management and administrative functions (such as legal, regulation, programme and commercial) as well as the more network specific functions (including technical support and test assurance).

3.26 In reviewing DCC's challenge regarding our assumption around the permanent / contractor staff ratio for reach of the projects, we accept the view of DCC operating an in-house legal team with a smaller group of permanent staff as opposed to contractor staff. **We have revised our benchmarking model[34] accordingly, which as a result, reduces the disallowance in this area by £0.298m.**

3.27 We welcome DCC's review of our benchmarking model and agree with the respective grading and mapping errors that have been identified; **we propose to make these corrections which, as a result, reduces the disallowance in this area by £0.252m.**

3.28 We agree with DCC's view that the counterfactual calculations should, in principle, not assume a flat profile of days for each resource, regardless of grade; however, we would like to clarify that this approach has been adopted due to information asymmetry *ie* for the projects where DCC shared with us the contractual information, it was in most cases not possible to reconcile that information with the total reported incurred costs for the year.

3.29 More generally, and going forward, we would like to remind DCC to carefully assess all alternative options before defaulting to the outsourcing of an activity, particularly where this involves BAU work. DCC is expected to ensure that all costs are incurred in the most economic and efficient way; this is particularly important in the context of the significantly increased costs of non-resource activities in recent years. As per recent years, we will continue to closely monitor this area in future Price Control assessments, and expect DCC to share with us, upon request, any evidence of due diligence in this area.

[34] Our consultation position assumed a ratio of 70% / 30% for permanent / contractor staff for legal support; as part of our final decision, we are adjusting that ratio in our final decision to 30% / 70% for permanent / contractor staff.

3.30 **In summary, we have decided to adjust our consultation position to account for the additional evidence from DCC. We propose to reduce the disallowance to £5.569m and £6.647m for respectively RY23/24, and RY24/25 and RY25/26.**

Q13 Business Accuracy Programme

Proposal at consultation: *Reject all costs that are directly and indirectly associated with the Business Accuracy Programme (BAP) on the grounds of insufficient evidence of benefits realisation and concerns related to lack of transparency in customer engagement and overlap in scope and Shared Service Charge (SSC). The total disallowance cost amounts to £4.124m for RY23/24 and £1.133m for RY24/25 and RY25/26.*

Decision: *Remains unchanged from our consultation proposal.*

Respondents' views

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

3.32 Similar to the feedback to the RY22/23 DCC Price Control consultation,[35] respondents claimed that they had seen no benefits being delivered to customers. One respondent stated that the all the benefits presented to the programme related to either DCC and/or Capita only.

3.33 In its response, DCC reiterated that the Business Accuracy Programme (BAP) was an exercise to improve economy and efficiency within DCC. DCC set out that the programme had focused on the delivery of improvements into the Commercial, Finance, and Portfolio business areas, and that it had supported DCC's transition as it had grown in scale and complexity.

3.34 DCC noted that, overall, the programme's Cost Benefits Analysis (CBA) estimates the programme will deliver a benefit-cost-ratio of 1.8, meaning that there is an estimated £1.80 of benefits for every £1 of costs.

3.35 More specifically, according to DCC, the programme has delivered outputs across four main areas:

- **Process** and **Governance**: establishing efficient, repeatable processes and governance structures that provide control and assurance over activities and portfolios.

[35] DCC Price Control Consultation: Regulatory Year 2022/23

- **Systems** and **Data**: creating a data architecture that provides the business with timely, reliable, and aligned datasets for governance, reporting, and forecasting.
- **Reporting**: building a reporting framework and culture of accountability and transparency, enabling internal and external parties to understand expected and actual performance.
- **People:** promoting a more sustainable, process-driven culture at DCC.

3.36 DCC further stated that, once the BAP had formally completed in July 2023, workstreams were required to embed the enduring solutions and inevitable new improvement activities have been initiated. Whilst this may create the perception that costs are being incurred twice on the same areas, DCC confirmed that this is not the case; instead, DCC argued that the issues that BAP addressed and improvements that it delivered did not, and were not intended to, bring our internal processes and systems to a level where no further improvements were possible. DCC noted that as with all organisations, DCC will be continually look for improvement opportunities to drive cost efficiency or other benefits; the fact that BAP has already delivered some improvements does not mean that no further improvements will ever be identified, or all such future improvements are part of that programme.

3.37 DCC provided, to that effect, an overview of the specific projects that Ofgem had disallowed, notwithstanding that, according to DCC, these projects are not, and have never been, part of the BAP. These projects involve the adoption of a new project management methodology; a commercial pipeline and a commercial sourcing tool; and the ongoing support of DCC’s enterprise data to facilitate better internal reporting. DCC added that, irrespective of whether an activity is part of BAP or not, at least some of the expenditure incurred in respect of these should be allowed, where benefits can be demonstrated.

3.38 Finally, DCC repeated last year’s challenge to Ofgem’s assertion of there being a potential overlap between the scope of the BAP and “several other workstreams”, without explicitly stating which activities it was referring to.

Reasons for our decision

3.39 As expressed in previous years, we do not oppose DCC’s efforts to introduce improvements to its internal processes that enables it to realise cost efficiencies across all its programmes and activities. However, where such initiatives are being set up, we require DCC to ensure that the scope of such projects is clearly defined and that customers are presented with a robust cost benefit analysis that supports the investment.

3.40 We appreciate that DCC has reshared with us the BAP closure report and the BAP Benefit and Tracking report, however the findings within that report are insufficiently robust to demonstrate how and when the programme's benefits (in full or in part) will be realised, as well as how they will be monitored. DCC has not been able to share any further evidence, beyond these reports, that demonstrate that the costs of these projects (whether directly or indirectly associated with the BAP) are economic and efficient.

