

# Consultation

## DCC Price Control: Regulatory Year 2020/21

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

DCC submitted its price control information (based on the published Regulatory Instructions and Guidance (RIGs<sup>2</sup>) for 1 April 2020 to 31 March 2021 on 31 July 2021. On the same day, DCC also submitted proposals for adjustments to its Baseline Margin and External Contract Gain Share values.

<sup>1</sup> The Smart Meter Communication Licences granted pursuant to Sections 7AB(2) and (4) of the Gas Act 1986 and Sections 6(1A) and (1C) of the Electricity Act 1989. This consultation is in respect of both those Licences. Those Licences are together referred to as 'the Licence' throughout this document.

<sup>2</sup> Regulatory Instructions and Guidance 2021: <https://www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2021>

This document includes our review of the DCC's costs for the 2020/21 Regulatory Year and outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations and will publish the non-confidential responses we receive alongside a decision on next steps on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential and, if possible, put the confidential material in separate appendices to your response.

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## Executive Summary

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

DCC's price control submission for the 2019-20 Regulatory Year (RY19/20) described how DCC continued to scale the live service to support the migration of SMETS2 meters and the enrolment and adoption of SMETS1 meters. In this year's submission, DCC highlighted that it ensured full-service continuity during the Covid-19 pandemic. Since the start of the Covid-19 pandemic, more than 7.6m smart meters have been added to the DCC network, bringing the total at the end of RY20/21 to 11m meters. During RY20/21, work under the Network Evolution Programme increased with the Comms Hub and Network workstreams made significant progress. DCC also responded to a managed replan of the Design, Build and Test phase of the Faster Switching programme and are on track to launch the service in summer 2022.

There has been an increase in costs compared to last year's forecasts. As with previous years, this is mainly because DCC has not been able to forecast costs due to the complex and changing backdrop of business as usual and programme-related activities. DCC also incurred significant additional costs from its RY19/20 forecast in its NEP and SMETS1 programmes, driven by delays, testing and changing requirements.

Overall, DCC's total reported costs for RY20/21 are £628.4m.<sup>3</sup> This is a 21% increase in total costs compared to last year's forecasts. Over the Licence term (RY13/14-RY25/26), total costs are now forecast to be £4.4b, 10% greater than last year's forecast.

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<sup>3</sup> All Great British Pounds (GBP) figures given in this document are in current year (RY20/21) prices. Inflation adjustments have been calculated using the Consumer Price Inflation including owner occupiers' Housing costs (CPIH) inflation index.

## Cost Assessment

DCC's submission for RY20/21 was streamlined compared to previous years. While the submission provided reasonable justification for the majority of costs incurred, we believe there are areas where more clarity and justification would have been useful. We therefore reached out to DCC with clarification questions and will also engage with DCC to find areas of improvement for next year's submission. Our assessment of the submission revealed the following areas of concern:

- **forecast costs** – To include forecast costs as part of the Price Control submission DCC should justify with reasons why these costs meet the threshold of being significantly more likely than not to occur. As in previous submissions, DCC did not include justification for forecast costs beyond RY22/23; this year we felt in some areas justification for forecasts for RY21/22 and RY22/23 were not sufficient. We appreciate that given the continued uncertainty around DCC's activities a proportion of these forecast costs do not meet the required threshold and are not reasonably justified in the submission. DCC separately provides an estimate of forecast costs to its customers through charging statement forecasts, and has suggested this year to consider aligning price control forecasting to the charging statement forecasts. We will engage with DCC on how clarity and certainty in this area can be improved while keeping in mind the key objectives of the two different processes. Charging statement forecasts allow DCC customers to estimate the impact on their cash flows and Price Control forecasts are to ensure DCC is using and planning resources effectively.
- **payroll efficiencies** - As DCC continues to grow in terms of both permanent staff and contractors, it is important that DCC applies robust processes to ensure that the pay and benefits package offered is economic and efficient. As such, we welcome the changes DCC made to its approach to contractor benchmarking, though we remain concerned that the improved approach is not being applied consistently. This will continue to be an area of scrutiny.
- **contract management** – Core to DCC's role is its negotiation and management of service provider contracts. We continue to have concerns over the efficacy of aspects of DCC's procurement and contract management practices. Through our analysis, we have identified issues such as use of Urgent Work Orders (UWOs), delays in DCC's engagement with service providers and stakeholders in change management, the incurring of Working Capital Charges

(WCC), and lack of risk sharing mechanisms with external service providers. We would like DCC to make improvements across the board.

- **Shared Service Charge** – The costs that were not included at Licence Application Business Plan (LABP) are rising and expected to rise in coming years. As in previous years, for activities which were not fully costed at the LABP stage (e.g. SMETS1) we expect DCC to not apply Shared Service Charges on external service costs. We encourage DCC to actively ensure that it is achieving value for money for any Shared Service Charge applied to activities which were not fully costed at the LABP stage. We expect DCC to ensure that it continues to gain value for money for those services that should be provided by Capita as part of Shared Service Charges.

For the cost assessment itself, subject to further evidence, our position is that £1.38m<sup>4</sup> from DCC's total cost in RY20/21 are unacceptable costs. This comprises expenditure on recruitment costs; inefficiencies in contractor benchmarking; and activity relating to electric vehicles.

In addition, we are minded to disallow a total of £69.67m in forecast costs for RY21/22 and RY22/23, and a further £246.75m increase in its baseline forecast costs over RY23/24 to RY25/26 (the remaining term of the Licence) because DCC has not justified these costs. Any costs that we ultimately decide were not economically and efficiently incurred will either be excluded from the future calculation of Allowed Revenue or be subject to an undertaking about DCC's future management.

## Performance Incentives

All of DCC's margin is at risk against its performance. This is the third year in which DCC's performance is being assessed under the Operational Performance Regime (OPR).

We are proposing that all of DCC's Baseline Margin should be retained as they achieved all targets under the OPR. In the RY18/19 submission, we stated our concerns that the OPR may not be providing the best incentives to DCC. Following consultation on how the OPR could be

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<sup>4</sup> The unacceptable cost figures provided in the Executive Summary are inclusive of any associated Shared Service charge (SSC). Please see Appendix 3 for the detailed breakdown on the proposed unacceptable costs.

modified and improved, in October 2020 we published our decision<sup>5</sup> to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management.

The Baseline Margin Project Performance Adjustment Schemes (BMPPAS) enables the Secretary of State to create incentive regimes for specific projects. In RY20/21 there were no Projects to be assessed under the BMPPAS regime.

## **Baseline Margin Adjustment**

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

This year DCC has applied for a £15.33m adjustment to its Baseline Margin (BM) for increases in the volume and complexity of work, caused by both new drivers and drivers previously identified by DCC.

We are minded to adjust DCC's application to reflect the price control decisions on unacceptable costs. We are also minded to reject some parts of DCC's application, where we have not seen sufficient evidence of a material change that could not have been foreseen, or for which the driver does not appear to meet the conditions in the Licence, unless we receive further information.

Taking all of these disallowances into account, we are minded to amend DCC's application to an adjustment of £7.26m between RY20/21 and RY22/23, a decrease of £8.08m from the application. A significant proportion of BM reduction due to cost disallowances is due to forecast cost disallowance for RY21/22 and RY22/23. If these forecast costs are justified in future Price Control submissions, DCC will be able to keep the Baseline Margin associated with these costs.

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<sup>5</sup> DCC Operational Performance Regime Review: October 2020 Decision:  
<https://www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision>

## External Contract Gain Share

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

DCC has applied for a Relevant Adjustment of £14.53m across RY20/21 to RY25/26. This adjustment partly relates to the continuation of re-financing arrangements and the financing of Communication Hubs (CHs). This year's ECGS application included savings from DCC's in-house test lab service. We propose to accept DCC's ECGS Adjustment application of £10.54m relating to the continuation of re-financing arrangements and CHs financing. We are minded to reject £3.99m of the adjustment relating to DCC's in-house test lab service.

Between RY15/16 (DCC's first ECGS Adjustment application) and RY20/21 (including this year's application), DCC has secured cost reductions of around £156m and brought benefits of £91.1m (c.60% of total cost reductions) to DCC's customers (based on DCC's ECGS application).

## Switching Programme

DCC plays a central role in delivering the Switching Programme, established to improve consumer's experience of switching between energy suppliers. The costs and performance of the Switching Programme are dealt with separately from the rest of DCC's business.

We are minded to find DCC's costs associated with the Switching Programme in RY20/21 as economic and efficient, but propose disallowing DCC's forecasts for RY23/24 onwards (£7.053m) where DCC has not provided any justification.

In addition, the second and third of the delivery milestones under the Design, Build and Test Phase of the Switching Programme occurred in RY20/21. As all milestones were achieved, we propose that DCC should retain all margin associated with these milestones.

## **Next steps**

We welcome your views, and will consider them when we make our decision. Please send responses to [smartmetering@ofgem.gov.uk](mailto:smartmetering@ofgem.gov.uk) by 22 December 2021. We will publish our decision in February 2022.

## 1. Introduction

### What are we consulting on?

- 1.1. We are consulting on our proposed positions for DCC's costs, revenues and margin application for the Regulatory Year 2020/2021 (RY20/21) under the price control mechanism. As required by the Licence, our assessment of DCC's costs is based on comparing DCC's incurred costs and revised forecast with the previous year's forecast and with DCC's Licence Application Business Plan (LABP).<sup>6</sup> Our guidance document, published in June 2021, 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<sup>7</sup>.
- 1.2. Some stakeholders may find it difficult to provide meaningful input to the price control consultation process given limited detail of cost information provided within our consultation document. We are restricted as to the detail we can include in this document due to the commercially sensitive nature of much of the evidence we consider.
- 1.3. DCC provides additional transparency on costs direct to its customers through its quarterly finance forums under suitable confidentiality arrangements. Further, alongside this consultation, DCC has published parts of its price control submission for Regulatory Year 2020/2021.<sup>8</sup> This additional information should be helpful to stakeholders in responding to this consultation.
- 1.4. A stakeholder meeting will also be held in December to provide DCC's customers and other key stakeholders an opportunity to explore the issues highlighted in this consultation with both Ofgem and DCC.
- 1.5. The content of each section of this document is summarised below, along with the questions to which we are seeking your response.

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<sup>6</sup> <http://www.smartdcc.co.uk/media/6531/redacted-labp-marked-public-151021.pdf>

<sup>7</sup> <https://www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2021>

<sup>8</sup> <https://www.smartdcc.co.uk/about/price-control/>

## Section 1: Introduction

1.6. This section includes a short summary of the other sections in this document, a summary of DCC's activities during RY20/21, and an overview of DCC's costs during the year. It also sets out the stages in the consultation process, specifies how you should respond, and explains how we will treat your responses.

## Section 2: External Costs

1.7. This section summarises the costs incurred by DCC's Fundamental Service Providers (FSPs) and SMETS1 service providers, for RY20/21, and the updated forecasts for the remainder of the Licence term. It sets out DCC's justification for any changes in those costs and our response.

**Question 1: What are your views on our proposal to accept DCC's External Costs incurred in RY20/21 as economic and efficient?**

**Question 2: What are your views on our proposal to disallow the variance in enduring forecast costs for S1SP\_3b and a proportion of the UIT forecast costs for DSP?**

## Section 3: Internal Costs

1.8. This section examines DCC's Internal Costs, namely the costs that are incurred by DCC for the purposes of the provision of the DCC service (these exclude External Costs and Pass-through costs). It examines Internal Costs incurred in RY20/21 and DCC's updated forecasts for the remainder of the Licence term, focussing on changes in those costs compared with last year's forecast and the LABP. It sets out DCC's justification for any changes in those costs and our response, specifically considering payroll and external services. This section also investigates DCC's approach and the results of the benchmarking of permanent staff and contractor remuneration.

**Question 3: What are your views on our proposals on DCC’s approach to benchmarking of staff remuneration for both contractor and permanent staff?**

**Question 4: What are your views on our proposal to disallow the Shared Service Charge associated with external services procured for Additional Baseline activities such as NEP and ECOS?**

**Question 5: What are your views on our proposal to disallow non-resource recruitment costs in the Commercial and Operations cost centres?**

**Question 6: Do you have any views on potential proxy measures to calculate cost disallowances in areas where DCC may not have acted economically and efficiently, but the dependencies and scale of the impact are not clear?**

**Question 7: When it is determined that DCC may not have acted in an economic or efficient manner but an appropriate methodology cannot be applied to calculate the proportion of costs impacted, we propose to take these instances into account when deciding DCC’s score under the Contract Management and Customer Engagement aspects of the OPR. What are your views on this proposed approach to be adopted from RY2021/22 Price Control, if an alternative measure is not determined?**

**Question 8: What are your views on our proposal to disallow forecast variances in Network Evolution, SMETS1, and ECoS programmes?**

**Question 9: What are your views on our proposal to disallow the costs associated with DCC’s activity relating to EVs? Please provide any evidence if you have engaged with DCC in this area.**

**Question 10: What are your views on our proposals to disallow forecast cost variances in the Corporate Management, Commercial, Finance, Operations, and Programme (Service Delivery) Cost Centres in RY21/22 and RY22/23, and all baseline forecast costs for RY23/24 onwards?**

#### **Section 4: Performance Incentives**

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

**Question 11: What are your views on our proposed position on DCC’s performance under OPR and trial run for customer engagement, and implementation of the contract management incentive?**

## **Section 5: Baseline Margin Adjustment and External Contract Gain Share**

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

**Question 12: What are your views on our assessment of DCC's application to adjust its Baseline Margin?**

**Question 13: What are your views on our assessment of DCC's application to adjust its ECGS?**

## **Section 6: Switching**

1.11. This section examines DCC's costs associated with the switching programme, and our assessment of the second and third incentivised milestones for the Design, Build and Test phase of the programme.

**Question 14: What are your views on our proposed position on DCC's costs associated with the Switching Programme?**

**Question 15: What are your views on our assessment of Delivery Milestone 2 and Delivery Milestone 3 of the Switching Programme?**

## Related Publications

1.12. DCC's Licence is at:

<https://epr.ofgem.gov.uk/Content/Documents/Smart%20DCC%20Limited%20-%20Smart%20Meter%20Communication%20Consolidated%20Licence%20Conditions%20-%20Current%20Version.pdf>

1.13. The DCC Regulatory Instructions and Guidance 2021 is at:

<https://www.ofgem.gov.uk/cy/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2021>

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

<https://www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2021-0>

1.15. Last year's Consultation Document is at: <https://www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-201920>

1.16. Last year's Decision Document is at: <https://www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201920>

1.17. The Price Control element of the DCC's website is at:

<https://www.smartdcc.co.uk/about/price-control/>

## DCC's summary of RY20/21

- 1.18. In its submission, DCC provided an overview of its key activities during RY20/21 and the factors which drove the overall level of activity and spending across the organisation.
- 1.19. In RY20/21, DCC continued to progress in delivering its core programmes including SMETS2, SMETS1 and Switching. DCC highlighted the following achievements during RY20/21:
- hosting nearly 3.8m SMETS1 and 7.1m SMETS2 across the DCC network
  - successfully responding to a managed replan of the Design, Build and Test phase of the Faster Switching programme and on track to launch the service in Summer 2022
  - delivering 27 Smart Energy Code (SEC) Modifications and 3 Change Requests across the June 2020 & November 2020 releases, as well as the completion of 18 Preliminary Impact Assessments and 8 Full Impact Assessments
  - delivering the SEC Systems Release in June 2020 and November 2020
  - issuing an Invitation to Tender for the Network Evolution service, with responses received from potential tenders in February 2021
  - initiating a new approach to customer engagement based on giving customers visibility in matters that affect them and giving them a say in decision-making processes, through a structured three phase approach of Inform, Shape and Survey
- 1.20. DCC identified a number of key themes in its submission that summarise its work through the year:
- **responding to customer's needs:** Over the past 18 months, DCC have made efforts to listen and respond to how their customers would like to be engaged and continue to review its effectiveness.
  - **customer engagement:** DCC are continuing to review and improve their customer engagement approach, including being clearer on why they are engaging with customers, and how they will use that engagement for a better-quality service.
  - **managing contractors' performance:** DCC are ensuring contractors deliver in line with the specification. They have monitored the Service Credit Regime, organised

Monthly Service Reviews of all contracted measures, and held Forums to address issues and/or disputes.

- **good deal for customers:** DCC deployed a range of contract management tools when negotiating contracts and ensuring contractual compliance. DCC have taken steps to reduce charges to customers for poor performance within the Service Providers.

## Summary of DCC costs

### DCC RY20/21 Costs

1.21. Overall, DCC’s total reported costs for RY20/21 are £628m. Excluding pass-through costs<sup>9</sup>, the figure is £593m.

1.22. This is a 21% increase in total costs incurred in RY20/21 compared to last year’s forecasts (or a 23% increase with pass-through costs excluded). Table 1.1 shows how the main cost categories in RY20/21 compare to the forecasts of DCC’s RY19/20 submission.

**Table 1.1: RY20/21 reported costs compared to RY19/20 forecast in current year prices**

	<b>RY19/20 forecast (£m)</b>	<b>RY20/21 (£m)</b>	<b>Variance (£m)</b>	<b>Variance (%)</b>
Total External Costs	386	458	72	19%
Total Internal Costs (excl. SS)	74	97	23	32%
CRS total costs (excl. SS)	18	30	12	68%
Total Shared Services cost (for internal costs and CRS)	6	8	2	33%
Total Costs excl. Pass-Through Costs	484	593	109	23%
Pass-Through Costs	34	35	1	2%
<b>Total Costs</b>	<b>518</b>	<b>628</b>	<b>110</b>	<b>21%</b>

1.23. The greatest percentage change in the variance comes from the Centralised Registration Service (CRS) – the switching programme. The switching programme increased by 67% between the reported costs in RY20/21 and RY19/20 forecast, though the Design, Build and Test phase of the switching programme remains under budget compared to the

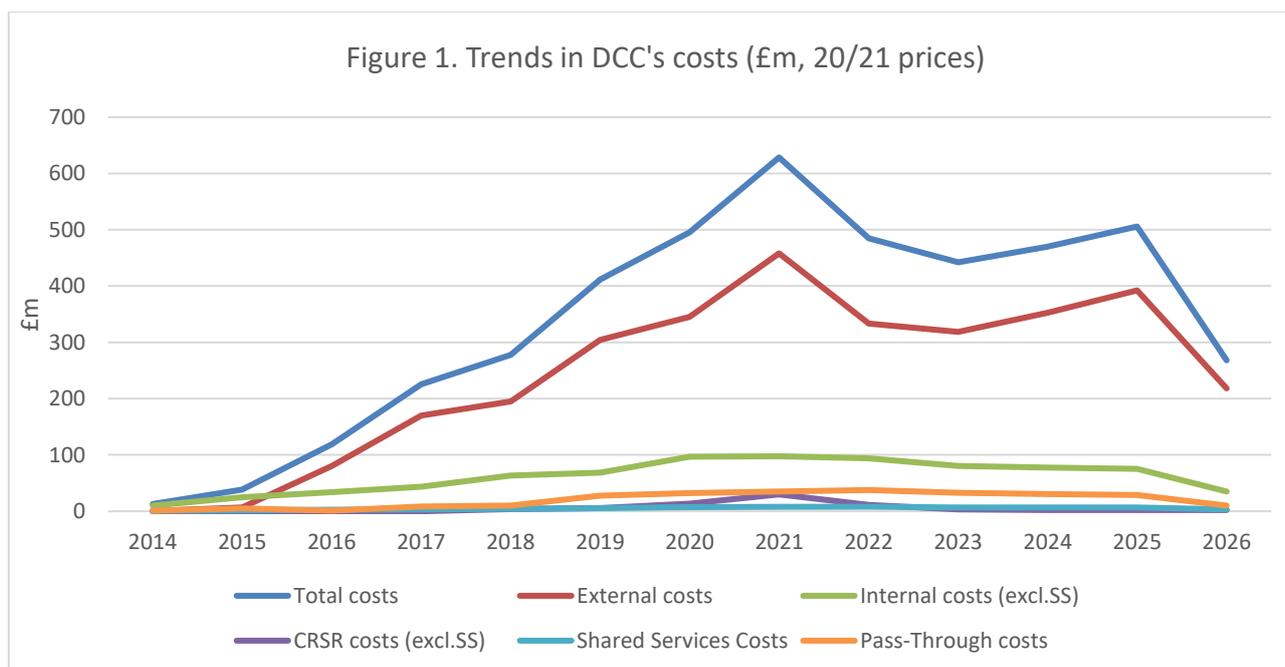
<sup>9</sup> Pass-through costs include the fee paid by the Licensee to the Authority and the payments to SECCo Ltd for purposes associated with the governance and administration of the Smart Energy Code (SEC).

business case. Notably, total internal costs also increased by 32% between the reported costs in RY20/21 and RY19/20 forecast.