3.41 In response to DCC's assertion that we did not explicitly elaborate on the areas of potential overlap between the scope of BAP and that of other workstreams, we refer to the concerns that we set out in our RY22/23 Price Control consultation[36] as well as in our RY23/24 Price Control consultation;[37] we explained ~~herein~~ that, in recent years, multiple projects with a specific focus on business improvements had been undertaken alongside the BAP. We also explained previously that it raises concerns that the outputs of each of these individual activities may not have necessarily been coordinated and adopted in the most optimal way, risking therefore a possible duplication of costs.

3.42 As to DCC's claim that some of the disallowed workstreams are not part (and never formed part) of the BAP, we note from the materials that DCC has shared with us this year,[38] as well as in previous years,[39] that some of the deliverables described in those documents closely align to the projected outputs from the respective workstreams.

3.43 As per previous years, DCC's continued claims that the costs for these additional projects do not form part of the original scope of BAP, raises concerns around DCC's transparency over the costs that they report. Irrespective of whether these additional initiatives are formally part of BAP, we require DCC to be able to demonstrate the full visibility over the scope and costs of these investments as well as how it monitors and ultimately deliver the anticipated benefits. By not doing so, customers risk having limited sight on the full cost and benefits of all

[36] Ofgem (2022), DCC Price Control consultation: Regulatory Year 2021/22. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202122
[37] DCC Price Control Consultation RY22
[38] BAP closure report and BAP Benefit Mapping & Tracking
[39] DCCT0296 [Redacted] Review; slide decks presented to the Finance Forums in Q4 (2021), Q1 and Q2 (2022).

the business transformation activities that are taking place over the years, and how they complement each other.

3.44 Finally, we also continue to have concerns as to what extent the business transformation improvements that have been made by DCC in RY23/24 as well as in previous years should already be provided for under the Shared Service charge (SSC). We have not received any satisfactory response from DCC on this point.

3.45 **Accordingly, we are maintaining our consultation position and are directing that these costs are excluded from the Allowed Revenue. The total disallowance cost amounts to £4.124m for RY23/24 and £1.133m for RY24/25 and RY25/26.**

Q14 Forecast Costs

Proposal at consultation: *Disallow £24.038m in RY24/25, £24.581m in RY25/26 and all baseline forecasts from RY26/27 onwards (£242.025m) across SMETS1, Network Evolution programmes, Corporate Management, Finance, Design and Assurance, Service Delivery (Programmes), Security and Operations cost centres.*

Decision: *Allow partial costs for Corporate Management but maintain all other positions.*

Respondent's views

3.46 Of the seven response, four respondents agreed with our proposed consultation position, two respondents did not provide any further comments, and DCC did not agree with our proposals. One respondent stated that DCC's forecast should be based on evidence and an understanding of future needs. This is particularly important as DCC moves towards an ex-ante price control regime.

3.47 Another respondent raised concerns over the growing headcount, particularly in relation to the increase in the number of senior roles. The respondent also raised concerns with the repeated disallowance which points to potential issues with DCC's current process. The respondent suggested that DCC should take the necessary steps to address these concerns to avoid issues with the move to ex-ante regime.

3.48 DCC expressed disappointment that Ofgem has not considered some of the forecast costs to have been sufficiently justified. DCC has asked that Ofgem reconsider its position on disallowing the forecast costs for RY24/25 and RY25/26 for the following cost centres: Licence Renewal, SMETS1, Network Evolution and MHHS programmes. DCC are of the view that the forecast has been 'well-justified' and argue that if Ofgem continues with its proposed position then we will be assuming that 'zero costs' will be incurred. DCC deems this to be an 'implausible assumption' for an organisation to accept.

Reason for our decision

3.49 We note DCC's concerns over the proposed forecast disallowances for Licence Renewal, SMETS1, Network Evolution and MHHS programmes. However, we do not accept DCC's argument that we have assumed zero costs will be incurred for these cost centres. In adopting this position, we have had regard to the following matters: it is important to reiterate that all forecast costs must be justified as economic and efficient. We expect DCC to also ensure that forecast variances meet the certainty threshold as part of the Price Control.

3.50 Given that most stakeholders explicitly supported our position and that DCC has not provided further evidence to justify the forecasts, we are maintaining our consultation position to disallow the unjustified forecast costs with a correction to the Licence Renewal cost centre disallowance; **the total disallowance for the RY24/25 and RY25/26 will be reduced from £3.532m to £1.405m**.[40]

3.51 Regarding baseline forecast costs, we note that DCC usually provides justification for two years of forecasts and does not attempt to justify any costs it expects to incur after these two years. This is because costs may become more uncertain the further into the future they are. We have historically disallowed these forecast baseline costs until the end of the Licence term due to the lack of justification. In line with our previous decisions and based on the fact DCC has not further justified these costs, we will keep to our consultation position and disallow all baseline forecast costs from RY26/27 onwards. **This amounts to a disallowance of £242.025m (excluding the associated SSC).**

3.52 Lastly, regarding the Shared Service Charge associated with forecast costs, we have adjusted the rate at which we are accepting SSC on accepted forecast costs for RY25/26. As part of our September 2024 Decision[41] on the continuation of the Smart Meter Communication Licence, we also decided to adjust the SSC rate on all costs forecast for, or incurred in, RY25/26 onwards from 9.5% to 4.5%, effective for the RY23/24 Price Control onwards.

3.53 As this decision was made after DCC's RY23/24 Price Control submission, DCC had applied for SSC on forecast costs for RY25/26 at the original rate of 9.5%.