### DCC costs over the Licence period

1.24. Figure 1.1 reports the trends in DCC’s costs over the Licence period as reported in its latest submission. DCC’s forecast costs increase, with total costs peaking at £628m in RY20/21, before decreasing in RY22/23 and rising again towards the end of the Licence term as the SMETS2 rollout nears completion.

**Figure 1.1: Trends in DCC’s costs (£m, 20/21 prices) in current year prices**



1.25. DCC’s latest forecast for total costs over the Licence period (RY13/14-RY25/26), as contained in its submission, is £4.38b. Excluding pass-through costs, its forecast for costs over the Licence period is £4.12b.

1.26. This is a 10% increase in total costs compared to last year’s forecasts (and a 13% increase with pass-through costs excluded) over the Licence period. Table 1.2 breaks this down by type of cost and shows how costs reported in the RY20/21 submission have changed compared to last year’s forecast over the Licence period.

**Table 1.2: Data Table for Figure 1.1**

<b>£m</b>	<b>RY13/ 14</b>	<b>RY14 /15</b>	<b>RY15 /16</b>	<b>RY16 /17</b>	<b>RY17 /18</b>	<b>RY18 /19</b>	<b>RY19 /20</b>	<b>RY20 /21</b>	<b>RY21 /22</b>	<b>RY22 /23</b>	<b>RY23 /24</b>	<b>RY24 /25</b>	<b>RY25/ 26</b>
<b>Total costs</b>	12.9	38.7	118.7	225.6	277.9	411.8	495.6	628.4	484.5	442.3	469.7	505.7	268.2
External costs	0.6	6.5	80.6	169.9	195.2	304.5	345.4	458.0	333.3	318.4	352.3	392.1	218.0
Internal costs	10.9	26.9	36.9	47.1	68.2	73.9	104.1	105.4	102.1	87.4	84.4	82.1	37.9
CRSR costs (excl.SS)	0.0	0.0	0.0	0.0	4.7	6.4	13.9	30.7	12.0	3.7	2.4	2.4	2.3
Shared Services costs	0.8	1.9	2.7	3.3	4.7	5.6	7.4	7.8	8.0	6.9	6.8	6.7	3.1
Pass-Through costs	1.3	5.3	1.2	8.6	10.3	27.7	32.3	35.1	37.7	33.1	30.6	29.1	9.9

**Table 1.3: RY20/21 forecast and variation compared to RY19/20 forecast over the Licence period (RY13/14-RY25/26) in current year prices**

	<b>RY19/20 forecast (£m)</b>	<b>RY20/21 forecast (£m)</b>	<b>Variance (£m)</b>	<b>Variance (%)</b>
External - Baseline	1,649	1,786	137	8%
External – New Scope	1,245	1,350	105	8%
External – Other Costs	154	39	-115	-75%
<b>Total External Costs</b>	<b>3,048</b>	<b>3,175</b>	<b>127</b>	<b>4%</b>
Internal – Baseline (excl. SS)	458	745	287	63%
Internal – New Scope (excl. SS)	57	57	0	N/A
<b>Total Internal Costs</b>	<b>515</b>	<b>802</b>	<b>287</b>	<b>56%</b>
CRS (excl. SS)	51	75	24	47%
Total Shared Services cost (for internal costs and CRS)	42	66	24	58%
<b>Total Costs excl. Pass-Through Costs</b>	<b>3,655</b>	<b>4,118</b>	<b>463</b>	<b>13%</b>
Pass-Through Costs	334	262	-72	-22%
<b>Total Costs</b>	<b>3,989</b>	<b>4,380</b>	<b>391</b>	<b>10%</b>

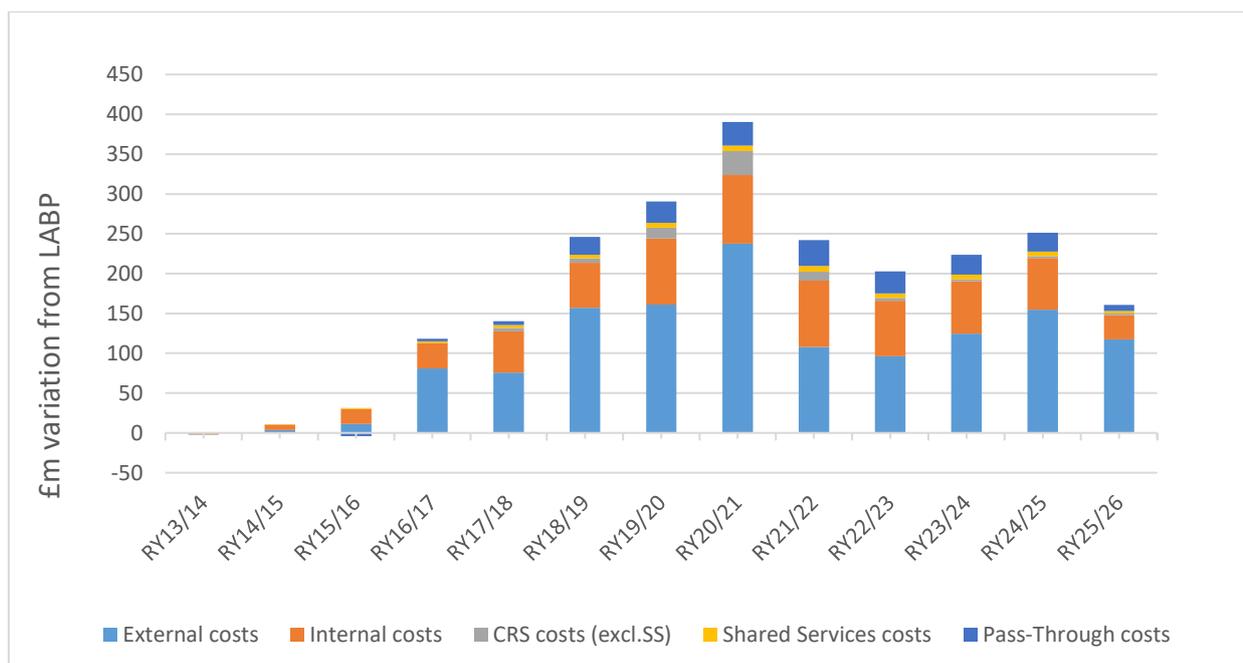
- 1.27. External Costs over the Licence term have increased by 4% compared to the RY19/20 forecast to £3.18b. This increase is primarily due to the costs associated with the Fundamental Service Providers. Section 2 summarises the External Cost variations, DCC’s justifications and our response.
- 1.28. Total Internal Costs have increased by 56% over the Licence term compared to last year’s forecast, from £515m to £802m. This is largely driven by increases in Additional Baseline Costs, Operations and Corporate Management cost centres. Section 3 summarises the Internal Cost variations, DCC’s justifications and our response.

### Comparison to the Licence Application Business Plan (LABP)

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

1.30. Figure 1.2 shows how the main cost categories in RY20/21 compared to the forecast at LABP. In aggregate, costs are £2.078b, or 111%, higher over the Licence term compared to DCC’s forecast as part of the bid.

**Figure 1.2: Comparison of RY20/21 costs to LABP in current year prices**



**Figure 1.2: Data Table**

£m	RY13 /14	RY14 /15	RY15 /16	RY16 /17	RY17 /18	RY18 /19	RY19 /20	RY20 /21	RY21 /22	RY22 /23	RY23 /24	RY24 /25	RY25 /26
External costs	0.6	3.7	11.4	80.8	75.6	157.1	161.3	237.6	107.7	96.2	124.5	154.7	117.5
Internal costs	-1.7	6.7	18.6	32.1	52.0	56.5	82.7	86.4	83.4	69.7	66.0	64.9	30.5

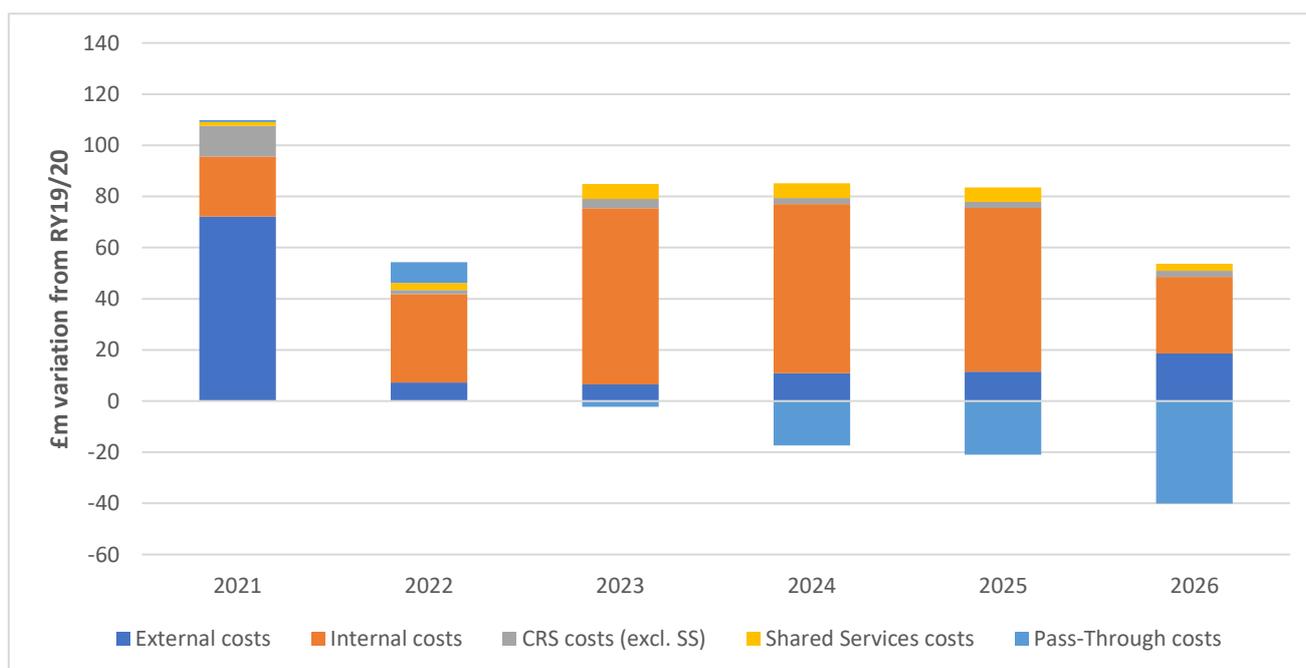
£m	RY13 /14	RY14 /15	RY15 /16	RY16 /17	RY17 /18	RY18 /19	RY19 /20	RY20 /21	RY21 /22	RY22 /23	RY23 /24	RY24 /25	RY25 /26
CRS costs (excl.SS)	0.0	0.0	0.0	0.0	4.2	5.7	13.7	29.9	11.5	3.5	2.4	2.4	2.3
Shared Services costs	-0.2	0.1	1.2	2.2	3.6	4.4	6.1	6.7	7.0	5.9	5.7	5.7	2.7
Pass-Through costs	-0.4	-0.1	-4.2	3.2	4.9	22.4	26.9	29.7	32.3	27.7	25.2	23.7	7.7

### Comparison to last year’s forecast

1.31. Figure 1.3 shows how the main cost categories in RY20/21 compare to the forecast created as part of DCC’s RY19/20 submission.

1.32. Overall, costs are £391m higher over the Licence term compared to the forecasts in DCC’s RY19/20 submission.

**Figure 1.3: Comparison to RY19/20 forecast in current year prices**



**Figure 1.3: Data Table**

£m	Ry20/21	Ry21/22	Ry22/23	Ry23/24	Ry24/25	Ry25/26
External costs	72.1	7.2	6.5	10.9	11.5	18.6
Internal costs (excl. SS)	23.4	34.6	68.9	66.1	64.0	30.0
CRS costs (excl. SS)	12.1	1.6	3.5	2.4	2.4	2.3
Shared Services costs	1.4	2.8	5.9	5.8	5.7	2.7
Pass-Through costs	0.8	8.0	-2.2	-17.4	-21.0	-40.1

### Over-recovery of revenue

1.33. The Licence requires DCC to take all reasonable steps to ensure that its Regulated Revenue does not exceed a prudent estimate of Allowed Revenue for each Regulatory Year.<sup>10</sup> Detailed information on Allowed Revenue, Regulated Revenue, and DCC’s Charging Statement can be found in the RY15/16 Consultation Paper.<sup>11</sup>

1.34. We have in place a penalty interest rate regime, which is designed to incentivise DCC to improve the accuracy of its charges to customers and to deter it from over-recovering revenues.<sup>12</sup> The threshold to apply the penalty interest rate for over-recovery is equal to 110% of allowed revenue. Where DCC exceeds this threshold, a penalty interest rate of 3% above the Bank of England base rate on any proportion of over-recovery that DCC has not justified to the Authority’s satisfaction is to be applied.

<sup>10</sup> See LC36.4

<sup>11</sup> <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-decision-regulatory-year-201516>

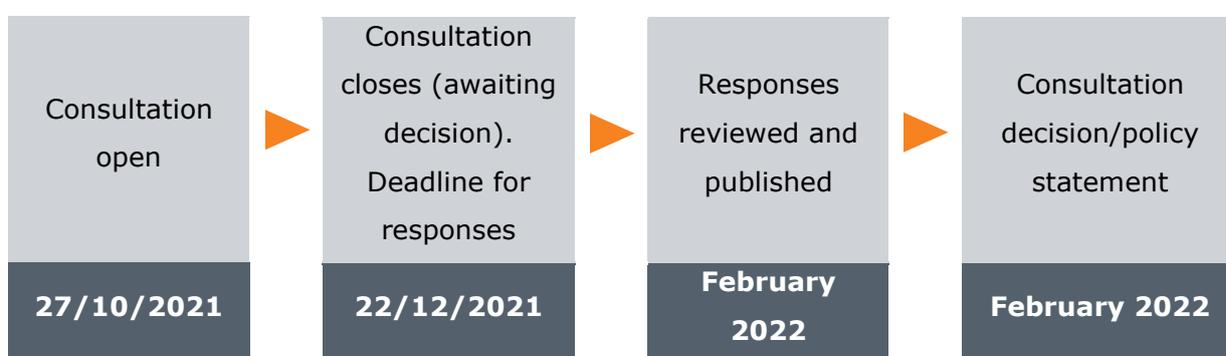
<sup>12</sup>[https://www.ofgem.gov.uk/system/files/docs/2016/05/decision\\_to\\_modify\\_smart\\_meter\\_communication\\_licence\\_for\\_dcc\\_penalty\\_interest\\_rate\\_web\\_version.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/05/decision_to_modify_smart_meter_communication_licence_for_dcc_penalty_interest_rate_web_version.pdf)

1.35. DCC over-recovered revenue from customers by 108% in RY20/21, which is below the 110% threshold. This is a slight decrease from RY19/20 where DCC’s over-recovery revenue was 109%. In RY18/19, the over-recovered revenue value was also 108%.

## Consultation stages

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

**Figure 1.4: Consultation stages**



## How to respond

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

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

1.39. We will publish non-confidential responses on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## Your response, data and confidentiality

- 1.40. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 1.41. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 1.42. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.
- 1.43. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

## General feedback

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

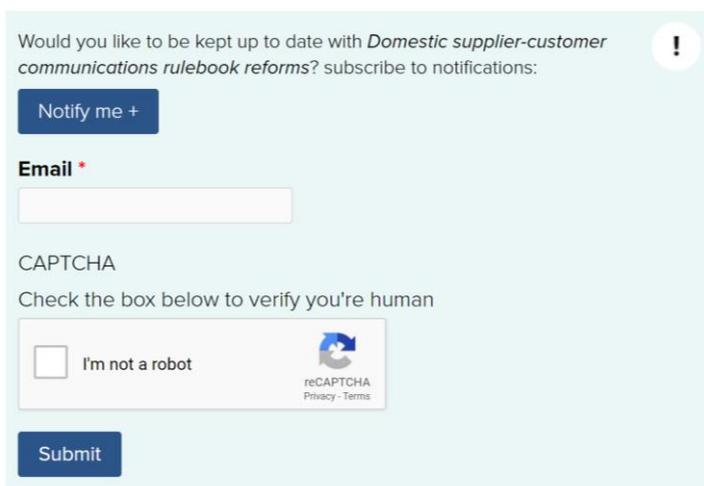
1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6.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

1.45. Please send any general feedback comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)

### How to track the progress of the consultation

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

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



## 2. External Costs

### Section summary

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

External costs form the largest part of DCC's costs at ~73%. This chapter provides an overview of DCC's external costs in RY20/21, both incurred and forecasted, and our assessment of DCC's submission and justification.

We are minded to accept the external costs which DCC incurred in RY20/21; however, we propose to disallow a portion of forecast costs on the grounds of insufficient evidence and uncertainty.

Through our analysis, we have also identified a number of issues of concern, including: DCC's reliance on Urgent Work Orders (UWOs), delays in DCC's engagement with service providers in change management, the incurring of Working Capital Charges (WCC), and lack of risk sharing mechanisms with external service providers. We expect DCC to make improvements across the board and provide value for money.

### Questions

**Question 1: What are your views on our proposal to accept DCC's External Costs incurred in RY20/21 as economic and efficient?**

**Question 2: What are your views on our proposal to disallow the variance in enduring forecast costs for S1SP\_3b and a proportion of the UIT forecast costs for DSP?**

## What are External Costs

- 2.1. External Costs form a part of DCC's allowed revenue (~73% in RY20/21). These costs are incurred by DCC's Fundamental Service Providers (FSPs) in their delivery of the core SMETS2 programme as well as other service providers delivering more recent SMETS1 and Switching programmes.
- 2.2. The FSPs were appointed following a competitive tender process that was run by the government. They include the Data Service Provider (DSP), CGI, and the two Communication Service Providers (CSPs), Arqiva and Telefonica. Together, the FSPs are responsible for delivering the data and communications services to support smart metering across Great Britain.
- 2.3. The SMETS1 service comprises several components provided by a number of providers:
  - SMETS1 Service providers translating DCC format service requests into a format that SMETS1 meters can understand (in effect acting as upgraded SMSOs);
  - Dual Control Organisation (DCO) software enhancing security arrangements of the SMETS1 solution;
  - Communications Service Providers whose network allows DCC to communicate and control the SIMs in each comms hub; and
  - in addition, DCC itself provides the Commissioning Party service to enable smart metering system, which have been successfully migrated to DCC, to be set up as 'commissioned'.

**Table 2.1: Overview of DCC’s contracts with SMETS1 service providers**

Role + Capacity	Provider	RY of contract
Initial Operating Capability (IOC)	S1SP_1	18/19
Middle Operating Capability (MOC)	S1SP_2	18/19
Final Operating Capability (FOC)	S1SP_3a S1SP_3b	18/19
Dual Control Organisation (DCO)	S1_DCOa S1_DCOb	18/19 <sup>13</sup>
Communications Service	S1CSP_1 S1CSP_2	19/20

## How have External Costs changed?

- 2.4. Over the course of RY20/21, DCC incurred **£458.02m** in external costs. (Cost incurred by the FSPs accounted for £363.77m, while SMETS1 external costs were £94.26m.) Table 2.2 shows the variance in External Costs (adjusted for inflation) for RY20/21 and the full Licence term relative to RY19/20 and LABP forecasts.
- 2.5. Compared to the forecast accepted under last year’s price control, external costs are 19% higher for RY20/21 and 4% higher over the Licence term. In comparison to the LABP forecast (ie costs forecast in the business plan submitted at the Licence award), external costs are 108% higher for RY20/21 and 72% higher over the full Licence term.