[40] The total disallowance for RY24/25 and RY25/26 is £48.768m instead of the proposed consultation disallowance of £50.895m.
[41] Decision on the continuation of the Smart Meter Communication Licence and the rate of Shared Service Charge and Baseline Margin

We consulted on figures equivalent to a rate of 9.5%. We have corrected this as part of our decision on these forecast costs, which reduces the amount of SSC we are accepting for RY25/26 by a further **£5.651m**. As we are disallowing all forecast Internal Costs for RY26/27 onwards, the amount of SSC we are disallowing for these years remains **£22.112m**.

4. Performance Incentives

Section summary

This section covers DCC's submission of its performance under the Operational Performance Regime (OPR), which includes system performance, contract management, and customer engagement incentives.

Regarding the system performance incentive, in our consultation we proposed to award DCC the full margin of £6.258m.

For the contract management incentive, we proposed to reduce the score awarded by the auditor from 2.33 out of 3 to 2.05 out of 3. This corresponds to a reduction of £0.426m of DCC's margin from a possible £1.341m.

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 awarded a score of 2.08 to DCC, corresponding to a reduction of DCC's BM by £0.410m.

Questions posed at consultation

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

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

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

Background

4.1 All DCC's BM (including adjustments) is at risk against one of DCC's performance regimes.[42]

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

4.3 In RY23/24 there were no projects to be assessed under the BMPPA regime.

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

[42] See Part C of LC36 of the Smart Meter Communication Licence

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

4.6 Following consultation, in October 2020 we published our decision to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management.[43] As part of our decision, we also implemented a Licence change to enable Ofgem to publish guidance, regarding the process, procedures, and criteria of the OPR.[44]

4.7 In March 2021, we published the OPR Guidance to enable implementation and published a revised OPR Guidance document in March 2022.[45] This included setting the performance levels and values for the system performance penalty mechanisms, and detailed processes for the customer engagement and contract management incentives. We did a trial run in RY20/21 for customer engagement, without margin attached, for the incentive to come into effect with margin attached in RY21/22. While we were unable to conduct a trial for contract management, we set out in our RY20/21 Price Control decision that the incentive would come into effect with margin attached to this regulatory year as originally intended.[46] We decided to implement a 12-month grace period ("Transition Year") for system performance measures in RY21/22.

4.8 The total BM at risk for RY23/24, under the OPR, is £8.938m. In accordance with the OPR Guidance, 70% of this margin is associated with system performance, 15% is associated with customer engagement, and 15% with contract management.

Q15 System Performance

Proposal at consultation: *Zero-weight SRV8.11 metric for RY23/24 and award DCC full system performance margin of £6.258m.*

Decision: *Unchanged from consultation.*

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

Respondent's views

4.9 We received 6 responses to this question. DCC agreed with our proposal to zero-weight the SRV8.11 metric and award the full margin, while all other respondents disagreed. As was the case last year, respondents disagreed with our proposals on 2 fronts:

- First, they disagreed that a full margin award was reflective of the system performance quality they had experienced as DCC Users
- Second, they disagreed with the proposed zero-weighting of SRV8.11

4.10 Respondents considered a full margin award for system performance inappropriate given service issues they had experienced in RY23/24, particularly in the CSP-North region. The SEC Panel provided detail on CSP-N performance issues and the work conducted by the Panel to investigate and attempt to resolve these issues and argued that their continuation and perceived worsening indicates a "lack of proactive contract management" by DCC to ensure CSP-N meets its contractual requirements.

4.11 The SEC Panel, in their response, noted that DCC's Performance Measurement Reports (PMRs) – from which the OPR system performance measures are derived – do not provide an accurate reflection of experienced system performance, as DCC and its Service Providers can exclude measures from its reporting, meaning the overall scope of performance being reported in PMRs is unclear. This, combined with the current OPR system performance measures, means that DCC's performance is not being measured or reported on in a way that, in the view of the SEC, aligns with DCC's actual performance.

4.12 Multiple respondents detailed some of the service interruptions experienced in RY23/24, noting that these interruptions will have had greater impact on PPM customers. However, one respondent did highlight that the overall volume of both planned and unplanned maintenance events had declined compared to RY22/23.

4.13 Lastly, in order to provide further context into the system performance issues faced by DCC Users in RY23/24 which have not been captured by the OPR system performance measures, the SEC Panel also provided details of instances where DCC had fallen short of its Code Performance Measures (CPMs) – these included the percentage of Power Outage Alerts and Firmware Updates delivered within relevant Target Response Times, and the percentage of Category 1 and 2 Incidents resolved within their Target Resolution Times.

4.14 Other respondents raised similar points as the SEC Panel around service availability issues and reporting accuracy, including:

- While Planned Maintenance events had decreased compared to RY22/23, there was a correlation between completion of maintenance work and Major Incidents in the days immediately following
- Issues in CSP-N have directly impacted the installation and operation of SMETS2 meters in the North in RY23/24
- DCC and CSP-N had fallen short of DCC Users' expectations

Reason for our decision

4.15 We acknowledge the ongoing issues that DCC Users have faced with the DCC system in RY23/24 and in prior years. However, having considered all arguments provided, we have decided to proceed with our proposal to zero-weight SRV8.11 and, therefore, award DCC the full margin of £6.258m.

4.16 As part of our March 2024 OPR Guidance Decision, we have already zero-weighted SRV8.11 on an enduring basis for RY24/25 onwards.[47] We also, in our RY22/23 Price Control Decision, zero-weighted SRV8.11 for RY22/23. Our primary reason for doing so was that we accepted DCC's argument that there are elements outside of its control – and outside of CSP-N's control – which led to suboptimal SRV8.11 performance.

4.17 We are of the view that deviating from this position for RY23/24 would require additional evidence which establishes:

1. The system performance issues faced by DCC Users for this year are different to, and/or beyond those already detailed in prior years
2. The factors that led to this worsening were, to a greater extent than otherwise previously understood, within DCC's control
3. Part or all of this degradation in performance can be measured in order to calculate an appropriate potential margin reduction

4.18 Having reviewed the evidence provided in response to our consultation alongside information gathered over the course of the past year through engagement with DCC, SEC and wider industry on this issue, we note that WAN issues in the North region have worsened to an extent in RY23/24 compared to RY22/23. However, it is not apparent that any of the issues described as having occurred in RY23/24 – or their potential underlying causes – are new or different to those discussed and assessed last year.

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

4.19 Similarly, as with last year, we remain of the view that the proportion of this underperformance that can or should be attributed to DCC (or CSP-N) compared to other factors cannot feasibly be quantified, nor do we consider it fair to apply a margin reduction to DCC's system performance outside of one which has been pre-calculated by the outputs of objective, data-driven metrics that underpin this element of the OPR and which been agreed upon by industry.

4.20 Similarly, as we continue to accept that factors outside DCC's control contribute to the WAN issues in the North which impact SRV8.11 performance, we do not consider it appropriate to deviate from our proposal to zero-weight SRV8.11 for RY23/24.

4.21 We therefore award the full system performance margin of £6.258m.

Q16 Contract Management

Proposal at consultation: *Reduce the score awarded by the auditor from 2.33 out of 3 to 2.14 out of 3. This corresponds to a reduction of £0.383m of DCC's margin out of a possible £1.341m.*

Decision: *Reduction from proposed consultation position of 2.14 out of 3 to 2.05 out of 3. This correspondents to a reduction of £0.426m of DCC's margin out a possible £1.341m.*

Context

4.22 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. RY23/24 marks the third year of the audit.

4.23 An independent auditor assessed DCC's performance in contract management and procurement, in accordance with the OPR Guidance. The auditor produced a final report on the findings and awarded a score of 2.33 out of a possible 3 to DCC, using the scoring framework set out in the Guidance. The auditor also provided a set of recommendations for improvement.

Respondents' views

4.24 Of the seven responses we received to our consultation, four respondents explicitly agreed with our consultation position. The remaining two, excluding DCC, did not have a view or required more information.

4.25 One of the respondents, who agreed with our position, stated that they would like to see further reduction in DCC’s margin due to DCC’s continued use of direct award, and the ongoing performance issues with External Service Providers.

4.26 Another respondent, who also agreed with our proposed position, welcomed the changes that DCC has made. The respondent also welcomed the recommendations made by the auditor for the PIA, FIA and SEC timeframes for the SEC Modification process. However, the respondent cautioned that particular attention needs to be paid to the SEC Modification process to ensure the improvements made by DCC are not lost with the transition to a new Data Service Provider.

4.27 DCC raised concerns over the level of justification provided for the reduction in scores provided by the auditor. DCC argued that Ofgem has disregarded the scores provided the auditor and ‘unliterally downgraded’ them.

4.28 DCC also stated that one of the suppliers that we refer to in our RY23/24 consultation document did not fall within the scope of the Terms of Reference and that the scope requires for the auditor to assess the three SMETS1 service providers that have incurred the highest costs of the Regulatory Year. DCC also noted that we refer to the Annual Service Report (ASR), but this was not published until September 2024 and therefore would not have been considered by the auditor.

Reason for our decision

4.29 We acknowledge DCC’s concerns regarding our proposal to reduce some of the scores awarded by the auditor, as well as the level of justification provided for each of proposed reductions. Our primary concerns on the back of the RY23/24 audit report revolves around DCC’s continued use of direct awards and the ongoing issue with poor supplier performance.

4.30 As part of the contract management process, the auditor is tasked with carrying out an independent audit of DCC’s contract management approach. The auditor assesses DCC’s performance based on evidence that is presented to them at the time of the audit period. Given that the audit period is only for a duration of 3-months, the auditor’s review is restricted to limited samples of DCC’s documentation and provide a judgement based on this. Whereas, Ofgem has the jurisdiction to review the documentation over the entire Reporting Year. Accordingly, as mentioned in our RY22/23 decision document, Ofgem reserves the right to “…consider responses and any additional evidence submitted by stakeholders".[48] This includes taking into consideration further clarification from auditors on the scores provided. "We, as part of the OPR contract management process, are required to assess DCC's performance and provide the final scores, ensuring to take into consideration any views of stakeholders and further evidence available to us. When making our assessment, we used materials such as the audit report, the Annual Service Report, past consultations, decisions, and information provided to us by DCC through the Price Control submission process."[49] Our proposed position is based on information that is readily available to DCC, and is in keeping with the concerns we have previously raised in our price control documents; further information of this can be found in our RY21/22 and RY22/23 price control consultation and decision documents. The concerns have also been raised in several forums, which DCC has been a privy to, by both Ofgem and various other stakeholders. Therefore, we believe the decisions made were done so openly and transparently and based on the information that is readily available to us and DCC.

4.31 We note the caution provided by one of the respondents in relation to the SEC Modification process and the risk of losing the progress DCC has made with the transition to a new Data Service Provider.

4.32 We also note that one of the respondents would welcome further reduction in DCC's margin given the ongoing performance issues with External Service Providers and the DCC's continued use of direct awards. As mentioned above, as part of the contract management process, Ofgem will use the information that is readily available to assess DCC's contract management approach in a manner that fair and justifiable.