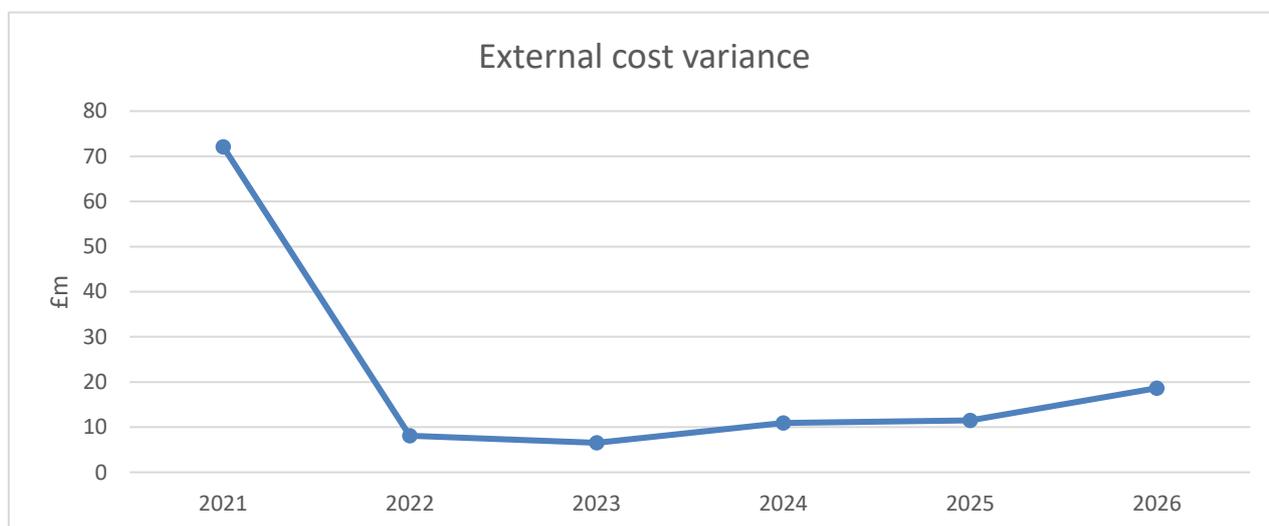
**Table 2.2: External Costs variance compared to RY19/20 and LABP forecasts (adjusted for inflation)**

	Variance in RY20/21		Total variance over the full Licence term	
	£m	%	£m	%
From RY19/20 forecast	72.125	19	126.905	4
From LABP forecast	237.576	108	1,328.567	72

<sup>13</sup> Enduring contract with S1\_DCOb was put in place in RY19/20

2.6. The forecast variance of 4% in external costs across the Licence period translates into a growth by over £126m, as demonstrated in Figure 2.1. However, as in the previous year, this projection includes a reduction in the forecast costs of Communication Hubs (CHs) of -£66.52m. This decrease, affecting the costs of the CSPs, has been driven by DCC aligning its assumptions with BEIS’s projections for the smart meter rollout under the post-2020 framework which extends to end 2025. These decreases therefore do not represent any newly found cost efficiencies.

**Figure 2.1: External Cost Variance across the whole Licence period**

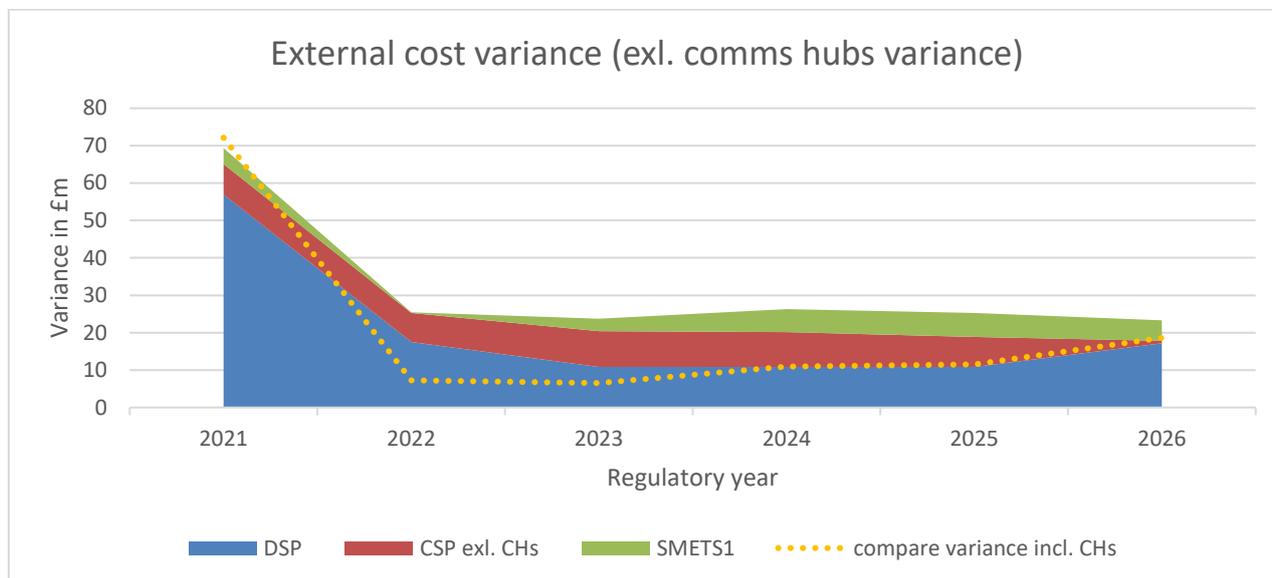


**Figure 2.1: Input table**

Reg. year	20/21	21/22	22/23	23/24	24/25	25/26
Variance (£m)	72.13	7.23	6.53	10.90	11.49	18.62

2.7. Controlling for the negative component in the CHs costs, the net variance in external costs over the Licence period is £193.42m, or an increase by 6%, compared to last year’s forecast. As evidenced in Figure 2.2, this variance is driven mainly by the increase in the DSP costs.

**Figure 2.2: External Cost Variance across the whole Licence period (controlling for CHs cost decrease)**



**Figure 2.2: Input table**

Variance in each reg. year (£m)	20/21	21/22	22/23	23/24	24/25	25/26	Total Variance
<b>SMETS2 (CSPs only, excl. CHs)</b>	8.115	7.762	9.539	9.307	8.041	0.639	<b>43.404</b>
<b>DSP</b>	56.961	17.503	10.852	10.842	10.846	17.166	<b>124.170</b>
<b>SMETS1 providers</b>	4.264	0.166	3.375	6.142	6.362	5.542	<b>25.850</b>
<b>Total Variance</b>	69.340	25.431	23.766	26.291	25.250	23.347	<b>193.424</b>
<b>Compare Variance incl. CHs</b>	72.125	7.229	6.535	10.902	11.492	18.622	<b>126.905</b>

2.8. It is important to note that the CHs reductions only affect CSP cost from RY21/22 and there was in fact a small year-on-year increase in CHs costs in RY20/21. This can be seen in the first column (RY 20/21) of the data input table for Figure 2.2.

2.9. Figure 2.3 provides further detail on the variance in external costs in RY20/21. The year-on-year increase was primarily driven by a significant growth in the DSP costs, which increased by £56.96m compared to last year's forecast, accounting for ~79% of the total variance. The SMETS2 CSPs contributed further £10.90m or approximately 15% of the variance. The remaining 6% are attributed to the external costs incurred by the SMETS1 service providers, which rose by £4.26m on last year's forecast.

2.10. Table 2.3 sets out the percentage increase in the costs of DSP, CSPs and SMETS1 compared to last year's projection. The DSP costs drive the variance in both a year-on-year comparison and the forecast for the remainder of the Licence. The DSP costs in RY20/21 were driven by:

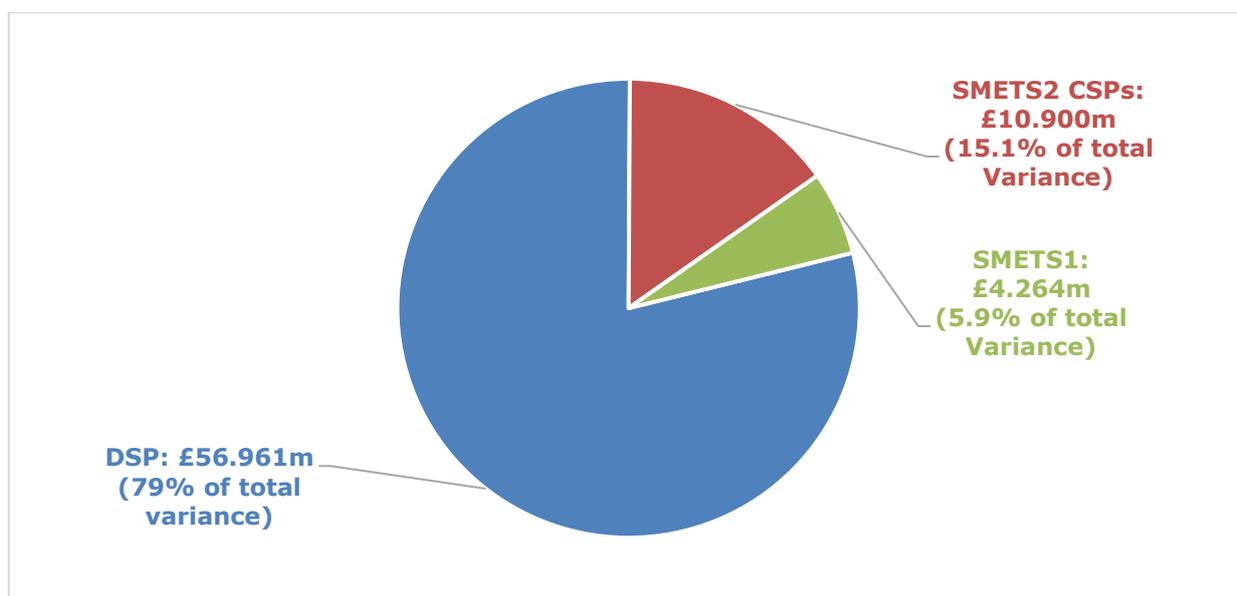
- newly justified material 'change request and project requests' (hereafter CRs/PRs) in the SMETS2 programme totalling £16.75m;
- newly justified material CRs/PRs in the SMETS1 programme worth £13.85m;
- newly justified material CRs/PRs incurred by DSP as a service provider in the switching programme amounting to £9.13m;
- user Integration Testing costs of £7.09m; and
- costs below materiality threshold (£1m) incurred on previously justified CRs/PRs.

2.11. In addition to the year-on-year increase of £56.96m, above, the variance over the full Licence term (£124.17m) has also been driven by:

- newly justified CRs/PRs (across programmes) incurring costs in RY22/23 totalling £6.97m; and
- projected enduring costs of User Integration Testing of £12.50m per year from RY22/23 (£62.50m in total).

2.12. The year-on-year increases in the CSP and SMETS1 SP costs were comparatively less significant. Among the SMETS2 CSPs, the costs of CSP-N grew the most since RY19/20 by £5.96m (or 8%). CSP-C and CSP-S costs increased by £2.17m (3%) and £2.77m (5%), respectively. The key drivers in the SMETS2 area were: R2.0, November 2020 SEC Release, Enterprise Change and SM-WAN Coverage database. CSP-N costs were particularly affected by CRs/PRs relating to R2.0 (GBCS update), Enterprise Change (refresh of test environments for UIT<sup>14</sup> and PIT<sup>15</sup>), and SM-WAN Coverage Database.

**Figure 2.3: External Cost Variance in RY20/21**



**Figure 2.3: Input table**

	SMETS2 CSPs	SMETS1	DSP
Variance from RY19/20 (in £m)	10.900	4.264	56.961
As % of total Variance	15.1%	5.9%	79.0%
Total Variance (in £m)	72.125		

<sup>14</sup> User Integration testing

<sup>15</sup> Pre-Integration Testing

**Table 2.3: Cost variation by FSPs and SMETS1 SPs compared to RY20/21 forecast**

Cost Variance	RY20/21	Over the Licence term (controlling for CHs)
DSP	55%	24%
CSP N	8%	4%
CSP C	3%	2%
CSP S	5%	1%
SMETS1	5%	5%

2.13. The SMETS1 costs rose by £4.26m, or approximately 5%. A proportion of new costs expended over RY20/21 were incurred due to delays of the SMETS1 Programme and the extension of activities relating to: additional testing and enduring support for the IOC cohort; MOC testing and migration; and FOC testing, extended DCO support and re-design of the migration solution. Further information can be found in *Annex 2*. DCC’s justification of incurred costs is discussed in the following section. Some of this variance has been offset by a drop in the costs of S1\_CSP\_1 on account of reduced volume of migration, and S1SP\_3a due to FOC delays and resulting deferrals milestone payments.

2.14. The SMETS1 SP forecast over the licence period has increased by £25.85m, or roughly 5%; in large part driven by:

- S1SP\_3b enduring operational costs extrapolated for the period after the contract expiry and additional network capacity required to handle anticipated transaction messaging volumes over the licence period; and
- S1\_CSP\_2 operational costs owing to reprofiling of monthly SIMs and previously under-forecasted data charges for MOC (MDS)<sup>16</sup> meters.

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<sup>16</sup> Middle Operating Capability

2.15. These increases in the forecast are partially offset by a reduction in the costs of S1SP\_2 due to the reprofiling of anticipated meter migration volumes and associated monthly charges over the licence period. The detailed cost variances per service provider are set out in table 2.4 below (variances mentioned in paragraphs 2.13 and 2.14 have been highlighted).

**Table 2.4: Cost variances for individual SMETS1 service providers in RY20/21**

	RY 20/21		Over the Licence period	
	Cost variance from RY19/20 (in £m)	Variance from RY19/20 forecast (in %)	Cost variance from RY19/20 (in £m)	Variance from RY19/20 forecast (in %)
S1SP_1	11.621	174%	15.394	37%
S1_CSP_1	-7.067	-60%	0.310	0%
S1SP_2	-3.195	-13%	-40.338	-27%
S1_CSP_2	-1.160	-64%	7.118	73%
S1SP_3a	-6.056	-38%	-2.447	-3%
S1SP_3b	4.945	35%	40.218	88%
S1_DCOa	3.707	32%	4.208	6%
S1_DCOb	1.470	35%	1.386	5%
<b>Total variance</b>	<b>4.264</b>	<b>5%</b>	<b>25.850</b>	<b>5%</b>

## DCC's Justification

2.16. DCC has justified material External Costs by programme/project-related Change Requests (CRs) and Project Requests (PRs). Material external costs are defined as CR/PR costs with a 'life value' that exceeds £1m.

- 2.17. DCC justified individual material CRs/PRs through a narrative submission linked to quantitative reporting and provided supporting evidence of scope, drivers and the change management process that was followed, cost breakdowns, and any savings achieved through negotiations (averaging at ~15%). DCC further explained how it sought to secure value for money in each instance; these strategies included: challenging costs and resource profiles, iterative revision of the scope of work, negotiating expense reductions during the lockdown periods, or opting for financing on a 'time and materials' basis as opposed to 'fixed price' where scope was uncertain.
- 2.18. Tables 2.5 and 2.6 show new costs for individual project areas within the SMETS2 and SMETS1 programmes, which were justified under material CRs and PRs.

## **SMETS2**

- 2.19. DCC reported that in RY20/21, the SMETS2 programme consisted of four key project areas of material cost increases: R2.0, November 2020 SEC Release, Enterprise Change, and SM-WAN Coverage Database. As set out in table 2.5 below, DCC justified 10 new CRs/PRs with the total combined cost of £36.33m. Of these, 5 were raised with the DSP, accounting for £17.58m. The remaining 5 were raised with the CSPs with the total value of £18.75m.<sup>17</sup>
- 2.20. The largest proportion of the new SMETS2 costs (46%) has been incurred under 4 CRs/PRs within the *Enterprise Change* area delivering enhancements to testing services. The main costs in this area are attached to the extension and refresh of CSP-N test environment for UIT and PIT, and DSP Enduring UIT testing service for both SMETS2 and SMETS1 with support for Migration Device User System Test (MDUST).

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<sup>17</sup> Please note that some of these costs are distributed over the Licence period; therefore these costs alone do not amount to the year-on-year variance.

2.21. R2.0 accounted for 34% of the newly justified SMETS2 costs, including the restart and completion of Dual Band DIT, and an update to GBCS v.3.2.<sup>18</sup> November 2020 SEC release wrapped up activities beyond PIT completion through the final stages of the release lifecycle into production. DCC also sought changes to CSP-N SM-WAN Coverage database to allow installation of electricity smart meters that fail to meet a 7dB noise rise specification.

**Table 2.5: Costs incurred on newly justified CRs/PRs within the SMETS2 Programme**

SMETS2 Programme Area	# of new CRs/PRs over £1m <sup>19</sup>	Cost (£m)	% of total new costs (within Programme)	Σ (£m)
R2.0	3	12.46	34%	<b>36.33</b>
November 2020 SEC Release	2	5.27	15%	
Enterprise Change	4	16.69	46%	
SM-WAN Coverage Database	1	1.913	5%	
<b>Split between DSP &amp; CSPs</b>				
DSP	5	17.58	48%	<b>36.33</b>
CSPs	5	18.75	52%	

## SMETS1

2.22. The newly justified costs in the SMETS1 Programme were incurred across four areas: SMETS1 core capabilities, IOC, MOC and FOC. As in previous year, the key driver behind the costs has been delays and subsequent extension to the testing and migration of the three cohorts. DCC provided justification for 16 material CRs/PRs with the total combined value of £25.29m. Table 2.6 below provides an overview of their aggregate costs and split between service providers.

<sup>18</sup> The Great Britain Companion Specification (GBCS) sets out data security and other operational standards for Comms hubs.

<sup>19</sup> Where the same CR/PR was raised with more than one FSP, it is recorded as two separate CRs/PRs.

- 2.23. 50% of the new SMETS1 costs (£12.61m) were recorded in the FOC cohort, where DCC justified 10 new CRs/PRs, including extensions to SIT<sup>20</sup>, and covers requirements for associated support functions on extended timelines. DCC explained that after an initial delay to the start of FOC SIT execution, a full redesign of the migration solution was required due to the failure of its application for two service providers as a result of their execution activities. DCC argued that as a result of these complexities and the non-contingent nature of the JIP plan<sup>21</sup>, the SIT activities had to be renegotiated while the work was ongoing. DCC explained the steps it had taken to follow due diligence and secure value for money, including foreshortening the original SIT Execution CR, switching away from fixed price to a time and materials financing through extensions, and using Urgent Work Orders (UWOs) as an interim commercial mechanism. (UWOs allow DCC to finance ongoing work while contract negotiations are ongoing. We discuss UWOs in more detail in paragraphs 2.31-2.39.)
- 2.24. DCC explained that the solution to the FOC delivery (split into multiple releases) led to increased costs due to additional testing and extended timelines for migration support functions.
- 2.25. The new MOC costs amounted to £4.33m across 3 CRs/PRs. MOC-Secure SIT execution also experienced delays and issues necessitating extensions, and DCC again utilised UWOs to progress the work while engaging with the service provider. DCC also justified a change request raised to maintain RNSP<sup>22</sup> channels for a period 336 hours after migration to allow consumers to top-up PPM. DCC provided evidence of consulting the industry and BEIS.
- 2.26. The newly justified IOC costs (£6.65m) were driven by 3 CRs/PRs, seeking enduring BAU operational service and extended migration support. DCC also raised a PR for the execution of additional DMCT<sup>23</sup> which was needed as the original IOC SIT had not covered 100% of SMETS1 devices deployed at the time.