4.33 Based on the explanation provided in paragraphs 2.59 to 2.61 we have made the decision to reduce the scores for domains 4.1 and 6.3 by 1 point. The final score awarded to DCC is 2.05 out 3. This equates to a margin reduction of £0.426m out of a possible £1.341m.

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

[49] Ofgem (2024), DCC Price Control decision: regulatory year 2022 to 2023, p.69. www.ofgem.gov.uk/decision/dcc-price-control-decision-regulatory-year-2022-2023

Table 4.1: Summary of scores awarded against each supporting question in the NAO Framework domain

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**
2.1 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**
3.1 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**
4.1. Is there an appropriate allocation of risk between DCC and the supplier?	**1**
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**
5.1 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**

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?	**0**
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:	**2.05**

Q17 Customer Engagement

Proposal at consultation: *Based on the submissions from both DCC and SEC Panel, we recommend an overall score of 2.08 out of 3.*

Decision: *Remains unchanged from the consultation proposal, corresponding to a margin reduction of £0.410m.*

Context

4.34 For the third time, DCC's customer engagement is financially incentivised under the new OPR. DCC's performance in this area was 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 customers' views.

4.35 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.[50]

4.36 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 OPR Guidance. We considered both the submissions and evidence provided to assess DCC's customer engagement performance in RY23/24.

Respondents' views

4.37 Of the six responses we received to our consultation, three respondents agreed with our score for DCC's customer engagement. One of the respondents expressed concerns over DCC's customer engagement and provided an appendix referencing examples of poor engagement. The remaining two respondents did not have a view.

4.38 One of the respondents who agreed with our position expressed concerns that the current regime is too restrictive and tends to over-reward DCC. This respondent stated that, whilst engagement has improved in specific areas, the operational and project areas of the DCC have had to be reminded of the impacts of outages or incidents on energy consumers through RY23/24 and RY24/25. They believe that a dedicated cost scrutiny SEC Sub-Committee with suitable funding, DCC

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

user representation, and non-disclosure agreements, would support scrutiny of DCC's procurement and contract management arrangements.

4.39 Another respondent expressed the importance of DCC improving the quality of customer engagement as we approach the end of the licence term and provided an appendix and attachment detailing examples of poor Customer Engagement from DCC.

4.40 DCC asked Ofgem to reassess our score and has referenced the revised OPR Guidance for 2024[51], explaining that Ofgem can use the DCC and SEC Panel score to determine a final score up to two decimal places.

Reason for our decision

4.41 We have reviewed all the responses have received and maintain our consultation position.[52]

4.42 We note that DCC has referenced the revised OPR Guidance for 2024[53] within their response, however, as stated in the section summaries, the changes will come into effect from 1 April 2024, meaning that these changes will not apply for RY23/24. As part of these changes, the number of assessment questions will also be reduced from nine questions, which both DCC and SEC submitted a response to for RY23/24, to three overarching questions.

4.43 We note ongoing concerns surrounding the current regime being too restrictive and believe that the changes coming into effect under the Revised OPR Guidance 2024,[54] in relation to the scoring and amending some of the terminology for the questions, will ensure better assessment of DCC's customer engagement performance.

4.44 We are disappointed to receive evidence from a stakeholder within their consultation response referencing the lack of quality engagement they have experienced with DCC. We understand there remains issues with the quality and detail of information provided by DCC and note from the responses that inconsistencies and mixed views regarding DCC's overall customer engagement. We encourage DCC to note the areas listed for improvements, including the need

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[51] Ofgem (2024), Revised OPR Guidance, Accessible at: https://www.ofgem.gov.uk/publications/revised-opr-guidance-decision-march-2024
[52] Note, the score was incorrectly rounded in our consultation. However, Ofgem's individual scoring for each assessment question detailed in the table in the consultation remains correct.
53 Ofgem (2024). Revised OPR Guidance: March 2024 Decision. Available at: https://www.ofgem.gov.uk/sites/default/files/2024-03/Revised%20OPR%20Guidance%20decision%20March%202024.pdf
[54] Ibid.

for greater consistency with the quality of customer engagement and ensuring customers understand how their views have informed its decision-making.

5. Baseline Margin and External Contract Gain Share

Section summary

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

DCC applied for an adjustment of £31.537m for RY23/24 to RY25/26. We proposed to accept £1.994m of this application in our consultation. We considered £21.115m of DCC's application had not been applied for under appropriate grounds, and requested DCC resubmitted this element of its application as part of its consultation response. Having reviewed DCC's resubmission, we are adjusting upwards our Baseline Margin Adjustment to £11.256m.

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 proposed to accept this in full. Following consultation, our position remains unchanged.

Questions posed at consultation

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

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

Q18 Baseline Margin

Proposal at consultation: *Accept £1.994m of DCC's £31.537m application for an adjustment to its Baseline Margin. Reject: the entirety of DCC's core resource application under the 'Facilitating Additional Relevant Service Capability' ground pending re-submission (£21.115m); margin associated with activities under £150k with no separate justification (£1.851m); the new 'Licence Renewal' ground and all associated margin (£0.424m); margin applied for on non-resource activities under the 'Other Activities Facilitating Additional Relevant Service Capability' sub-ground related to work drivers we consider irrelevant to the ground (£2.907m).*

Decision: *Accept £4.138m from resubmitted application. Adjust margin rejected associated with disallowed Internal Costs to reflect final Internal Cost determinations. Maintain all other rejections. Final Baseline Margin Adjustment: £11.256mm.*

Context

5.1 We requested that DCC re-submit the portion of its Baseline Margin Adjustment (BMA) application relating to its core (*ie* non-Programme) resource costs. In the original model provided, DCC had applied for a BMA on all these costs (£14.226m net) under the 'Facilitating Additional Relevant Service Capability' ground.

5.2 Prior to submitting its full consultation response, DCC provided a revised BMA submission for its core resource costs. This assigned the £14.226m (net) in core resource costs being applied for to new grounds, detailed below:

Table 5.1: Breakdown of drivers in DCC's resubmitted core resource BMA application

Change Driver	Grounds (core resource only)	Driver first raised
Certainty	Facilitating Additional Relevant Service Capability People Transformation	RY18/19 RY17/18
Technology Driven Change	Security Driven Change Technology Transformation – General	RY17/18 RY17/18
Supporting a Changing Business	Support – Resourcing Planning and Management Increase in Customer Service Expectations	RY17/18 RY22/23
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

5.3 All these grounds were already raised in DCC's original application as part of its RY23/24 Price Control submission except for the 'Increase in Customer Service Expectations' ground. As such, save for this ground, DCC had already provided justification for all grounds within its initial BMA submission.

Respondent's views

5.4 Aside from DCC, all other respondents either agreed with our proposals or did not comment. 3 respondents explicitly supported our proposal to reject the new 'Licence Renewal' ground, sharing our view that the ground (and the work justified under it) did not meet the LC requirements for a BMA as the renewal of the Licence and the ongoing requirement of a Business Handover Plan would have been known of at the time DCC was appointed as the Licensee.

5.5 Conversely, DCC stated it was surprised and disappointed that we proposed to disallow the 'Licence Renewal' ground. It also said, "combined with its extensive disallowances of the costs, there is little to no incentive for DCC and Capita to provide support to Ofgem's process beyond the bare minimum in the licence".

5.6 Regarding our proposal to reject the entirety of its core resource cost application under the 'Facilitating Additional Relevant Service Quality' ground, and our request that DCC resubmitted this portion of its application with more appropriate grounds, DCC considered that our proposal was based on a misunderstanding of the original model it had submitted and that our methodology had been applied inconsistently, as we had accepted the negative elements of this portion of DCC's application (*ie* the elements which reflected a lower-than-forecast realisation of, or downward revision of existing forecast costs) while rejecting any positive values.

5.7 DCC also restated some other views on the BMA process from prior years:

- Ofgem's baseline – against which DCC must justify its expenditure to earn a BMA – is significantly below its own business plan forecast, leading to DCC having to justify ongoing spend on hundreds of members of staff and procurement
- Similarly to the above, because of the way the BMA works, DCC must be able to provide an extremely granular reconciliation of costs and margin to prior years, which creates a powerful disincentive to make any improvements to our cost data as it makes reconciliation "extremely onerous"
- The BMA process is no longer fit for purpose, given that its activities are "dramatically different to those assumed at Licence award" which leads to a structural bias against DCC in applying for margin
- More than 80% of DCC's margin is now created through the BMA and is subject to Ofgem's decision-making process after the money has already been spent, which is not the original assumption in the LABP as it was expected that the BMA would be an adjustment mechanism rather than the main mechanism through which margin is awarded

Reason for our decision

Margin applied for in original BMA submission

5.8 DCC did not provide any additional supporting evidence for the elements of its original BMA application which we proposed to reject outside of its resubmitted core resource BMA application.

5.9 As such, we are proceeding with all of our rejections as proposed at consultation. This includes:

- Margin applied for on activities rejected in prior years (£0.322m)
- Activities under £0.15m with no separate Internal Cost justification (£1.851m)
- The portion of margin associated with the portion of costs disallowed as part of the staff benchmarking process (£0.005m)
- The portion of margin associated with Internal Costs determined to be Unacceptable Costs as part of the Price Control process (£2.924m)
- The newly raised 'Licence Renewal' ground and all associated margin (£0.424m)

Margin applied for in resubmitted BMA application

5.10 Regarding DCC's view that our proposal to reject only the positive margin under the 'Facilitating Additional Relevant Service Capability' ground represented an inconsistent methodology, we did not propose to reject the negative elements of DCC's resource cost application under this ground as negative BM adjustments do not involve an active decision by the Authority. Negative adjustments simply reflect underspend against previously forecast costs, or downward revisions of forecasts against prior forecasts. We have no reason to scrutinise or reject DCC's own applications to reduce its margin in the same way we do its applications for additional margin. Historically, negative margin adjustments were exclusively classified as 'Cost Reduction' in the models submitted by DCC. It is only in recent submissions that DCC has instead assigned "grounds" to these negative adjustments. This issue demonstrates the importance that the grounds used in DCC's BMA models match the real-life drivers of additional costs for which DCC is applying for margin on. The disconnect between the grounds used in this year's model and the real-life drivers of costs is what led to our proposal to reject this portion of DCC's application and request it resubmit its application.

5.11 Regarding the re-submitted resource portion of DCC's BMA application, we reject the following elements:

- We are rejecting the amount applied for under the 'Increase in Customer Service Expectations' ground. We rejected this ground when it was first raised in RY22/23. DCC cannot re-apply for margin under grounds we have previously rejected. **This amounts to a rejection of £1.001m.**
- As we are proceeding with our proposal to reject the 'Licence Renewal' ground, **we are rejecting a further £0.169m which DCC has applied for under this ground in its resubmitted model.** As stated in our consultation, we do not consider that the work detailed under this ground meets the criteria for a BMA as this work could have been envisaged at the time of Licence award.