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<sup>20</sup> System Integration Testing

<sup>21</sup> The Join Industry Plan, consulted on in autumn 2019, laid out the delivery schedule for all three cohorts, including FOC SIT: <https://www.sms-plc.com/media/4427/dcc-smets1-delivery-plan-consultation-final.pdf>

<sup>22</sup> Retail Network Service Providers, through which PPM customers are able to purchase credit to top up their meters, eg. Post Office, Payzone, Paypoint.

<sup>23</sup> Device Model Combination Testing

**Table 2.6: Costs incurred on newly justified CRs/PRs within the SMETS1 Programme**

<b>SMETS1 Programme Area</b>	<b># of new CRs/PRs over £1m</b>	<b>Cost (£m)</b>	<b>% of total new costs (within Programme)</b>	<b>Σ (£m)</b>
Core Capabilities	2	1.70	7%	<b>25.29</b>
IOC	3	6.65	26%	
MOC	3	4.33	17%	
FOC	8	12.61	50%	
<b>Split between SMETS1 SPs</b>				
S1SP_1	11	17.82	70.5%	<b>25.29</b>
S1SP_2	1	1.11	4.5%	
S1SP_3b	2	3.30	13%	
S1_DCOa	2	3.06	12%	

## Our view

2.27. **We consider DCC's submission acceptable and are minded to accept the external costs which DCC incurred in RY20/21.**

2.28. We accept DCC's explanation of the drivers behind individual newly justified material costs and the details of how DCC sought to resolve challenges that arose. We note that DCC has made some improvements in its reporting, notably in the quantitative submission through supplementary schedules providing detailed cost breakdowns linked to the narrative.

2.29. Nevertheless, we felt that the submission alone did not provide all the information we needed to assess DCC's costs, and we asked 56 clarification questions to obtain further evidence. Going forward, we would welcome the following improvements in the quality of DCC's submission:

- a clear explanation of any disparities between the costs justified in the narrative submission and the RIGs reporting (despite an improvement on last year, there were still a number of misaligned amounts requiring clarification);
- where negotiations last past the starting date of relevant work, an explanation for those delays and the commercial cover provided without a contract in place;
- evidence around stakeholder engagement prior to progressing new projects or changes; and
- a clear summary of cost variances linked to their drivers. As highlighted in our last year's consultation, the costs justified through the narrative submission should align with the overall cost variance reported in the RIGs. Notably, in this year's submission, where DCC referred to the narrative justification for explanation of certain cost variances, those explanations were missing (for example, changes in set-up or enduring costs of some service providers).

2.30. Whilst we consider that DCC has justified its incurred costs, we have concerns in a number of areas:

### **Use of Urgent Work Orders (UWOs) & Timeliness of negotiations**

2.31. We previously expressed concerns over DCC's excessive use of Letters of Instruction (LOIs), an emergency mechanism providing commercial cover for work in the absence of a final contract. DCC has since replaced LOIs with 'Urgent Work Orders' (UWOs). UWOs fulfil the same function but are intended to provide stronger controls. They comprise three parts: a purchase order, terms and conditions setting out their use and the scope of work to be carried out.

2.32. UWOs (or LOIs prior to February 2020) financed the majority of new CRs/PRs in the SMETS1 programme and several CRs/PRs in the SMETS2 programme. In at least two cases, the financial cover provided by UWOs represented over 90% of the final cost.

2.33. Their use appears to be in part due to poor timeliness of negotiations: In at least 3 cases in the SMETS1 programme alone, change or project requests were sent by DCC to the service provider for preliminary assessment less than a month before the work was due to commence; and in at least 2 cases, *after* the relevant work had commenced. In all CRs/PRs raised with one particular service provider, the IA or the SOWA<sup>24</sup> was approved after the relevant work had begun and in at least 2 cases after it had finished. In all of these instances, DCC resorted to UWOs.

2.34. DCC argued that UWOs are only used in exceptional urgent cases, or where extremely high uncertainty precluded finalising a contract in advance. DCC explained the use of UWOs in the SMETS1 programme on the grounds of urgency resulting from unique technical complexities (eg device specific behaviour or defects undetected until SIT) and the noncontingent nature of the delivery plan, which required work to progress while negotiations and solution design were underway.

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<sup>24</sup> Statement of Work Authorisation

- 2.35. DCC provided evidence of the controls in place, explained how the mechanism aligns with its procurement policy and argued that in their view UWOs do not represent any commercial risk.
- 2.36. We recognise the improvements in the processes DCC has put in place as part of the transition away from LOIs to UWOs. This includes providing a material basis for the scope of UWOs in the form of a binding SOW, limiting duration of individual UWOs to one month, ExCo-level oversight, and the use of trackers. However, we remain concerned about the contractual risk UWOs introduce, the potential weakening of DCC's negotiating position, and the potential impact on overall costs as a result of payments made on the basis of a changing scope of work during negotiations.
- 2.37. We acknowledge that the use of UWOs may be appropriate in some instances, but we remain concerned that DCC may have become overly reliant on this mechanism, and so exposing itself to the inherent risks. In particular, DCC should always proactively engage with service providers to allow sufficient time for negotiations between the parties prior to commencement of any work. As highlighted in our RY19/20 price control consultation, lack of adherence to the change management process caused by undue delays to the starting date of negotiations may not lead to best possible outcomes, including the efficiency of the costs incurred under such conditions.
- 2.38. In recognition of these challenges in the SMEST1 programme, DCC should build on its experience and apply lessons learnt to anticipate and effectively manage risks and programme complexities to avoid unnecessary delays in the future – including in other programmes, such as Network Evolution.
- 2.39. Where interim commercial mechanisms are used, DCC must have robust internal processes in place, and adhere to those processes, to ensure it can exercise effective control over spend and mitigate against any risks. We will continue to monitor this area and expect DCC to keep its processes under review.

### **Working Capital Charges**

- 2.40. DCC incurs Working Capital Charges to the value of 6.79% p.a. on certain projects where DCC does not meet a deadline for making a payment to the service provider upon receiving a tracker evidencing completed work.

- 2.41. DCC explained that the charges are associated with work financed upfront by the service provider, for example where payments are deferred until a contracted milestone is reached. However, DCC did not provide full explanation for the delays which led to the application of those charges. We expect DCC to explore if some of these charges could have been avoided through better negotiations and timely payments.
- 2.42. We expect DCC to exercise diligence in its contract management to avoid any penalty charges being incurred. We will continue to scrutinise this area in the next regulatory year's price control.

### **Risk sharing**

- 2.43. The issues experienced in the delivery of the SMETS1 programme highlight the need for DCC to have appropriate risk sharing mechanisms in place. While we recognise the technical and commercial complexity of the programme, we are concerned that to date DCC customers may have borne disproportionate amount of risk, as evidenced by the large increase in costs driven by the redesign of the FOC migration solution, whose application failed due to two providers' execution activities.
- 2.44. DCC should look to take advantage of any contract extensions or procurement to ensure a more balanced risk allocation in the future.

### **Forecast Costs**

- 2.45. In its submission, DCC did not provide sufficient explanation for some variances in the forecast external costs. In particular, we questioned variance in enduring costs of S1SP\_3b<sup>25</sup> (totalling £35.458m from RY21/22 to the end of the Licence term) and DSP UIT forecast costs (£12.500m/pa from RY21/22).
- 2.46. With regards to S1SP\_3b, DCC explained that the enduring operational costs were not previously forecasted for the period following their contract expiry date (July 2022) and have now been extrapolated over the licence period.

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<sup>25</sup> SMETS1 FOC service provider

- 2.47. We do not consider the S1SP\_3b costs forecasted beyond the contract expiry to be sufficiently certain. It is our view that a contract expiry should provide DCC with the opportunity to renegotiate these costs and provide a more accurate forecast. **We are therefore minded to disallow the variance in the enduring operational costs of S1SP\_3b from RY22/23, totalling £33.803m.**
- 2.48. With respect to DSP UIT, DCC explained that of the £12.50m/pa forecast costs, £7.40m are attached to specific CRs/PRs up to October 2021. The remaining £5.60m was included as a 'placeholder' for the period beyond October 2021.
- 2.49. We accept DCC's justification of those forecast costs which are associated with approved changes and programmes in RY21/22. However, we do not consider the forecast costs beyond October 2021 to be sufficiently certain. **We are therefore minded to disallow the variance in the User Integration Testing forecast costs of DSP in RY21/22 to the value of £5.60m, and thereafter from RY22/23 to the end of the Licence term to the full value of £12.50m/pa (£55.60m in total).**
- 2.50. We encourage DCC to provide further evidence in support of these forecast costs. In future reporting, DCC should ensure that all forecast costs are evidenced and accompanied by a justification in the price control submission.

### 3. Internal Costs

#### **Section summary**

This section summarises DCC's incurred Internal Costs for RY20/21 and updated forecasts. DCC has justified the majority of these costs. However, we propose to disallow £1.38m of costs<sup>26</sup> incurred in RY20/21. This is due to inefficiencies in contractor benchmarking, shared service charges, recruitment costs, and activity relating to Electric Vehicles given that this is not part of DCC's Authorised Business.

We are minded to disallow £45.736m of DCC's forecast costs over RY21/22 and RY22/23 due to a lack of clarity, justification, or certainty over forecasts, and in particular forecasts associated with the Network Evolution, SMETS1, and ECoS programmes. We are also minded to disallow £174.222m of baseline forecast costs from RY23/24 to the end of the Licence term due to a lack of justification provided by DCC.

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<sup>26</sup> The unacceptable costs shown in the section summary are inclusive of any associated Shared Service Charge (SSC). Please see Appendix 3 for the detailed breakdown on the proposed unacceptable costs.

**Question 3 : What are your views on our proposals on DCC’s approach to benchmarking of staff remuneration for both contractor and permanent staff?**

**Question 4: what are your views on our proposal to disallow the Shared Service Charge associated with external services procured for Additional Baseline activities such as NEP and ECOS?**

**Question 5: What are your views on our proposal to disallow non-resource recruitment costs in the Commercial and Operations cost centres?**

**Question 6: Do you have any views on potential proxy measures to calculate cost disallowances in areas where DCC may not have acted economically and efficiently, but the dependencies and scale of the impact are not clear?**

**Question 7: When it is determined that DCC may not have acted in an economic or efficient manner but an appropriate methodology cannot be applied to calculate the proportion of costs impacted, we propose to take these instances into account when deciding DCC’s score under the Contract Management and Customer Engagement aspects of the OPR. What are your views on this proposed approach to be adopted from RY2021/22 Price Control, if an alternative measure is not determined?**

**Question 8: What are your views on our proposal to disallow forecast variances in Network Evolution, SMETS1, and ECoS programmes?**

**Question 9: What are your views on our proposal to disallow the costs associated with DCC’s activity relating to EVs? Please provide any evidence if you have engaged with DCC in this area.**

**Question 10: What are your views on our proposals to disallow forecast cost variances in the Corporate Management, Commercial, Finance, Operations, and Programme (Service Delivery) Cost Centres in RY21/22 and RY22/23, and all baseline forecast costs for RY23/24 onwards?**

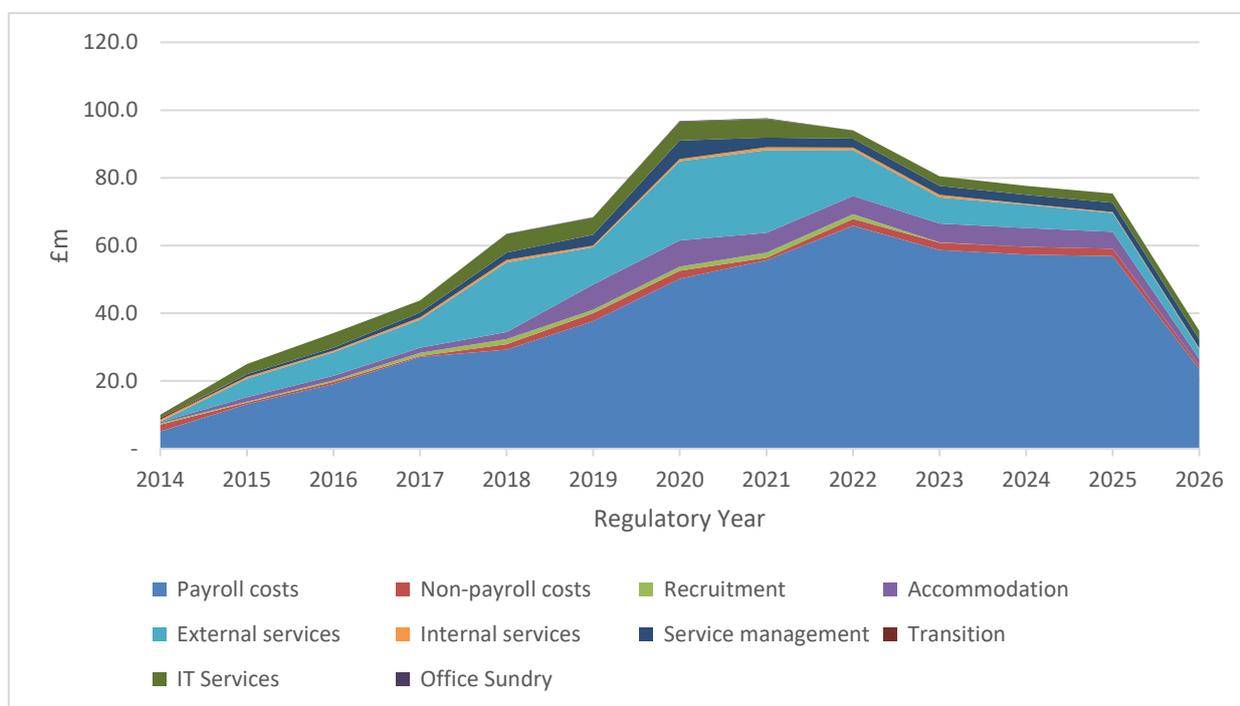
## What are Internal Costs?

3.1. Internal Costs comprise the costs that are economically and efficiently incurred by DCC for the purposes of the provision of the DCC service (excluding External Costs and pass-through costs). These are defined by nine general ledger (GL) categories: payroll costs, non-payroll costs, recruitment, accommodation, external services, internal services, service management, transition, IT services, and office sundry. Internal Costs are reported by 'cost centres' which cover the main activities where DCC incurs costs. Please see Appendix 2 for more detail.

## How have Internal Costs changed?

3.2. Figure 3.1 shows the distribution of costs by general ledger (GL) code over the Licence period, based on DCC's RY20/21 submission. Based on DCC's price control forecast, which includes only those costs that are significantly more likely to occur than not, Internal Costs peak in RY20/21, and fall in subsequent Regulatory Years. Internal Costs in RY20/21 are £97.6m, £23.4m more than was forecasted for RY20/21. The GL codes are dominated by payroll costs – this reflects the fact that DCC is a relatively asset light company with a primary focus on contract management and programme delivery. Total internal costs are therefore driven primarily by salaries and headcount.

**Figure 3.1 Internal costs by cost type or GL code in current year prices**



**Figure 3.1 data table**

£m	RY13 /14	RY14 /15	RY15 /16	RY16 /17	RY17 /18	RY18 /19	RY19 /20	RY20 /21	RY21 /22	RY22 /23	RY23 /24	RY24 /25	RY25 /26
Payroll costs	5.1	13.1	19.1	27.1	29.3	37.7	50.2	55.7	65.8	58.7	57.4	56.8	23.6
Non-payroll costs	1.9	0.5	0.7	0.3	1.5	2.4	2.4	0.7	2.1	2.2	2.2	2.2	1.0
Recruitment	0.4	0.3	0.4	0.9	1.6	1.0	1.2	1.5	1.3	0.0	-	-	-
Accommodation	0.3	1.3	1.4	1.6	2.1	7.4	7.7	5.9	5.4	5.7	5.6	4.9	2.0
External services	0.3	5.5	6.9	8.2	20.6	11.1	23.4	24.4	13.6	7.7	6.9	5.6	2.8
Internal services	0.5	0.5	0.6	0.7	0.7	0.4	0.7	0.8	0.7	0.7	0.2	0.3	0.3
Service management	-	0.7	0.8	1.5	2.2	3.2	5.5	2.9	2.7	2.7	2.7	2.7	2.7
Transition	0.5	0.0	-	-	-	-	-	-	-	-	-	-	-
IT services	0.9	3.0	4.3	3.6	5.5	5.1	5.5	5.5	2.5	2.8	2.7	2.8	2.5
Office sundry	0.0	0.1	0.1	-	0.1	0.0	0.2	0.2	0.0	0.0	0.0	-	-

3.3. Figure 3.2 shows the distribution of Internal Costs. Additional Baseline, Operations and Corporate Management cost centres are the three largest cost drivers in RY20/21. The increased headcount, as well as costs associated with the SMETS1 and Network Evolution

programmes – both reported under Additional Baseline - are significant drivers of Internal Costs in RY20/21.

Figure 3.2 Internal costs by cost centre in current year prices

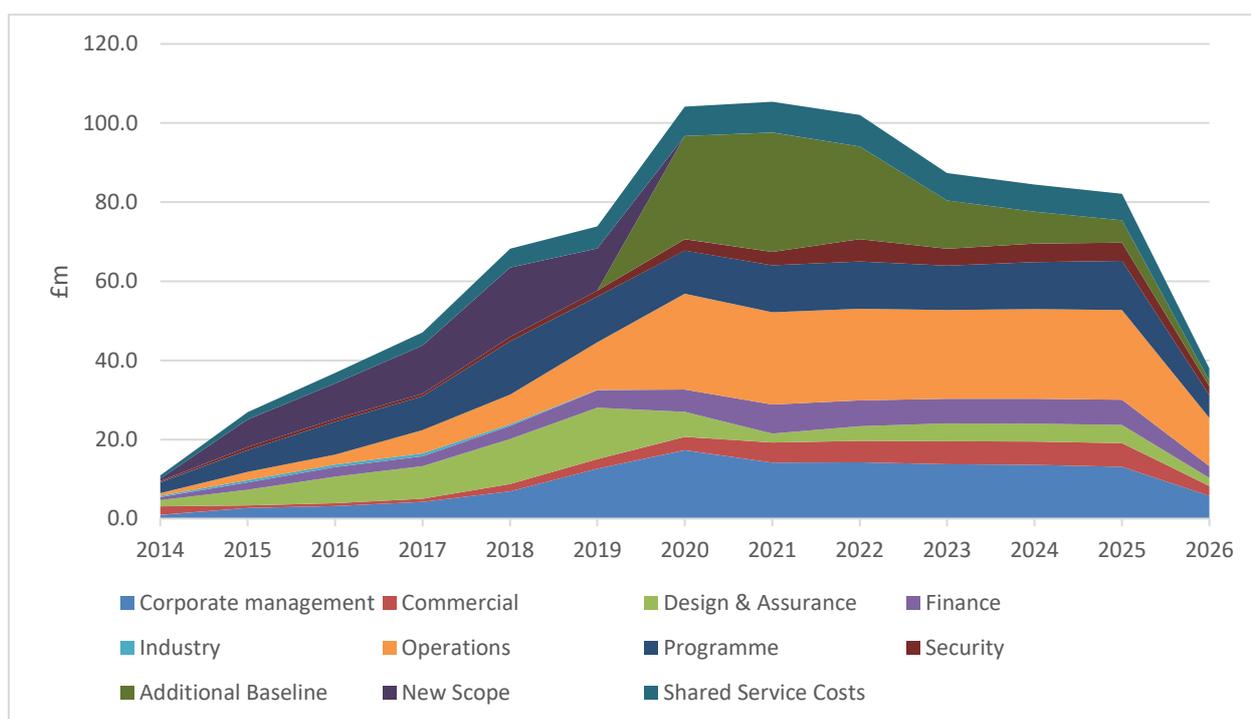


Figure 3.2 data table

£m	RY13 /14	RY14 /15	RY15 /16	RY16 /17	RY17 /18	RY18 /19	RY19 /20	RY20 /21	RY21 /22	RY22 /23	RY23 /24	RY24 /25	RY25 /26
Corporate management	1.0	2.7	3.2	4.3	6.9	12.7	17.3	14.2	14.3	13.7	13.6	13.1	5.8
Commercial	2.2	0.6	0.7	0.8	1.9	2.4	3.4	5.1	5.4	5.8	5.9	6.0	2.5
Design & Assurance	1.6	4.0	6.7	8.2	11.4	13.0	6.4	2.2	3.7	4.5	4.5	4.6	2.0
Finance	0.8	1.9	2.4	2.5	3.3	4.4	5.6	7.3	6.6	6.2	6.4	6.4	3.0
Industry	0.3	0.6	0.6	0.7	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operations	0.7	2.0	2.5	5.9	7.5	12.0	24.2	23.3	23.1	22.4	22.6	22.7	12.2
Programme	2.7	5.5	8.3	8.5	13.5	11.5	11.0	11.9	11.9	11.2	11.9	12.4	5.7
Security	0.3	0.8	0.7	0.7	1.1	1.5	2.9	3.4	5.6	4.3	4.6	4.6	2.3
Additional Baseline	0.0	0.0	0.0	0.0	0.0	0.0	26.1	30.2	23.4	12.2	8.1	5.6	1.3
New Scope	0.6	6.9	8.9	12.2	17.5	10.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shared Service Costs	0.8	1.9	2.7	3.3	4.7	5.6	7.4	7.8	8.0	6.9	6.8	6.7	3.1

**Variance on last year’s forecast**

3.4. In RY20/21 Internal Costs, excluding Shared Services, were £97.6m. This is £23.4m (32%) higher than forecast in RY19/20 and £86.4m higher than the LABP forecast. Over the remainder of the Licence period, Internal Costs are forecast to increase by a further £287.1m relative to the RY19/20 forecast, and by £647.7m compared to the LABP.