5.12 DCC has applied for a further £5.043m under the 'Facilitating Additional Relevant Service Capability' ground in its resubmitted application. Within this ground, as utilised for its non-resource activities in its initial BMA submission, DCC raised the 'Other Activities' sub-ground. DCC explained that this sub-ground covered the following activities:

- 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

5.13 DCC raised this sub-ground (and described the same activities as above) in its RY22/23 BMA submission. In our Decision for that year, we rejected any margin applied for on the above activities except for the last one in the list above (activities to manage capacity on the network) as we considered only these activities related to the valid justification DCC provided around the 'increase in complexity' criterion for a BMA.[55]

5.14 We applied the same rationale in our RY23/24 consultation proposal. Through a Clarification Question as part of this year's price control process, we asked DCC to map the non-resource activities it had applied for under this sub-ground to the activities described, in order to determine which activities, we proposed to reject. DCC provided this breakdown, which led to our proposal to reject £2.907m of £3.077m (94.5%) of margin applied for on non-resource costs under this sub-ground, as only the remaining £0.170m related to activities to managing capacity on the network.

5.15 Upon receiving DCC's resubmitted BMA application, we asked DCC for an equivalent breakdown for the resource costs it was applying for under this sub-ground. However, DCC did not provide this breakdown in response. As we cannot ascertain the proportion of the £5.043m in resource costs related to managing capacity on the network, we cannot accept DCC's application for a BMA under this ground in full. Given this, we are rejecting an equivalent proportion of margin applied for on resource costs as we have rejected on non-resource costs under this ground.[56] This amounts to a rejection of £5.009m.

Baseline Margin rate amendment for RY25/26

5.16 DCC's BMA application relates to costs incurred in the current RY as well as those forecast to be incurred over the next 2 RYs. In this year's case, RY23/24, RY24/25 and RY25/26.

5.17 In our September 2024 Decision on the continuation of the Smart Meter Communication Licence, we also decided to reduce the Baseline Margin rate earned on any costs incurred or forecast to be incurred in RY25/26 onwards from 15% to 9%.[57] This was to take effect on any BMA applications from the RY23/24 Price Control submission onwards.

5.18 As this decision was published after DCC had provided its RY23/24 Price Control submission (and thus at a point when any new prospective BM rate was not yet

[55] See paragraph 5.12 in our RY22/23 Price Control Decision.
[56] The proportion of margin which we are rejecting has been updated to reflect the amount of margin on non-resource costs applied for under this ground against the corrected rate of 9% for RY25/26, which has the effect of adjusting the proportion from 94.5% to 94%. Details on this rate change can be found in paragraphs 5.16-5.19 of this chapter.
[57] 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

confirmed), DCC applied a rate of 15% for its forecast costs for RY25/26 in its BMA application. We consulted on figures that were calculated at 15% of the costs in question. However, these figures should have been re-calculated to equal 9% of the costs.

5.19 We have applied the correct margin rate for RY25/26 for our final determinations. This has had the effect of reducing DCC's application by £6.692m, from £31.537m to £24.845m. However, for consistency with the figures provided in our Consultation, in this chapter we have referred to the figures as DCC applied for them.

Final BMA position

5.20 Combining DCC's original BMA application, its resubmitted core resource cost application, and applying the corrected margin rate for the portion of the application relating to forecast costs for RY25/26, we are rejecting a total of £20.281m of DCC's £31.537m application, leaving £11.256m awarded to DCC. This is an upward adjustment of £9.262m from our consultation position of £1.994m.

Q19 ECGS

Proposal at consultation: *Award full ECGS application (£4.991m).*

Decision: *Unchanged from consultation.*

Respondent's views

5.21 We received four responses to our proposal. All agreed with our proposal.

5.22 One respondent expressed the view that DCC seem over-reliant on interest rate savings in their ECGS applications, which could mean it is not exploring or realising savings in other significant operational areas.

Reason for our decision

5.23 Having reviewed all responses, **we are proceeding with our consultation proposal to award DCC its full ECGS application of £4.991m**.

6. Switching

Section summary

This section covers our assessment of DCC's costs associated with the Switching Programme in RY23/24 and the forecasts to the end of the Licence period. It also sets out our view on DCC's submission of its performance under the Switching Incentive Regime (SIR), which includes System Performance and Customer Engagement Incentives.

We proposed to disallow DCC's forecast costs of £29.953m (£8.438m of Internal Costs and £21.496m of External Costs) through to the end of the Licence term as DCC did not provide any justifications for these costs.

Under the SIR, we proposed 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 proposed a score of 2.25, corresponding to a reduction of DCC's BM of £0.310m.

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

Questions posed at consultation

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

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

Q20 Switching Costs

Proposal at consultation: *Disallow all forecast costs for RY24/25 to the end of the Licence period, which totals £29.953m (Internal costs of £8.438m and External Costs of £21.496m).*

Decision: *Remains unchanged from the consultation proposal.*

Context

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

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

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

Respondents' views

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

6.5 RECCo noted concerns regarding a £1.815m discrepancy between the costs reported under the REC budget for RY23/24 and in DCC's price control submission. Furthermore, RECCo raised concerns regarding details of CR4967, which amounted to £3.1m, and the reporting of this CR.

6.6 DCC welcomed that we did not propose to disallow any costs incurred in RY23/24. However, DCC expressed concerns about our proposal to disallow the entirety of the forecast costs associated with the Switching Programme for RY24/25 through to the end of the Licence term, as it is clear that some costs will be incurred.

Reasons for our decision

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

6.8 We have engaged with DCC and RECCo regarding concerns about the reporting of costs. We have received evidence to clarify the reasoning behind the discrepancies within the costs reported to RECCo and Ofgem, including where the reporting of costs associated with CR4967 has been accounted for in the budget submitted to RECCo and to Ofgem in DCC's Price Control submission.

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

Q21 Switching Performance

Proposal at consultation: *Disallow all of DCC's margin associated with system performance for RY23/24 under the Switching Incentive Regime (SIR) and award a customer engagement score of 2.25, corresponding to a reduction of DCC's baseline margin of £0.310m.*

Decision: *Remains unchanged from the consultation proposal.*

Context

6.10 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.[58]

6.11 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.

6.12 During the RY DCC collects its entire allowed margin 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.

6.13 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.

Respondents' views

6.14 Three respondents supported our proposal for DCC to lose all margin at risk for the system performance element of the SIR and award a score of 2.25 for customer engagement. Three other respondents did not have a view.

6.15 DCC reiterated its concerns about the SIR not being fit for purpose and its support of the changes coming into effect under R0210 from 1st of January 2024, which will amend the methodology behind the SIR.

Our views

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

[58] Our January 2023 decision to establish the Switching Incentive Regime is accessible at: www.ofgem.gov.uk/decision/decision-policy-and-statutory-consultation-establish-dcc-switching-incentive-regime

Appendix 1: Determination of Allowed Revenue

Table A1.1. Allowed Revenue for each year to the end of the Licence term, in £m (RY23/24 prices)

Regulatory Year	RY23/24	RY24/25	RY25/26	RY26/27	RY27/28
LABP (23/24 prices)	**295.462**	**305.066**	**129.028**	**0.000**	**0.000**
Previous year (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	RY23/24	RY24/25	RY25/26	RY26/27	RY27/28
SMETS1: service stabilisation	0.505	0.000	0.000	0.000	0.000
SMETS1: Increased charges for interim DCO contract	0.437	1.772	2.085	2.414	2.759
DSMS: nugatory spend	0.300	0.000	0.000	0.000	0.000
SMETS2: GBCS 4.1 SIT, UIT and Pilot Support	0.129	0.000	0.000	0.000	0.000
SMETS1 Device swap-out	0.000	0.000	0.000	0.000	0.000
ECoS Monitoring Solution and Integration	2.917	0.000	0.000	0.000	0.000
TAF programme delays	0.740	0.000	0.000	0.000	0.000
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	***5.028***	***14.872***	***16.054***	***16.863***	***16.610***
Internal Cost Disallowances	RY23/24	RY24/25	RY25/26	RY26/27	RY27/28
ES - Planning, Scoping & Resourcing	5.569	6.400	0.247	0.000	0.000

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	2.064	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	0.742	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	1.154	2.483	6.778	10.796	11.316
CRS Internal Costs (Switching)	0.000	4.513	3.925	3.980	4.094
Total Internal Cost Disallowances	***15.157***	***38.247***	***36.000***	***133.585***	***138.627***
Total Cost Disallowances	***20.185***	***53.119***	***52.054***	***150.448***	***155.237***
Performance Adjustment Reductions	**RY23/24**	**RY24/25**	**RY25/26**	**RY26/27**	**RY27/28**
OPR	-0.835	0.000	0.000	0.000	0.000
BMPPA - SMETS1	-1.385	0.002	0.000	0.000	0.000
Switching Incentive Regime (SIR)	-0.310	0.000	0.000	0.000	0.000
Allowed Revenue excluding BM and ECGS Adjustments	***614.757***	***648.941***	***608.379***	***508.799***	***506.170***

Baseline Margin and ECGS Adjustments	**RY23/24**	**RY24/25**	**RY25/26**	**RY26/27**	**RY27/28**
Baseline Margin Adjustment (23/24 prices)	0.000	0.000	2.007	3.345	5.904
ECGS Adjustment	0.000	0.000	4.991	0.000	0.000
Allowed Revenue including BM and ECGS Adjustments	***614.757***	***648.941***	***615.376***	***512.144***	***512.074***

Table A1.2. Allowed Revenue for across entire Licence term, in £m (RY23/24 prices)

Regulatory Year	Total across Licence term (RY23/24 prices)
LABP (23/24 prices)	**2,507.856**
Previous year (23/24 prices)	**5,231.963**
Submitted AR RY23/24 (excludes any performance adjustments)	**6,891.943**
External Cost Disallowances	**(£m)**
SMETS1: service stabilisation	0.505
SMETS1: Increased charges for interim DCO contract	9.467
DSMS: nugatory spend	0.300
SMETS2: GBCS 4.1 SIT, UIT and Pilot Support	0.129
SMETS1 Device swap-out	0.000
ECoS Monitoring Solution and Integration	2.917
TAF programme delays	0.740
Forecast costs	11.347
CRS External Costs (Switching)	44.022
Total External Cost Disallowances	***69.427***
Internal Cost Disallowances	**(£m)**
ES - Planning, Scoping & Resourcing	12.216
ES - Business Accuracy Programme (BAP)	5.257
PR - Programme (Service Delivery) - Incurred & Forecast Costs	8.021

PR - Future Connectivity Programme (FTTP) Resource Costs	6.351
PR - Network Evolution - Incurred & Forecast Costs	19.574
PR - Design and Assurance - Forecast Costs	6.975
PR - Corporate Management - Forecast Costs	1.405
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	32.526
CRS Internal Costs (Switching)	16.512
Total Internal Cost Disallowances	***361.615***
Total Cost Disallowances	**431.042**
Performance Adjustment Reductions	**(£m)**
OPR	-0.835
BMPPA - SMETS1	-1.383
Switching Incentive Regime (SIR)	-0.310
Allowed Revenue excluding BM and ECGS Adjustments	**6458.373**
Baseline Margin and ECGS Adjustments	**(£m)**
Baseline Margin Adjustment (23/24 prices)	11.256

ECGS Adjustment	4.991
Allowed Revenue including BM and ECGS Adjustments	**6474.620**