3.5. Figure 3.3 shows the variance in costs by GL code compared to the RY19/20 forecast. Payroll costs account for the greatest proportion of the variation in Internal Costs over all forecast years. However, in RY20/21, External Services accounted for the largest proportion of the variation (62%) followed by Payroll costs (32%). The majority of the variance in External Services is attributed to the SMETS1 Enrolment and Adoption programme, accounting for 50% of the External Services variance.

**Figure 3.3 Internal Cost variance by cost type or GL code relative to RY 19/20 forecast (excluding Shared Services) in current year prices**

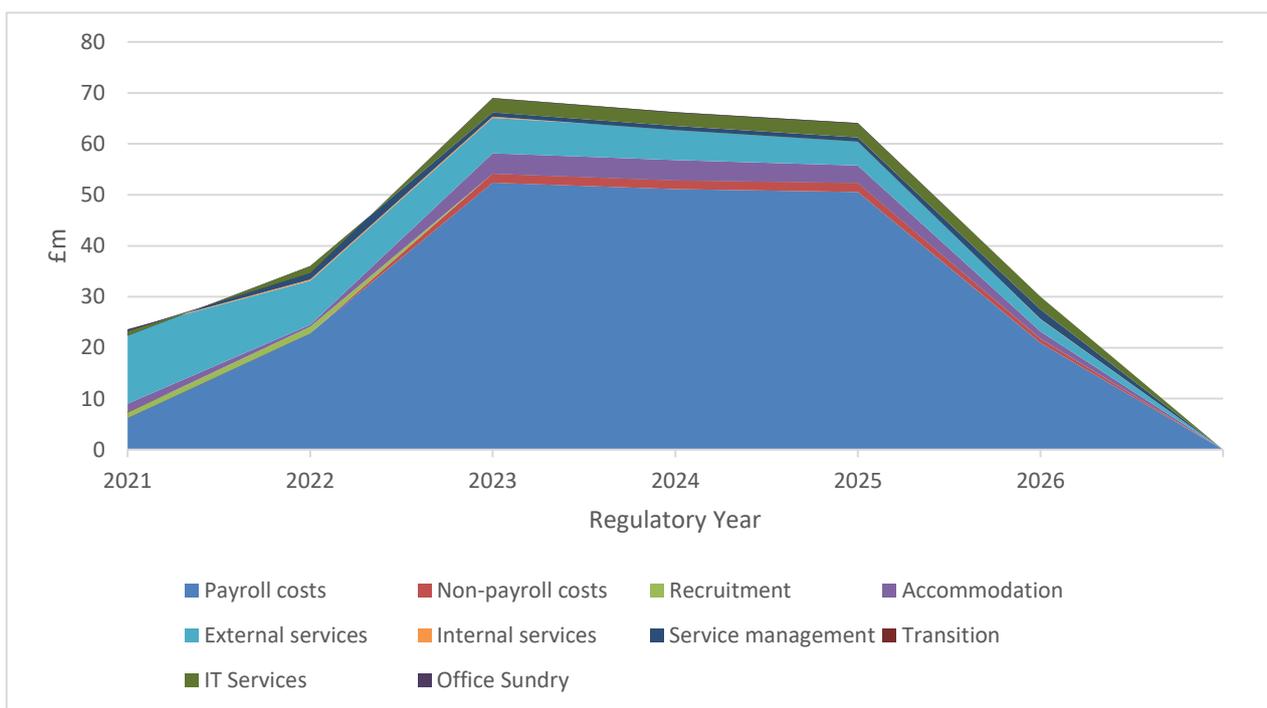


Figure 3.3 data table

£m	RY13 /14	RY14 /15	RY15 /16	RY16 /17	RY17 /18	RY18 /19	RY19 /20	RY20 /21	RY21 /22	RY22 /23	RY23 /24	RY24 /25	RY25 /26
Payroll costs	7.5	22.9	52.4	51.1	50.6	20.9	7.5	22.9	52.4	51.1	50.6	20.9	7.5
Non-payroll costs	-1.3	-0.1	1.8	1.8	1.8	0.8	-1.3	-0.1	1.8	1.8	1.8	0.8	-1.3
Recruitment	1.0	1.3	-0.1	-0.1	-0.1	0.0	1.0	1.3	-0.1	-0.1	-0.1	0.0	1.0
Accommodation	1.8	0.4	4.1	4.0	3.5	1.5	1.8	0.4	4.1	4.0	3.5	1.5	1.8
External services	14.5	8.6	7.0	6.2	4.9	2.3	14.5	8.6	7.0	6.2	4.9	2.3	14.5
Internal services	0.1	0.3	0.2	-0.3	-0.2	0.0	0.1	0.3	0.2	-0.3	-0.2	0.0	0.1
Service management	-1.2	2.6	0.8	0.8	0.8	1.9	-1.2	2.6	0.8	0.8	0.8	1.9	-1.2
Transition	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IT services	0.9	-1.4	2.8	2.7	2.8	2.5	0.9	-1.4	2.8	2.7	2.8	2.5	0.9
Office sundry	0.2	0.0	-0.1	-0.1	-0.1	0.0	0.2	0.0	-0.1	-0.1	-0.1	0.0	0.2

## Payroll

3.6. DCC has applied for the payroll costs shown in Table 3.1. Payroll costs incurred in RY20/21 are more than forecasted in RY19/20 and continue to increase over the forecast in future years.

Table 3.1 Payroll costs compared to last year’s forecast, in current year prices

Payroll (£m)	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
19/20 accepted forecast	48.1	42.9	6.3	6.3	6.3	2.6
Variation proposed in 20/21	7.5	22.9	52.4	51.1	50.6	20.9
<b>Total</b>	<b>55.7</b>	<b>65.8</b>	<b>58.7</b>	<b>57.4</b>	<b>56.8</b>	<b>23.6</b>

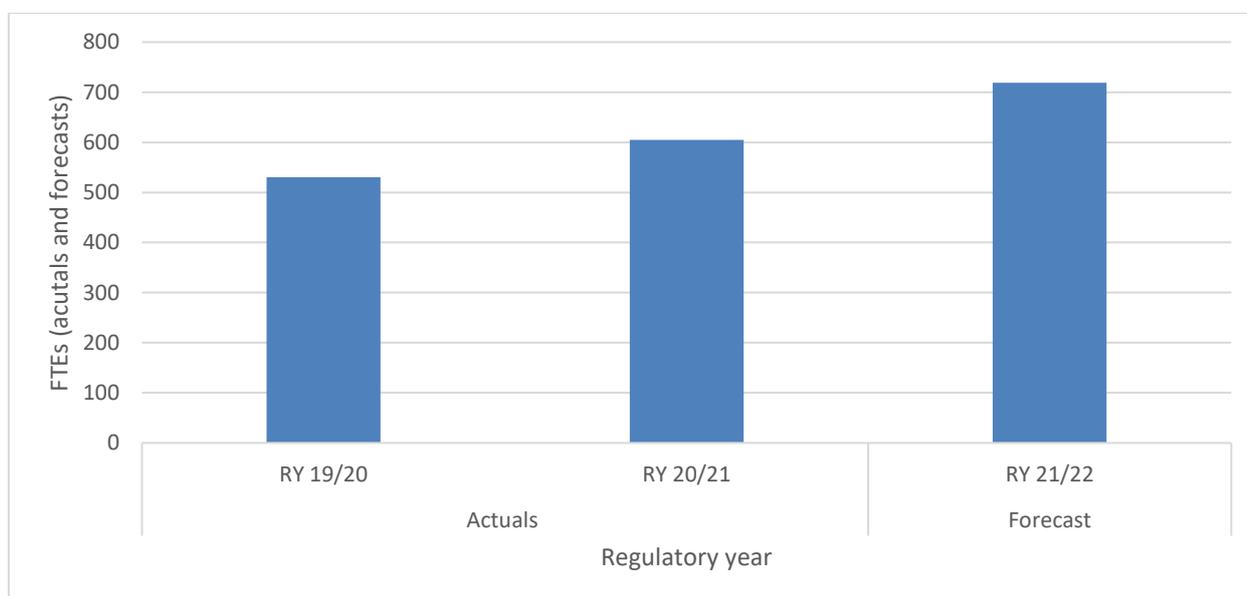
## Headcount

3.7. Figure 3.4 shows that DCC’s staff headcount has increased from 530 full time equivalents (FTEs) in RY19/21 to 605 FTEs in RY20/21. This is a slight increase of 6% compared to

last year’s forecasts of 570 FTEs for RY20/21. The number of permanent staff has increased from 416 FTEs to 480 FTEs. This is a slight decrease of 5% compared to last year’s forecast of 506 FTEs for RY20/21. The number of contractors increased from 114 in RY19/20 to 125 FTE in RY20/21. This is a 95% increase over last year’s forecast of 64 FTE for RY20/21.

3.8. Headcount is then expected to increase for permanent staff to 598.4 FTEs and decrease for contractors to 120.5 FTEs in RY21/22. DCC did not provide forecasts for its headcount beyond RY21/22.

**Figure 3.4 DCC headcount (FTEs, excluding service desk staff)**



**Figure 3.4 data table**

	Actual RY19/20	Actual RY20/21	Forecast RY21/22
FTEs	530	605	719

**Permanent-contractor staff ratio**

3.9. In RY16/17 the ratio was around 40% contractor to 60% permanent staff. In RY17/18 there was a significant reduction in DCC’s dependence on contractors and the ratio was 22% contractor to 78% permanent staff. The ratio has remained at this level for RY 20/21, with 21% contractor to 79% permanent staff.

## Benchmarking

### Context

- 3.10. We expect DCC to recruit staff at economic and efficient remuneration levels. Similar to six previous price controls, DCC provided evidence of this for permanent staff through a benchmarking exercise that compared base salaries to equivalent roles in the wider employment market, using the Hay Group's "PayNet" Benchmarking salary database. It is worth noting that this benchmark does not include non-base salary benefits such as bonuses and car allowance. These benefits are discussed in paragraphs 3.47-3.64 below.
- 3.11. When recruiting permanent candidates DCC's default strategy is to offer remuneration packages that are in-line with market rates. For benchmarking purposes, using the Hays database, the "market salary rate" would be defined as the median salary, ie 50th percentile (50P) of a distribution of salaries for comparable roles.
- 3.12. For RY20/21 DCC have changed their approach for contractors, which is now more aligned with their approach for permanent staff. In particular, the strategy now is to hire contractors at the median salary rather than at the higher end of the benchmark. DCC continued to use an independent I.T. recruitment consultancy to benchmark contractors. However, during RY20/21 the benchmarking dataset has been expanded with data from two additional recruitment specialists.

### DCC's justification

#### *Permanent staff*

- 3.13. Hay's PayNet Benchmarking database includes a comprehensive range of job families, roles and levels across different industries in the different regions of the UK. The database produces benchmarks based on percentiles from a distribution of salaries of comparable roles. The database allows for a benchmark to be tailored to specific industries and job families, and a benchmark is only supplied if there is a sufficient number of comparable roles to make the data meaningful. To reach the benchmark for a specific role or 'grade', the database draws data from dozens of companies and hundreds of individuals within these companies. In addition, DCC's use of PayNet has now been externally assured by consultants from Korn Ferry (owners of the Hay model) to ensure that DCC's mapping of roles to the model is appropriate.

- 3.14. DCC's aim is generally to offer remuneration rates that equate to the market average for permanent members of staff up to the 50th percentile (50P). However, DCC states it may offer higher than the 50P of the benchmark to attract the right candidates. This can be due to the role requiring niche or technical skills, or merely the lack of supply in the market. Thus, recruiting managers have the discretion to offer up to 10% above the benchmark with approval required by the Chief Regulatory Officer and Chief People Officer. If the salary is in excess of this, a business case is required for approval.
- 3.15. DCC uses the Hay's PayNet database to benchmark permanent staff based on salary only. DCC has previously conceded that this may be different for employers that contribute to the benchmark. DCC clarified it chooses this approach as benefits, such as an employee's annual bonus rate, are set by DCC/Capita policy and are not subject to negotiation in the hiring process. DCC sets the bonus rate based on the seniority of the role, with employees receiving either a 10%, 20%, 30% or 50% rate. The majority of permanent staff (55%) receive a 20% annual bonus rate. We analyse DCC's bonus policy further in paragraphs 3.51 – 3.56 below.
- 3.16. DCC stated that it benchmarks at three distinct stages during the recruitment process:
- before the role is launched;
  - before DCC chooses to interview a candidate; and
  - prior to agreeing a remuneration package with a candidate.
- 3.17. As part of its submission, DCC presented a comparison of the remuneration of permanent members of staff against Hay's Benchmark, showing how it differs (in aggregate) from both the 50P and 50P + 10% (50P10). The information is presented in a way that sets out both the net outcome of the results as well as the marginal overspend against the 50P10 benchmark.
- 3.18. This year DCC reported recruiting approximately 5 roles in RY20/21 with a salary above the 50P10 benchmark. DCC calculated that this resulted in an overall marginal cost<sup>27</sup> of

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<sup>27</sup> Sum of adverse cost variance to the relevant benchmark only (ie only variances *above* the 50P10 benchmark are counted) for each role.

£0.019m. Note this figure assumes that all staff were hired at the beginning of RY20/21, whereas staff might have only commenced employment midway through the regulatory year. This results in an over-estimate of the incurred cost to DCC.

- 3.19. In their submission, DCC gives some justifications for the individual roles recruited above the 50P10 benchmark. DCC argued that four of the roles showed only a minor overspend above the benchmark (of around or below £3k). For the 5<sup>th</sup> role DCC argued that exceeding the benchmark was necessary due to the difficulty to recruit given the benchmark level, and the level of experience required for the role as well as the geographic premium.

### *Contractors*

- 3.20. DCC employed 221 contractors in RY20/21. Approximately 85% of contractors and their associated expenditure fell within the Design & Assurance, Programme, Operations and Security cost centres. This is in line with the situation in the previous three regulatory years.
- 3.21. Following Ofgem's feedback, DCC reviewed and changed its contractor benchmark process during RY19/20. Up until 20 December 2019, DCC hired contractors based upon the maximum benchmark, as was their approach in previous regulatory years. Following this re-benchmarking process, on 20 December 2019 DCC began to hire contractors up to the 50P benchmark, with hiring managers able to exceed this by up to 10% with the approval of the HR business partner. However, to offer a day rate in excess of this requires the approval of a business case. DCC has continued using this methodology in RY20/21.
- 3.22. Similar to permanent staff, DCC stated that it benchmarks at various stages during the recruitment process:
- before the role is launched;
  - before DCC chooses to interview a candidate; and
  - prior to agreeing a remuneration package with a candidate.
- 3.23. During RY20/21 DCC expanded their benchmarking dataset, with data from two additional recruitment specialists. The resulting methodology is a weighted benchmark with each

data set given an equal weighting. Furthermore, this year DCC has only used comparable market salaries drawn from a minimum of 20 data points. Which DCC claims removes the outliers and avoids a situation where DCC benefits or suffers from an unrepresentative salary.

- 3.24. As part of its submission, DCC presented a calculation of the net and marginal costs associated with all contractors employed in RY20/21 against the 50P10 benchmark. This resulted in a net negative variance<sup>28</sup> of £2.020m and a total marginal cost<sup>29</sup> of £0.430m, based on 167 roles hired under and 54 roles hired over the relevant benchmark. This shows that 76% of contractors were paid below the 50P10 benchmark, which is an improvement from the 66% figure in RY19/20. In its submission DCC argued that the salaries paid below the 50P10 benchmark should be considered as “savings” which offset the salaries paid above that benchmark, as shown by the net negative variance.
- 3.25. DCC provided some justifications for contractors hired above benchmark where the variance between the incurred cost and the relevant benchmark was deemed to be significant. In general, DCC argued that it was sometimes necessary to exceed the benchmark on the basis of the complexity and specialised nature of these roles as well as the strategic importance of certain roles for the timely delivery of key programmes.
- 3.26. DCC also presented data on how the roles that exceeded the 50P10 benchmark in RY20/21 compared against its major suppliers’ rate cards, showing the day rates paid by its service providers for similar roles. This analysis showed that the large majority of these roles still remain within range of the 50th percentile + 10% tolerance of these rate cards. However, it is worth noting that rate cards do not form part of DCC’s contractor benchmarking methodology.

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<sup>28</sup> The net variance is calculated as the sum of the cost variances against the relevant benchmark (ie 50P10 benchmark) for each role. The net variance could be defined as the sum of the differences between the cost of each role and the benchmark value. In this case, the net variance is negative because the total cost below the benchmark is greater than the total cost above it.

<sup>29</sup> The total marginal cost is calculated as the sum of adverse cost variance against the relevant benchmark only (ie only variances *above* the 50P10 benchmark are counted) for each role.

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

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

### **Our view**

#### *Permanent-contractor staff ratio*

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

#### *Permanent staff*

3.29. This year DCC's permanent staff FTE increased from 530 full time equivalents (FTEs) in RY19/20 to 605 FTEs in RY20/21. As such, and as we noted in last year's consultation document, it is increasingly important that DCC applies its hiring policies robustly to drive payroll efficiencies.

3.30. We note and welcome that in RY20/21 DCC has very significantly improved, compared to last year, on how consistently it has hired staff at salaries below the 50th percentile + 10% (50P10) benchmark.

3.31. We also note DCC's justification around some individual roles and recognise that DCC needs some flexibility around the 50th percentile in order to attract the best talent.

3.32. As such, in RY19/20 Consultation Document we proposed a methodology to calculate whether DCC's approach to benchmarking permanent staff hired in a given Regulatory Year is efficient or not. This methodology used the 50P10 benchmark for roles in the majority of cost centres, with the 75th percentile (75P) used for cost centres that require specialised, technical skills. This approach ensures that DCC has some flexibility to offer

salaries at higher than the market rate in business-critical areas, while also ensuring adherence to a benchmarking approach. In RY19/20 Decision Document<sup>30</sup> we confirmed that we would apply this methodology from RY20/21, with the intention of making a disallowance if DCC continue to incur an inefficiency in this area.

3.33. If we apply this approach pro-rata across all hires in RY20/21, we would consider making a disallowance of £0.011m. For comparison, this figure in RY19/20 was £0.299m. As noted above, this shows a positive change in this area.

3.34. **As such, our minded-to position is not to make a disallowance in this area for RY20/21 recognising that the inefficiency is small and the improvement from RY19/20. If we decided to proceed with this minded-to position we will keep it under review in upcoming price controls when applying the same methodology and basing our decision on the results of our analysis.**

3.35. We welcome this change and encourage DCC to continue improving and applying its hiring policies for permanent staff rigorously going forward.

#### *Contractors*

3.36. We agree, in principle, that the changes to the benchmarking dataset with data from two additional recruitment specialists is positive. We understand that this change increases the robustness of the benchmarking process by increasing the number of comparable data points. However, we would like to further understand the costs implications for the DCC of using two extra recruitment specialists to expand the dataset going forward.

3.37. We would also like to note that the resulting weighted benchmark produces a higher 50P10 benchmark compared to the original benchmark, effectively allowing DCC to hire contractors at a higher daily rate. While this might more accurately reflect the market rates, it also strengthens our view that significant deviations from the median of the

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<sup>30</sup> RY19/20 DCC Price Control Decision: <https://www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201920>

benchmark are uneconomic, and that the 10% margin above that should give DCC enough flexibility to hire the talent and skills needed.

- 3.38. We welcome that DCC has continued using their reviewed approach to benchmark contractors based on the 50P10 benchmark, rather than on the maximum benchmark, during RY20/21. This has resulted in a significant improvement in the cost efficiency of contractors hired in RY20/21 compared to previous years. We encourage DCC to continue to apply this approach consistently going forward.
- 3.39. However, a significant number of contractors (54) were paid above the 50P10 benchmark during RY20/21, including 33 contractors hired in RY20/21. As noted above, our position is that hiring up to the median of the benchmark is the economic and efficient approach, and that a 10% margin above that should give DCC enough flexibility in most cases. This is in line with our position from previous price controls.
- 3.40. Nonetheless, we do recognise that in certain situations DCC might require to depart from this approach and hire contractors above the 50P10 benchmark. However, we are not satisfied with the justifications presented to us as part of DCC's submission. In particular, we would expect DCC to be able to fully justify these cases beyond generic references to skill, seniority, urgency or a simple job description. For example, through the approval of a business case, which we understand is DCC's policy for hiring above the 50P10 benchmark.
- 3.41. Accordingly, we requested DCC to submit to us the business case, or similar document, for a sample of contractors hired above the 50P10 benchmark. DCC answered that these contractors were approved by an ExCo member decision, rather than through a business case, based on urgency. We do not see urgency alone as a good enough justification to hire above the 50P10 benchmark. This is because good planning should minimize the need to hire contractors urgently at a premium, and we expect DCC to plan and manage its work efficiently in line with best business practices.
- 3.42. In relation to DCC's internal analysis based on rate cards from its major suppliers, we note some of the issues we raised in last year's Decision document. Namely, that a significant proportion of these benchmarks were based only on one equivalent role, and only a small proportion had a sample size of more than 10.

- 3.43. As we said last year, it is important that any approach to benchmarking should apply a robust methodology, and we noted that DCC are unlikely to have the skills and information to undertake this internally. Given the clear limitations to this analysis, particularly when compared to the robustness of the reviewed benchmark methodology, we do not consider it sufficient to take it into account for our proposal.
- 3.44. Finally, we disagree with DCC's argument that salaries paid below the 50P10 benchmark should be considered as "savings". Our view is that salaries below the 50P10 benchmark are economic and efficient, but that cannot automatically imply a saving. The threshold for considering a cost a saving should be higher than simply economic efficiency, which is the minimum we expect from DCC.
- 3.45. As a result, we have decided to disallow some costs where they fall above reasonable market rates. To calculate this inefficiency, we have applied DCC's revised methodology (using the 50P10 benchmark based on the expanded dataset) to all contractors employed during RY20/21. Including all contractors employed during the regulatory year is consistent with our approach in RY18/19 and RY19/20.
- 3.46. **In light of the above, we are therefore minded to disallow £0.430m of contractor costs in RY20/21.**
- 3.47. As in previous years, we remain open to receiving additional evidence from DCC to justify its remuneration of contractors and would use such evidence to revisit the proposed disallowance.
- 3.48. We expect to see DCC applying consistently its approach to recruiting contractors. We also expect DCC to be able to provide evidence of its decision-making, particularly when it deviates from the stated methodology on benchmarking.

## **Permanent staff benefits benchmarking**

### **Context**

- 3.49. As we have noted in previous years, DCC excludes non-base salary benefits from its permanent staff benchmarking methodology. In RY18/19 we said that we would expect more justification around bonuses going forward. In RY19/20 we noted that the benefits

package makes up a significant part of an employee's remuneration package, and therefore encouraged DCC to incorporate these benefits into their approach to benchmarking permanent staff. We also said that we would further scrutinise this aspect of DCC's benchmarking in RY20/21.

- 3.50. As a response to our feedback from previous years, for this year's submission DCC has commissioned an external recruitment and reward specialist, to undertake a high-level benchmarking exercise of the wider benefits package that its staff receive against that of comparable companies and organisations in comparable sectors and markets.

### **DCC's justification**

- 3.51. DCC argued that in the past it has benchmarked its permanent staff on salary only because that was the only data reported by its data provider, and because the bonus ranges are set by DCC/Capita policy and are not subject to negotiation in the hiring process. However, as noted above, during this Regulatory Year DCC initiated a sample study to benchmark its benefits beyond base salary, including bonuses, pension arrangements and holiday entitlements. During the cost visit, DCC clarified that car allowances were initially part of the scope of the analysis, but the results on this benefit were not included in the submission due to a lack of comparable data.
- 3.52. DCC explained that this analysis was an interim approach to provide some additional information to us, and that it is currently looking at how best to move to whole-remuneration benchmarking.
- 3.53. The analysis was carried out using a sample of 50 key roles across the different cost centres, including a mixed variety of seniority. In order to establish relevant comparator organisations, the recruitment specialist examined the job descriptions individually. Subsequent to that, the recruitment specialist researched organisations that are comparable or have comparable roles to DCC, considering factors such as annual turnover of the organisation, geographical location and sector. To further enhance this comparator group, the recruitment specialist used their extensive in-house database and other sources to validate the data. The analysis is set out in quartiles, defined as the 25<sup>th</sup> (lower quartile), 50<sup>th</sup> (median quartile) and 75<sup>th</sup> (upper quartile) percentiles, as well as the average.

### *Bonus*

- 3.54. DCC currently allocates a bonus based on % of annual salary as a proxy for seniority. The analysis looked at the bonus range for the benchmarked permanent staff only, setting out three bonus categories: 10% bonus (category 3), 20% bonus (category 2), and 30% bonus (category 1).
- 3.55. As part of this year's submission, DCC has included a high-level summary of the benefits benchmarking results. The data presented sets out the range of discretionary bonuses awarded to staff at the comparator organisations who were benchmarked as having similar skills and responsibilities as each of DCC's staff categories (as defined above). DCC's bonus appears to sit above the average and median quartile (MQ), but below the upper quartile (UQ), across all three staff categories.
- 3.56. DCC argues that the above shows that its bonus range is consistent with its comparators.

### *Pension and holiday entitlement*

- 3.57. As with the bonus, DCC has included a summary of the analysis in this year's submission for both pension and holiday entitlement. In relation to pension, the data presented shows the range of pension contributions as a percentage of salary for the comparator organisations. DCC's pension contribution sits below the average and MQ but above the lower quartile (LQ), however it's closer to the LQ than to the MQ.
- 3.58. In relation to holiday entitlement, the data shows the range of days of holiday per annum broken down by "senior staff" and "other employees". DCC's entitlement falls between the MQ and the LQ.
- 3.59. DCC claimed that when pensions and annual leave are factored in together with the bonus, its non-base salary benefits are entirely in keeping with comparators.

### **Our view**

- 3.60. We welcome the additional information around the non-base salary benefits shared by the DCC in this year's submission. We note that this is presented as a one-off benchmarking exercise, and that DCC expected to use the results to help it move to whole-remuneration

benchmarking. We welcome that DCC is taking steps to ensure its permanent staff costs are more economic and efficient by improving the benchmark methodology.

- 3.61. In relation to the bonus, our position is that a remuneration up to the median of the benchmark is the economic and efficient approach. Therefore, our view is that the bonus paid by the DCC to its permanent staff is not completely economic and efficient. The use of median of the benchmark is consistent with our position on both permanent staff and contractor salary benchmark approach in previous years. However, we also recognise that this is the first time the bonus has been benchmarked, and that DCC is currently reviewing its benefits package and benchmark methodology.
- 3.62. Regarding the pension and holidays entitlement, we welcome that DCC offers below the median of the benchmark. Our view is that this an economic and efficient cost.
- 3.63. In relation to the car allowance, we encourage DCC to further explore how this benefit (as well as any other benefits that DCC might offer to its permanent staff and that we are not aware of) compares with the market rates and practices for next year's submission. We would like to understand how the value of the allowance compares to similar organisations, but also how common this practise is among comparable organisations.
- 3.64. **In light of the above, we do not propose any disallowance of permanent staff benefits costs in RY20/21.**
- 3.65. However, we would encourage DCC to review its benefits package to ensure is economic and efficient going forward. In particular, bonus rates should be better aligned with market rates, and the car allowance should be properly benchmarked. The permanent staff benefits would remain an area of scrutiny in RY21/22.
- 3.66. Finally, we disagree with DCC's argument that this year's benefit benchmarking exercise allow us to consider the economic value of the non-base salary benefits package as a whole. Firstly, because the different benefits were benchmarked individually, and the results do not allow for a robust holistic comparison. Therefore, each benefit should be considered on its own merits. Secondly, the analysis was incomplete because, as noted above, it did not cover the car allowance, which incurs a significant cost.

## Shared Service Charge

### Context

- 3.67. DCC pays a Shared Service Charge to its parent company, Capita, to cover support services such as HR tools, property services, payroll, IT and senior management input. Inclusion of the Shared Service Charge was part of the competitive bid during the Licence tender. It is calculated as a percentage of Internal Costs, as set out in the LABP.
- 3.68. DCC is required by the RIGs to report information on the Shared Service Charge, including how it has been calculated and how the Shared Service Charge provides value for money. DCC must also ensure there is no cross-subsidisation across affiliates or related undertakings.<sup>31</sup>
- 3.69. In the RY16/17 price control decision,<sup>32</sup> we decided that in future years we would not require further justification for the Shared Service Charge associated with Baseline Activity for price control purposes.
- 3.70. In its response to the RY17/18 consultation DCC proposed to “undertake an in-depth review of Capita Shared Services to provide greater assurance of their value for money. This will ensure also that there is no ‘double-counting’ between services provided by DCC and those same equivalent services that should be provided under the Shared Service Charge”.<sup>33</sup>
- 3.71. For New Scope Activities,<sup>34</sup> DCC must provide full justification to demonstrate that any Shared Service Charge relating to these activities is economic and efficient.

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<sup>31</sup> This is a requirement under Licence Condition 11 of the Smart Meter Communication Licence.

<sup>32</sup> <https://www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201617>

<sup>33</sup> <https://www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201718>

<sup>34</sup> New Scope Activities are activities associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence Award. The Switching Programme is considered New Scope.

3.72. DCC does not apply Shared Service Charge on external services procured for Additional Baseline activities<sup>35</sup>, and some other components such as the costs associated with Brabazon House.

### **DCC's justification**

3.73. This year DCC applied the Shared Service Charge at a rate of 9.5% on Baseline costs, which amounted to £7.796m in RY20/21 and £31.602m in forecast costs to the end of the Licence term.

3.74. This year DCC did not apply for a Shared Service Charge for New Scope Activities, such as the Switching Programme.

3.75. DCC did not apply for a Shared Service Charge on certain Additional Baseline activities such as the SMKI-ES, Service Management-ES, Parsing and Correlation Service-ES, ATG-ES, SMETS1-AC, SMETS1-ES, SMETS1-IS, SMETS1-IT, SMETS1-OS and Brabazon House fit-out.

3.76. This year DCC reported costs incurred for Network Evolution Programme (NEP) and Enduring Change of Supplier (ECOS) which are Additional Baseline activities. DCC has applied Shared Service Charge on external services procured for NEP and ECOS.

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<sup>35</sup> Additional Baseline activities are associated with requirements that the Licensee was expected to deliver at the time of Licence Award, but which had not been fully costed in the LABP. For example, SMETS1 enrolment and adoption costs are considered Additional Baseline.

## Our view

- 3.77. As in previous years, we propose to accept the 9.5% Shared Service Charge associated with the baseline costs of DCC's core smart metering service.
- 3.78. We also maintain our position that, as New Scope activities were not part of the LABP and therefore not subject to competition, DCC will need to provide full justification that any Shared Services costs related to these activities are economic and efficient.
- 3.79. As in previous years, for Additional Baseline activities we propose DCC does not apply Shared Services Charge on external services costs. External services costs are costs of third party suppliers including consulting fees, legal fees and bank charges.
- 3.80. We expect DCC to actively ensure that it is achieving value for money from the Shared Service Charge applied to baseline and Additional Baseline activities.
- 3.81. **We propose to disallow the Shared Service Charge associated with external services procured for Additional Baseline activities such as NEP. This amounts to a disallowance of £0.212m in RY20/21.**
- 3.82. **We also propose to disallow the Shared Service Charge associated with the proposed unacceptable Internal Costs. Taking this into account, the total disallowance amounts to £0.311m in RY20/21 and £17.409m in forecast costs to the end of the Licence term.**

## Recruitment Costs

### Context

- 3.83. The incurred Recruitment cost across all cost centres for RY20/21 was £1.516m. DCC has forecast that incurred costs on Recruitment will be £1.230m in RY21/22. The Recruitment costs were primarily driven by three cost centres, which all incurred a material variance.
- 3.84. The Commercial cost centre incurred £0.462m in Recruitment costs for RY20/21, with a variance of £0.440m. The Operations cost centre incurred £0.420m in Recruitment costs in RY20/21, with a variance of £0.270m. The Finance cost centre incurred £0.216m in Recruitment costs for RY20/21, with a variance of £0.176m.
- 3.85. In response to clarification questions and questions raised in the cost visit, DCC stated that a new DCC Resourcing model went live in June 2021, where DCC has outsourced their Recruitment team. Through this new model, DCC expect to save 40% in costs on like-for-like hiring.

### DCC's justification

- 3.86. DCC split recruitment costs in the cost centres into resource and non-resource cost. In response to clarification questions, DCC stated that non-resource recruitment costs were largely associated with paying recruitment agencies to search, screen and sift potential candidates for DCC.
- 3.87. In the Commercial cost centre, DCC attributed £0.370m of the incurred variance to non-resource costs. The non-resource costs were driven by recruitment fees for the recruitment of 3 ExCo members, one of which was recruited twice in RY20/21, and 5 other roles.
- 3.88. In the Operations cost centre, DCC attributed £0.303m of the incurred variance to non-resource costs. These non-resource costs were driven by recruitment agency fees for the recruitment of a number of senior roles.
- 3.89. In the Finance cost centre, DCC attributed £0.089m to non-resource recruitment costs, and provided a breakdown of these non-resource costs, in which £50,000 was spent on recruitment fees, reflecting an immaterial spend.

3.90. In response to clarification questions, DCC stated that the fee payable to the relevant agency is typically a percentage of the salary for the relevant hire, but this percentage is not set. DCC stated that typically the fee will be greater for more senior roles, and that fees are agreed up front with recruitment agencies prior to the search commencing.

### **Our view**

3.91. We acknowledge that DCC is taking steps to make their recruitment costs more economic and efficient through the introduction of a new Resourcing model in RY21/22.

3.92. However, we are concerned over the material non-resource recruitment costs DCC incurred in RY20/21, which DCC attributed to recruitment agency fees. While we acknowledge that recruitment agency fees will likely be a higher percentage of the base salary for the recruitment of senior roles, it is important that DCC does not incur recruitment agency costs which are higher than the market average.

3.93. We deem that 20%<sup>36</sup> of the base salary is an appropriate recruitment agency fee to pay for senior roles. In our view, recruitment agency fees which DCC incurred above 20% of the base salary for each of the roles DCC attributed the non-resource costs to in the Commercial and Operations cost centre are not an economic and efficient spend.

3.94. We remain open to receiving additional evidence from DCC and other stakeholders on prevalent market rates and appropriate recruitment agency fees.

3.95. **We are therefore minded to disallow £0.150m of incurred non-resource recruitment costs in the Commercial cost centre, and £0.129m of incurred non-resource recruitment costs in the Operations cost centre, totalling a disallowance of £0.279m in RY20/21.**

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<sup>36</sup> Based on our assessment of prevalent market rates

## Programme costs

### Context

- 3.96. DCC is running four distinct programmes of work which are reported separately in the price control. These programmes are SMETS1, Network Evolution, Enduring Change of Supplier (ECoS), and Market-wide half-hourly settlement (MHHS). The SMETS1 and Network Evolution programmes in particular were a significant driver of variance in Internal Costs in RY20/21. There were also a number of delays in the programmes over RY20/21, due to a variety of reasons, some of which have had a direct impact on costs or resourcing requirements.
- 3.97. The SMETS1 programme, required for the enrolment and adoption of SMETS1 meters into DCC's secure network, incurred £18.850m in RY20/21, which was an £11.991m variance over RY19/20's forecast. Key drivers of costs in the SMETS1 programme include migrating the Middle Operating Capability (MOC) and Final Operating Capability (FOC) cohorts of meters, testing activities, and delivering Core Release 1.1.
- 3.98. Network Evolution is a portfolio of programmes with an overarching aim of future-proofing the network. It incurred £7.706m in RY20/21 – a £5.464m variance over the RY19/20 forecast. It is further forecasting an £8.891m variance in RY21/22 and £4.155m variance in RY22/23. The programme comprises four distinct sub-programmes:
- re-procurement of the Data Services Provider (DSP)
  - designing and procuring future-proof communications hubs and networks (CH&N)
  - procuring a replacement or extension to the Smart Metering Key Infrastructure (SMKI) security service
  - designing and implementing automated testing of SEC releases.

- 3.99. The initial term of the DSP contract was due to expire in October 2021, with the option for three one-year extensions giving a final termination date of October 2024. The first of these extensions needed to be agreed with CGI by 1 April 2021.
- 3.100. The CH&N programme is required due to the expected sunseting of the 2G and 3G networks this decade. DCC is required to find an enduring solution, involving procuring a 4G (and future) comms hub.

### **DCC's justification**

- 3.101. DCC referred to delays being a driver in increased costs throughout its submission, providing specific examples in the SMETS1 programme such as an industry challenge which contested the addition of model combinations to the Eligible Products Combination List (EPCL)<sup>37</sup>, or defects found in late stages of testing which pushed back timelines. DCC also explained that additional testing was requested by the SEC Panel's Security Sub-Committee, which was not explicitly part of the programme's initial scope. Such extensions and delays impacted the availability of resource that would have been supplied to other programmes such as Network Evolution and ECoS.
- 3.102. Changes to Licence Condition 16, brought in by BEIS in March 2020, placed a requirement that DCC submit a business case for approval to the Secretary of State for procurement of new Relevant Service Capability. DCC explained this change also affected the levels of resource required for the programmes.
- 3.103. With regards to the large cost variances in Network Evolution, DCC explained that the LC16.6 requirement for a business case had not yet been authorised by BEIS during the forecasting process in RY19/20. As such DCC's forecasting for RY20/21 was extremely conservative, due to the certainty threshold required for the price control.
- 3.104. DCC's submission states that the existing DSP contract has been extended to provide continuity of service while the DCC works with customers to define the future requirements of the DSP. DCC noted the DSP programme was a driver of change in resource in RY20/21, and we asked DCC to expand upon this as part of our clarification process. DCC responded that the core activity in RY20/21 was developing the strategic outline business case (SOBC) in line with LC16.6, which was started in Q3 of RY20/21.

3.105. We noted our concerns at the Cost Visit that the DSP contract extension was signed very late, and discussed several areas which experienced delays in the SMETS1 programme.

3.106. Regarding CH&N, DCC explained in its submission that it had originally planned a non-competitive procurement and forecasts were based on this assumption. DCC explained that after further considering its licence requirements and other relevant obligations it decided to conduct a competitive procurement, which then required a large invitation to tender (ITT) and substantial commercial and legal input. However, DCC's responses to our clarification questions did not clearly explain how DCC had come to its original decision of non-competitive procurement. The Cost Visit discussions indicated that there were areas in which DCC could have planned better.

3.107. We requested a breakdown of CH&N programme costs from DCC that, in DCC's view, could have been saved had DCC planned better. We also requested DCC to provide a breakdown of the individual sub-programme each person within Network Evolution was working on, both of which DCC was unable to provide.

### **Our view**

3.108. We recognise that SMETS1 and Network Evolution are complex programmes, which require costs and resource to deliver. While there were delays to various areas of the programmes, we acknowledge that not all these delays were within DCC's control, and recognise DCC took mitigating actions or appropriate steps to ensure delivery where necessary.

3.109. However, there are areas we have identified which DCC could have managed better, by improving its planning, beginning processes much earlier and ensuring robust procedures are followed.

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<sup>37</sup> The EPCL is produced by the DCC in accordance with the Smart Energy Code. It lists each combination of SMETS1 Device Models and Communication Services Providers in relation to which the DCC has demonstrated, through testing, that it is able to successfully process SMETS1 Service Requests and relevant SMETS1 Alerts.

3.110. For example, we consider DCC has not effectively planned or managed the DSP programme. Through conversations with BEIS, SECAS<sup>38</sup>, and industry, we are aware that DCC's procurement of the DSP is not running to plan, and DCC negotiated the first of the three one-year extensions at a very late stage. We are aware that BEIS issued a direction to DCC in January 2021 requiring a business case for the DSP, and that stakeholders had raised concerns about the lack of a plan from DCC and level of engagement received.

3.111. We also consider DCC did not follow due process with CH&N, and are of the view that DCC should have carried out the necessary assessments to determine whether to conduct a competitive tender at a much earlier stage, to be able to plan better and factor this into the overall plan and timelines for CH&N. We note that, subject to certain caveats, LC16 requires DCC to procure Relevant Service Capability from External Service Providers on a competitive basis, unless it is satisfied that procuring from its own resources, an Affiliate or Related Undertaking, or from elsewhere, would be:

- the most economical and efficient option; or
- immaterial in terms of its value or use of resources within the overall context of DCC's Mandatory Business.

3.112. We therefore consider there are clear examples where DCC may not have acted in an economic or efficient manner, which is very likely to have impacted costs. However, inferring what proportion of costs were impacted and can be deemed as not economically and efficiently incurred is not straightforward. From the information provided to us from DCC – and the lack of breakdown of subprogrammes its resource was working on - it is not clear to what extent the DSP and CH&N programmes led to incurred costs within Network Evolution, nor to what extent delays or poor planning in any area led to increased costs which could have otherwise been avoided.

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<sup>38</sup> SECAS = Smart Energy Code Administrator and Secretariat

3.113. This lack of clarity also arises as we do not have sight of how costs may have been lower if timescales were planned better. For example, potential reduced spend on recruitment and/or procurements due to better planned and more favourable timelines.

3.114. **We are therefore asking stakeholders for their views on determining methods to identify non-economic and efficient costs in cases where it is challenging to understand how costs may have looked different under different circumstances,** when it is clear DCC has not acted in an efficient manner and could have made improvements to its processes in order to make cost savings. We would like views on how a proxy measure could be used in future years to calculate appropriate and proportionate disallowances in such cases. We are also interested in understanding whether DCC customers have undertaken their own assessments of how their costs have been impacted and to provide evidence of the methods used if so.

3.115. **In the absence of an alternative proxy measure, we propose to take such cases where we are unable to identify costs into account when we assess DCC's performance under the Contract Management and Customer Engagement aspects of the OPR.**

3.116. For example, after assessing the Customer Engagement submissions from DCC and the SEC Panel and awarding a score for DCC's performance, we may subsequently reduce this score – and therefore reduce the margin retained - as a case by case measure, in response to being unable to quantify the proportion of non-economic and efficient costs in the main submission.

3.117. Similarly, after assessing the auditor report for the Contract Management aspect of the OPR and awarding a score for DCC's performance, we may subsequently reduce the score - and margin retained - in response to being unable to quantify the proportion of non-economic and efficient costs.

3.118. This would be a discretionary reduction to the OPR score based on our assessment of DCC, and we expect, in general, to determine whether to modify the contract management score, customer engagement score, or both, based on the type of issue identified in the main submission. In order to arrive at an appropriate modified score we may take into account our assessment of the scale of the issue, including any relevant wider context, and any mitigating action DCC may have taken, for example.

3.119. If we were to use this option of a discretionary reduction to the OPR score in cases where we cannot identify the proportion of inefficient costs, we would consult on the modified OPR score as part of the Price Control consultation for the relevant year, and include how we arrived at the proposed reduction and our reasoning. Stakeholders would be able to provide views on this reduction in response to our Price Control Consultation. We would also provide further detail in our OPR Guidance and Price Control Guidance.

3.120. It is important to highlight that the Baseline Margin is at risk under the OPR, and not the costs DCC has incurred in the Regulatory Year. We therefore welcome any input from stakeholders to identify and explore alternative methods.

3.121. Due to the challenge in determining what proportion of costs were not incurred economically and efficiently in RY20/21, we consider that we don't have sufficient certainty that related forecast costs are justified as being economic and efficient. We also consider that there is a significant degree of uncertainty across the programmes, as highlighted by variances in this year's price control. **We are therefore minded to disallow all forecast variance associated with the SMETS1, Network Evolution, and ECoS programmes, amounting to £17.844m over RY21/22 and £9.115m over RY22/23.**<sup>39</sup>

3.122. We recognise that the disallowance of these forecasts would create a large apparent variance in future years. We will assess any incurred costs as part of our existing ex-post price control process.

## Electric Vehicles and Product Management

### Context

3.123. The Product Management team moved from the Corporate Management cost centre to the Design and Assurance cost centre in RY20/21 as part of an internal restructure. The incurred variance associated with the team was £0.334m. DCC forecasts variances for the

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<sup>39</sup> As MHHS is a new programme it does not have separate costs reported yet.

team of £0.491m in RY21/22 and the same in RY22/23, with no planned increases in headcount.

3.124. In RY19/20's price control we made a disallowance on the incurred costs of the Product Management team, based on DCC's activity on Electric Vehicles (EVs) and load-control, and exploring future products. We considered that DCC's focus should remain the delivery of the core business, and did not receive evidence that these additional activities complemented DCC's core service offer. We also disallowed the forecast costs of the team, as demand for products and services would be unknown.

3.125. DCC also procured a firm in RY20/21 to provide strategic advice on developing DCC's narrative, stakeholder approach and engagement on EVs. This EV engagement procurement incurred costs of £0.192m in RY20/21, and forecast a further £0.280m over RY21/22.

### **DCC's justification**

3.126. DCC's Product Management team leads the coordinated development and delivery of DCC's products and services. In its submission, DCC explained that in RY20/21 the team was carrying out the following activities, with approximately 25% of its time spent on each:

- Elective Communications Services (ECS) Overhaul, working with its customers to determine how the process can be improved
- supporting the introduction of improved test tools ('DCC Boxed'), a service designed to reduce testing charges for DCC customers
- providing support for load control and EV charging, supporting participants in BEIS-funded load control trials and additional projects looking at off-street EV charging solutions
- supporting BEIS and government policy through the electrification of transport, heat and energy efficiency in homes through DCC network reuse; supporting various government departments with EV charging propositions; engaging with Industry Specification work for Load Control.

- 3.127. At the Cost Visit DCC explained that the main drivers for work relating to EVs came from requests from government departments, and described ongoing engagement with BEIS. We requested DCC provide evidence of these requests from government to understand what has been communicated to DCC in terms of requirements regarding EVs, and what actions DCC has taken as a result.
- 3.128. Following the Cost Visit, DCC provided further evidence of BEIS setting out three asks relating to EVs for DCC to meet which were agreed in December 2020. DCC did not provide additional evidence from other departments or other requests.
- 3.129. With regards to future work in this area, DCC's submission states that the Product team also expect to be supporting BEIS and the Office for Zero Emission Vehicles (OZEV) with delivering government mandated priorities around EV Charging and other load control applications regarding the electrification of heat.
- 3.130. DCC's submission explained that the EV Engagement procurement was to develop its communication strategy, ensuring the scope of its network can be clearly communicated to decision-makers, stakeholders and other interested parties. DCC also explained that the forecast variance of £0.280m is based upon expectations of further work in this area, which is subject to external factors such as government consultations or government requests for further demonstration of the DCC system's capabilities.

### **Our view**

- 3.131. As with our position in last year's price control, we consider that DCC's focus should remain the delivery of its core business.
- 3.132. We do not consider that the BEIS-funded load control trials should involve DCC's product management team to any material extent as the trials use existing DCC capability – sending messages over the DCC network - and do not require DCC to develop additional products. We also consider DCC has resource capable of responding to consultations without requiring dedicated product staff.
- 3.133. We consider that increased adoption of EVs will bring significant benefits not only for EV users but to wider society, through reducing carbon emissions and improving air quality. EVs will also enable a better utilisation of the electricity network and generation assets,

and therefore we expect EVs can be an asset to the energy system, as well as to the environment.<sup>40</sup> However, while we are aware that EV policy requirements may become part of DCC's business in future, work in this area is not currently part of the Authorised Business. We do not consider it appropriate that DCC continues to incur costs where there are not defined mandated requirements upon DCC.

3.134. We recognise that DCC has been engaging with government regarding EVs. However, we have concerns that DCC may be placing undue focus in this area, and it is not clear that the activity DCC has undertaken as a result of conversations with government is proportional to the expectations that have been placed on DCC. We remain open to receiving additional evidence from government, DCC, and other stakeholders to determine the requirements placed on DCC – either in relation to additional services, or assistance with EV charging and load-control trials. We are also keen to understand whether requests have been open to broad interpretation.

3.135. Regarding the EV engagement procurement, while we expect DCC should be communicating effectively with its customers, we do not consider it appropriate that DCC has procured an external service to develop a communications strategy in this area.

3.136. **We are minded to disallow £0.167m of the cost variance associated with the product management team in RY20/21**, corresponding to the 50% proportion of the team's time spent on work relating to EVs and reuse.

3.137. **Additionally, we are maintaining our consultation position from RY19/20 and propose to disallow the forecasts associated with this team, amounting to £0.982m over RY21/22 and RY22/23.** We consider that future demand for products and services is not known, and therefore forecasts are not sufficiently certain nor justified as economic and efficient.

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<sup>40</sup> Our recent publication "Enabling the transition to electric vehicles: The regulator's priorities for a green, fair future" (September 2021) can be found here: <https://www.ofgem.gov.uk/publications/electric-vehicles-ofgems-priorities-green-fair-future>

3.138. **We are also minded to disallow the costs of the EV engagement procurement and its associated forecasts, amounting to £0.192m in RY20/21 and £0.280m in RY21/22.**

3.139. We plan to apply this approach to DCC activity in future years and would urge DCC to ensure there is clear justification for carrying out any activity, ensuring it falls within its Authorised Business.

## Forecast costs

### Context

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

3.141. In its Price Control submissions DCC usually provides justification for two years of forecasts, and does not attempt to justify any costs it expects to incur after this two years. This is because costs may become more uncertain the further into the future they are. We historically disallow these forecast baseline costs until the end of the licence term due to the lack of justification. However, this year there are also a number of forecast costs over RY21/22 and RY22/23 where we have concerns over DCC’s justifications.

### DCC justification

#### *Commercial cost centre*

3.142. DCC has forecasted roles in the vendor management team whose employment is dependent on successful awards made in the Network Evolution Programme. In response to a clarification question, DCC explained that the hiring of these roles is dependent on procurement processes which are still underway, with bids being assessed and contracts not yet having been awarded.

3.143. DCC attributed the forecast variance in the Commercial Operations team in RY21/22 to Ofgem disallowing the £1.259m forecast in the RY19/20 Price Control, explaining that if Ofgem had not disallowed this cost, the variance for this team would be £0.2m.

*Corporate Management cost centre*

3.144. DCC has forecasted new roles in the Regulatory Strategy and Performance Management team to develop policy expertise within DCC, leading discussions with Ofgem and government regarding the reuse of DCC's network and ensuring propositions that DCC put to government are fit for purpose. At the Cost Visit, DCC further explained these roles were to ensure DCC operates from a position of knowledge of government or regulatory policy priorities and is thus enabled to respond effectively to opportunities through which DCC might assist in the delivery of such policy objectives.

3.145. Additionally, DCC has provided forecasts for several procurements which DCC has described as expectations of future work or estimated costs, with these procurements not having yet gone to tender. For these procurements, the procurement type (competitive or non-competitive) is also to be confirmed.

*Finance cost centre*

3.146. In the Commercial Finance team, DCC state that they are forecasting a return to long-term headcount levels of around 13 FTE in this team and expenditure of just under £1.2m in RY21/22 and RY22/23. DCC state that this is in line with their forecasted level of FTE and expenditure in the RY19/20 Price Control, which was not subject to disallowances. DCC state the RY22/23 variance is the result of an artificially low baseline.

3.147. However, DCC does not provide sufficient justification for the £0.2m forecasted variance in RY21/22 or the work driving the recruitment of roles which had previously not been forecasted.

*Operations cost centre*

3.148. DCC state that the main drivers of work in the Design and Test Services team in the Operations cost centre include completing Architecture Transformation, implementing Management Reporting for Design Services and Completing Implementation of Design

Authority and Technical Feasibility Study of ongoing SMETS1 development to support Value Add.

3.149. DCC explain that the variance is largely due to the addition of 11 FTEs in RY21/22. However, DCC has not provided sufficient justification for this increase in resource over last year's forecast, other than to meet programme demand.

*Service Delivery (Programme)*

3.150. DCC has forecasted several project manager roles in this team, where the justification for the roles is due to a lack of resource to meet demand. At the Cost Visit, DCC explained that it has an internal consultancy model through which it deploys project managers as required, and more complex programmes require greater levels of resource.

*Network Evolution Programme - Commercial and Regulation team and Service Delivery team*

3.151. There are forecasted roles in both the Commercial and Regulation team and the Service Delivery team which lack sufficient justification or certainty in the submission. In particular, DCC explained that some roles in the Commercial and Regulation team may not be needed, and that a number of roles in the Service Delivery team will be assigned upon appointment depending on the needs of the programme at the time.

3.152. We have proposed to disallow all forecast costs in Network Evolution and have not double-counted these roles in the total proposed disallowances. However, in light of DCC's justifications we have highlighted these as roles of particular concern in the forecasts. These roles amount to £1.706m over RY21/22, and £0.673m over RY22/23.

*Forecast Baseline costs*

3.153. DCC baseline forecast costs for RY23/24 onwards increase by an average of £53m each year. DCC however did not provide any justification for this increase in forecast costs. As with the RY19/20 price control submission, and in line with our Price Control Processes

and Procedures Guidance<sup>41</sup>, DCC's criteria for inclusion of costs is whether activity and costs are significantly more likely to occur than not. DCC therefore only attempted to justify forecast costs for RY21/22 and RY22/23 as the certainty criteria had not been met for RY23/24 onwards.

### **Our view**

3.154. In our view, DCC has not provided sufficient justification for these forecast variances.

3.155. **As such, we are minded to disallow the forecast variance associated with these roles and procurements, amounting to £5.069m for RY21/22 and £9.157m for RY22/23.** Table 3.2 provides a breakdown of these disallowances.

3.156. **We are also minded to disallow all variation in DCC's baseline forecasts from RY23/24 onwards given the lack of evidence and certainty provided in justifying these costs. This amounts to £160.101m.**

3.157. We are supportive of DCC working to improve contract management capabilities so they are more in line with industry best practice, however we expect forecasted roles in this area to meet the certainty threshold.

3.158. We consider that DCC already has existing resource who are able to engage with Ofgem and government where relevant, and do not consider it appropriate for DCC to create additional roles focused on assisting or engaging with government on policy development.

3.159. In future regulatory years, we expect DCC to provide better justification for material variances and forecasted roles which contribute to the variance, including descriptions of why demand for resource has increased beyond that which was previously expected, and a clear description of the responsibilities of forecasted roles.

3.160. Further, while we recognise DCC wishes to align the forecast costs in the price control with the forecasts in the charging statement, we note that these processes serve different

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<sup>41</sup> DCC Price Control Processes and Procedures Guidance 2021:  
<https://www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2021>

purposes and we expect to apply certainty criteria to forecasts. We therefore expect DCC to ensure that forecast variances meet the certainty threshold.

**Table 3.2: Forecast disallowances per cost centre in RY21/22 and RY22/23**

<b>Cost Centre</b>	<b>RY21/22 Disallowance (£m)</b>	<b>RY22/23 Disallowance (£m)</b>	<b>Total</b>
Commercial	1.551	2.152	3.703
Corporate Management	0.870	0.407	1.277
Finance	0.209	0.722	0.931
Operations	1.700	5.534	7.234
Service Delivery (Programme)	0.739	0.342	1.081
<b>Total</b>	<b>5.069</b>	<b>9.157</b>	<b>14.226</b>

## 4. Performance Incentives

### Section summary

This section covers DCC's submission of its performance under the Operational Performance Regime (OPR) and any relevant Baseline Margin Project Performance Adjustment Schemes (BMPPAS). There are no decisions to be made on the BMPPAS for RY20/21.

DCC proposed that it should retain its full margin as it met all the targets under the OPR.

Following consultation on how the OPR could be modified and improved, in October 2020 we published our decision<sup>42</sup> to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management.

Under the revised OPR, DCC's customer engagement will be financially incentivised. As part of the trial run in RY20/21, we received submissions from both DCC and SEC Panel on DCC's performance during RY20/21. Based on the submissions received we recommend a score of 1.17 for this trial period.

**We propose to allow DCC to retain all Baseline Margin under the OPR as all targets were achieved.**

**Question 11: What are your views on our proposed position on DCC's performance under OPR and trial run for customer engagement, and implementation of the contract management incentive?**

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<sup>42</sup> DCC Operational Performance Regime Review: October 2020 Decision: <https://www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision>

## Background

- 4.1. All of DCC's Baseline Margin (BM) (including adjustments) is at risk against one of DCC's performance regimes.
- 4.2. The margin DCC recovered in RY16/17 and RY17/18 was not put at risk against a performance regime as the Implementation Performance Regime had concluded and the OPR was yet to begin. All of the Baseline Margin recovered in RY16/17 and RY17/18 is being put at risk across RY18/19, RY19/20 and RY20/21.
- 4.3. This is the third year in which DCC's performance is being assessed by the Operational Performance Regime (OPR).
- 4.4. In May 2020, we consulted on a revised OPR framework as we became concerned that the current OPR metrics may not be providing the best incentives to DCC and may not be reflective of customer experiences. Following consultation, in October 2020 we published our decision<sup>43</sup> to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management.
- 4.5. In RY20/21 there were no Projects to be assessed under the BMPPAS regime. R2.0 has been finalised and there were no relevant milestones for the SMETS1 and ECoS programmes.
- 4.6. Separately to the BM, DCC receives margin on the Switching Programme. This Switching margin is at risk under a separate performance regime. The second and third milestones of the Design, Build and Test Phase was assessed in this year. This is covered in the Switching section of this document.

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<sup>43</sup> DCC Operational Performance Regime Review: October 2020 Decision:  
<https://www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision>

## Operational Performance

### Context

- 4.7. The current OPR was initially consulted on in March 2016 and the final decision and direction was published in September 2017.<sup>44</sup>
- 4.8. The current OPR consists of five equally weighted performance measures: two Service User Measures (SUM) and three Service Delivery Measures (SDM). Table 4.1 lists the five measures and subdivisions.

**Table 4.1: Operational Performance Measures**

Measure	Area of reporting	Metric	Weighting
SUM1	DCC service desk	Percentage of incidents resolved within Target Resolution Time	20%
SUM2a	Communication Hubs	Percentage of Communications Hubs delivered on time	10%
SUM2b		Percentage of Communications Hubs accepted by customers	5%
SUM2c		Percentage of Communications Hubs not faulty at installation	5%
SDM1a	DCC WAN coverage	All CSP contractual milestone dates met	20%
SDM1b		Percentage of first time SMWAN connectivity at install	
SDM2	Core service requests	Percentage of service responses delivered within Target Response Time	20%

<sup>44</sup> For more detail on the current OPR please refer to the decision document and consultation documents: <https://www.ofgem.gov.uk/publications-and-updates/decision-dcc-s-operational-performance-regime>

SDM3	Service/System Availability	Percentage availability of Data Service, User Gateway, Service Management System and Self Service Interface	20%
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4.9. These OPR performance measures are composed of a selection of the performance measures reported to the SEC and described in DCC’s Performance Measurement Methodology.

**DCC’s submission**

4.10. The total BM at risk under the OPR this year is £8.911m. DCC proposed that it should retain its full margin as it achieved all the targets under the OPR (and therefore the BMOPA term takes the value of 0).

4.11. DCC reported that they met all targets except for SDM1. This was a similar scenario to RY19/20 where all milestones apart from SDM1 was met. Specifically, the SDM1a element was not met this year due to the inability of the DCC to complete site installations to provide the targeted WAN coverage. Although SDM1b was achieved, both parts of the delivery milestones must be met for all targets to be achieved.

4.12. DCC applied to the SEC Panel for an ‘OPR Exceptional Event’ to acknowledge the impact of Covid-19 on the completion of the SDM1a milestone. This application was accepted which resulted in the DCC achieving all OPR targets.

4.13. Last year the target for SDM2 (Percentage of Service responses delivered within the target response times) was not achieved. However, this year the DCC achieved a performance percentage of 99.31%, which is over the 99% target. Table 4.2 shows the overall performance DCC reported under the OPR for RY20/21.

**Table 4.2: DCC’s submitted OPR values**

<b>OPR Measures &amp; Performance Targets</b>	<b>BM at risk (£m)</b>	<b>BM reduction (£m)</b>	<b>DCC Performance</b>
SUM1 (90.16%)	1.782	0.000	90.26%
SUM2a (99%)	0.891	0.000	100%
SUM2b (99.9%)	0.446	0.000	100%
SUM2c (99.9%)	0.446	0.000	100%
SDM1 (89.66%)	1.782	0.000	99.85%
DM2 (99%)	1.782	0.000	99.31%
SDM3 (99.73%)	1.782	0.000	99.98%
<b>Total</b>	<b>8.911</b>	<b>0.000</b>	<b>-</b>

**Our view**

4.14. We accept the SEC Panel assessment of an OPR exceptional event with respect to SMD1a and therefore consider that DCC has achieved all targets for the OPR performance measures.

4.15. We propose to allow the DCC to retain all Baseline Margin under the OPR as all targets were achieved.

**Project Performance**

**Context**

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

4.17. Any reductions made due to a BMPPAS incentive regime are made through the BMPPA term given in the Licence.

4.18. In RY20/21 there were no Projects to be assessed under the BMPPAS regime.

- 4.19. In RY19/20 the DCC lost all baseline margin associated with the R2.0 Programme as the final milestones were late. DCC proposed amendments should be made to the R2.0 BMPPAS. In October 2020, BEIS published their decision on whether to revise the R2.0 BMPPAS. BEIS and industry concluded that they did not believe it was appropriate to make changes to the scheme. As a result, our decision from last year remains unchanged. Last year was the final year of the R2.0 project which was finalised in November 2020.
- 4.20. The SMETS1 programme has incentive elements based on the rate of enrolment and the completion of enrolment. BEIS has not yet made its decision on the Enrolment Target number. It will also only provide DCC with Project Activity Performance Factor (PAPF) information when enrolment is complete. As a result, there is no information on the SMETS1 performance to include in RY20/21. Also, no milestones for the new ECoS programme were within scope in RY20/21.

### **Our view**

- 4.21. There are no decisions to be made on BMPPAS for RY20/21.

### **OPR: Way forward**

- 4.22. We became concerned, following DCC's submission of its performance under the OPR for the RY18/19 Price Control, that the OPR metrics may not be providing the best incentives to DCC. We asked stakeholders in our DCC Price Control RY18/19 consultation<sup>45</sup> 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 current OPR framework.
- 4.23. Following consultation, in October 2020 we published our decision<sup>46</sup> to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management. As part of our decision, we also implemented a licence change

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<sup>45</sup> DCC Price Control Consultation: Regulatory Year 2018/19: <https://www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-201819>

<sup>46</sup> DCC Operational Performance Regime Review: October 2020 Decision: <https://www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision>

to enable Ofgem to publish guidance, regarding the process, procedures and criteria of the OPR.

- 4.24. In March 2021, we published the OPR Guidance<sup>47</sup> to enable implementation. This included setting the performance levels and values for the system performance penalty mechanisms, and detailed processes for the customer engagement and contract management incentives. We proposed a trial run in RY20/21 for both Customer Engagement and Contract Management, without margin attached, for these incentives to come into effect with margin attached in RY21/22. We decided to implement a 12 month grace period for System Performance measures in RY21/22, for the new regime to come into effect in RY22/23.

### **System Performance**

- 4.25. DCC will be financially incentivised initially using three performance measures: service availability, prepayment, and install and commission. Where relevant, these measures will be assessed by meter generation (SMETS1/2) and region; and a new penalty mechanism applied for regional measures, as set out in the OPR Guidance.
- 4.26. We expect DCC to use the 12 month grace period to work transparently with its customers to find a reporting solution for the OPR measures, as set out in the Smart Energy Code (SEC), which could be based on service provider data, DCC Technical Operations Centre (TOC) data, or other reporting arrangements.
- 4.27. DCC created a Working Group focussing specifically on the Systems Performance aspects of the OPR and organised four Working Group meetings between May and July 2021. Based on the discussions at these meetings DCC submitted to us a set of recommendations in August 2021. We provided feedback on these recommendations seeking further clarity on how DCC would be proposing to engage with SEC ahead of RY22/23 on development of the system performance measures and performance targets and how DCC would propose to report to SEC on performance within RY22/23.

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<sup>47</sup> OPR Guidance (2021): <https://www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021>

- 4.28. We understand DCC is working with SEC panel and SEC Operations group to review measures and targets. We expect DCC to implement a reporting solution supported by its customers and SEC before the new regime comes into effect in RY22/23.
- 4.29. If DCC is not in a position to report on these new measures for RY22/23, we have set out in the OPR Guidance<sup>48</sup> that for any month that DCC is unable to report a value for its performance, performance for that month will be scored as zero. This means that in the case DCC is still unable to deliver a reporting solution for system performance in RY22/23, the default position is that DCC will lose all margin attached to those measures. We will make this determination as part of our price control decision for RY22/23, and as such we will take into account the wider context, including events outside of DCC's control, when making this decision.

### **Contract Management**

- 4.30. Under the revised OPR, DCC's contract management performance will be financially incentivised. DCC's performance in this area will be assessed by an independent auditor using the National Audit Office (NAO) Framework. We consulted on a detailed timeline and process for the audit, as well as our proposed scope. We also published the draft Terms of Reference to be used to procure the auditor, alongside the consultation.
- 4.31. We proposed a trial run in RY20/21 for Contract Management, however this has not proved possible to deliver. We are in the process of running a procurement process to appoint an auditor for the Contract Management Incentive under the new OPR for RY21/22.
- 4.32. In our March 2021 OPR Guidance decision<sup>49</sup> we recognised DCC requested to implement the OPR in RY22/23 in order to allow DCC enough time to benchmark its performance and make improvements to their contract management processes, ahead of margin being put at risk. Our decision set out that we considered that, given DCC customers' and our longstanding concerns, and that DCC's contract management function should already be

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<sup>48</sup> OPR Guidance (2021): <https://www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021>

<sup>49</sup> Ibid.

sufficiently mature to perform well against the framework, it was appropriate to run the trial in RY20/21, with margin attached for RY21/22.

- 4.33. DCC has told us that they initially benchmarked their activities against the NAO framework after we first proposed that it should underpin the contract management aspect of the OPR.<sup>50</sup> We are also aware that DCC planned further activity to compare its activities against the NAO framework during RY20/21, taking account of the publication of our OPR Guidance Decision. We also note from DCC's RY20/21 price control submission that DCC has already made changes to its contract management processes to drive improvements. While we have not been able to run the trial, we consider that DCC has had sufficient time to prepare before the OPR coming into effect with margin attached over RY21/22 and are procuring an auditor to that effect. We consider that the expectations of DCC customers have not changed with respect to DCC's performance and remain of the view that it is reasonable to expect that DCC's contract management function should already be sufficiently mature to perform well against the NAO framework.
- 4.34. We also note that DCC had concerns around the scope of the contract management assessment and clarified this in our March decision. However, we would expect DCC to ensure its contract management processes are of a sufficient standard across all its contracts, regardless of whether they are in scope.

### **Customer Engagement**

- 4.35. We want to see DCC's decisions strongly informed by an understanding of its customers' needs, replicating the pressures a company would experience in a competitive market to drive better value for money. While we acknowledge that DCC has demonstrated recent improvements in customer engagement, it continues to be an area which requires greater focus.
- 4.36. Under the new OPR, DCC's customer engagement will be financially incentivised. DCC's performance in this area will be assessed based on qualitative submissions from both DCC

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<sup>50</sup> As set out in our March 2020 working paper: [https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/2020.02\\_dcc\\_opr\\_working\\_paper\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2020/03/2020.02_dcc_opr_working_paper_0.pdf); and our May 2020 OPR review consultation: [https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/opr\\_review\\_consultation.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/opr_review_consultation.pdf)

and the SEC panel. The assessment will cover: the timing and frequency of engagement; quality of information provided by DCC; and the incorporation of customer views.

- 4.37. The three areas of customer engagement under assessment have relative weighting and each have three assessment questions. The individual weighting for each assessment question is calculated as one third of its area weighting and the overall score will be calculated using a weighted average of the scores given to each question. For details on the scoring methodology please refer to our guidance.<sup>51</sup>
- 4.38. To inform the scoring, we received submissions from both DCC and SEC Panel on DCC's performance during RY20/21 against the criteria set out in OPR Guidance. We considered both the submissions and the evidence provided to assess DCC's performance in RY20/21.
- 4.39. We recognised that there are linkages between OPR and our cost assessment for RY20/21. There may therefore be a need to take into account any relevant examples from our cost assessment when assessing DCC's performance under the OPR, in particular in cases where we identify costs may not have been incurred economically and efficiently, but are unable to quantify such costs. More details on this are provided in chapter 3.

## **DCC and SEC Panel submission**

### **Timing and Frequency of engagement**

- 4.40. Expected timelines and frequencies for engagement, when set out clearly for DCC customers across projects and decision-making cycles, allows DCC's customers to engage effectively.
- 4.41. DCC believes that it proactively engaged with customers during RY20/21, enabling them to feed in views at appropriate points in decision-making cycles. DCC cited examples of existing established channels such as Quarterly Finance Forums and the annual process of Business and Development Planning which facilitates engagement on programme updates, new areas of work, financial updates and general updates. DCC also provided specific

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<sup>51</sup> OPR Guidance (2021): <https://www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021>

examples such as SMETS1 Final Operating Capability (FOC) and SMETS2 Self Service Interface (SSI), where DCC believes engagement has been timely and effective.

- 4.42. DCC notes that there is room for further improvement and is currently working on a joint project with SECAS and Sub-committee Chairs to review the process for engagement throughout the decision-making cycle, set a standard framework and agree specific artefacts to be shared at each gate across all programmes.
- 4.43. Overall DCC believes it undertook timely and frequent engagement with customers covering both general updates and reactive engagement to unplanned issues in RY20/21. Based on this, DCC recommended an average score of 2.6 in this area.
- 4.44. According to the submission by the SEC Panel, there are some examples where the DCC have engaged pro-actively with customers enabling them to feed in views at appropriate points in decision-making cycles and this has worked well. However, the engagement is inconsistent and there is not sufficient clarity to understand where in the process the engagement is taking place. SEC Panel believes that due to the lack of agreed engagement plans there is little clarity over timeframes and there have been instances when decisions were reached on the basis of a single meeting and DCC customers had little time to review papers and digest information. The submission cited engagement on Comms hubs and the Network Evolution Programme as an example.
- 4.45. Another key point noted was that while there is usually sufficient time to respond to DCC consultations, DCC customers were not confident that the timing of consultations always allowed DCC to take their views fully into account particularly when consultations close shortly before a decision is due.
- 4.46. SEC Panel believes broader engagement is also not consistent. SEC panel recommended an average score of 0.83 in this area.

#### **Quality of information provided by DCC**

- 4.47. Providing clear and relevant information allows DCC customers to give informed feedback.
- 4.48. DCC in its submission noted that although there are examples of good practice in some areas, it needs to be more consistent in the quality and detail it presents to customers to

enable them to compare costs and benefits of different options, and understand the drivers of those costs and benefits, particularly in relation to strategic programmes.

4.49. DCC pointed out that commercial constraints prevent DCC from sharing detailed cost information, even under an NDA. DCC stated it is committed to ongoing improvements in communications with customers about what cost and benefit information will be available, as well as sharing the information itself.

4.50. For RY20/21, DCC believes that it provided high quality information for broader engagement and reactive engagement. DCC also believes it has regularly shared relevant information with appropriate audiences and has therefore recommended a score of 2.6 in this area.

4.51. The SEC Panel's submission noted that engagement in this area is not satisfactory and suggested the following areas of improvement:

- clearly setting out what cost and benefit information will be available and when at the beginning of a project;
- using correct distribution lists to target the relevant audience;
- providing relevant information to the different SEC committees.

4.52. SEC Panel has recommended an average score of 0.83 in this area.

### **Taking account of customer views**

4.53. Clarity on the role of customers in the decision process and 'closing the feedback loop' is crucial for meaningful engagement.

4.54. DCC believes that it sets out clearly where customers' views can influence decisions and is committed to continuing to work with SECAS to provide greater clarity on all engagement processes throughout the decision-making cycle.

- 4.55. DCC believes that it took customers' views into account but recognises the need to gather and share the evidence on how it has done this more routinely with customers, and has started to do this more frequently moving into the current Regulatory Year.
- 4.56. DCC believes that it has communicated a clear rationale for decisions made to customers. DCC cited the example of Quarterly Finance Forums where programme updates for non-mandated work include sections on 'you said, we did' – explaining how DCC has acted on feedback and how the decision was reached. DCC also used other channels such as Consultation Response documents and ExCo Bilaterals to communicate back to customers the outcomes of DCC's decision making. DCC suggested an average score of 2.33 in this area.
- 4.57. The SEC Panel believes engagement in this area is inconsistent. The SEC Panel's submission noted that basic requests to update actions, provide information or engage earlier have not been addressed. Decisions have been made to proceed in a way that is counter to the requested approach leading customers to believe that expressed views have not been taken into account.
- 4.58. The SEC Panel suggested that improvement is needed in the explanation of how views have been taken on board and shaped decisions. The SEC Panel recommended an average score of 0.66 in this area.

### **Our view**

- 4.59. Based on the submissions from DCC and the SEC Panel, we note that there have been some positive examples, for instance SMETS1 service stability where regular updates and progress against plans have resulted in positive engagement. However, there are topics such as Comms Hubs returns process or Comms Hub exceptions where information requested by SEC for over a year is yet to be provided. Thus engagement seems inconsistent and DCC could do more in communicating its engagement plans more clearly to customers.
- 4.60. Engagement is inconsistent across different areas and also across the different channels used by DCC. It seems that while some existing processes such as DCC's consultation process works well, improvement is required in other channels. For instance, when engaging with different SEC committees feedback suggests DCC needs to tailor its focus

better to each subcommittee to provide relevant information, for example design issues at TABASC and operational issues at OPSG.

- 4.61. A clear plan and timetable of engagement which sets out what information will be shared, and the role of customers at each decision point in the programme cycle would benefit the process. We expect that DCC's joint project with SECAS and Sub-committee Chairs to review the process for engagement throughout the decision-making cycle and set a standard framework will lead to more effective engagement.
- 4.62. It is important that DCC's customer engagement should not be a tick box exercise but a more meaningful process that results in good outcomes for both DCC and its customers. Based on the submissions received we recommend a score of 1.17 for this trial period. If this year's BM were at risk, £1.34m would be the BM associated with Customer Engagement. This means with a score of 1.17, DCC would lose £0.817m (61% of BM associated with Customer Engagement). A breakdown of the scores is provided in table 4.3 below.
- 4.63. We will review the process followed for the trial period and will engage with DCC and SEC to make any changes required.

**Table 4.3: Customer engagement assessment criteria**

<b>Assessment questions</b>	<b>Ofgem Score</b>	<b>SEC Score</b>	<b>DCC Score</b>
<b>Timing and frequency of engagement</b>			
1. Has DCC engaged proactively with customers, enabling them to feed in views at appropriate points in decision-making cycles?	1	1	2
2. Has DCC set clear time frames such that customers understand when they can contribute views with sufficient lead times to enable them to do so?	1	1-2	3
3. Has DCC’s broader engagement (eg general updates, reactive engagement on unplanned issues impacting customers) been delivered in a timely manner and with sufficient frequency?	2	1	3
Average score	1.33	1.16	2.66
<b>Quality of information provided by DCC</b>			
4. Has DCC provided its customers with information of sufficient quality and detail to enable them to compare costs and benefits of different options, and understand the drivers of those costs and benefits?	1	0	2
5. Has DCC provided sufficient quality of information in its broader engagement (eg general updates, reactive engagement etc) for customers to understand the issues and the actions DCC is taking?	2	1-2	3
6. Has DCC provided the appropriate information to the relevant audiences when engaging with customers?	1	1	3
Average Score	1.33	0.83	2.66
<b>Taking account of customer views</b>			

<b>Assessment questions</b>	<b>Ofgem Score</b>	<b>SEC Score</b>	<b>DCC Score</b>
7. Has DCC ensured its customers understand on which issues their views will inform decision-making?	1	1	3
8. Has DCC taken customer views into account in its decision-making?	1	0	2
9. Has DCC communicated a clear rationale for decisions it has made to customers, explaining how customer views have informed its decision making, and where relevant why DCC has decided not to incorporate customer views?	1	1	2
Average Score	1	0.66	2.33
Final weighted score	1.17	0.83	2.5

## 5. Baseline Margin and External Contract Gain Share

### Section summary

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

DCC submitted an application for an adjustment to its Baseline Margin of £15.333m for RY20/21 to RY22/23. DCC cannot receive a Baseline Margin adjustment on costs that are not economic and efficient. We calculate the effect of the proposed disallowances in the cost assessment on the Baseline Margin application to be £8.08m. Thus we propose to amend DCC’s Baseline Margin application and allow £7.26m.

DCC submitted an application for an adjustment to its External Contract Gain Share (ECGS) of £14.53m across RY20/21 to RY25/26. This adjustment partly relates to the continuation of re-financing arrangements and the financing of Communication Hubs (CHs). This year’s ECGS application also includes savings that stem from the design, build and operation of DCC’s in-house test lab service in 2018. We propose to accept DCC’s ECGS Adjustment application of £10.55m relating to the continuation of re-financing arrangements and CHs financing. We are minded to reject £3.98m of the adjustment relating to DCC’s in-house test lab service.

### Questions

**Question 12: What are your views on our assessment of DCC’s application to adjust its Baseline Margin?**

**Question 13: What are your views on our assessment of DCC’s application to adjust its ECGS?**

## Baseline Margin

### Background

- 5.1. The Baseline Margin adjustment mechanism allows DCC to apply for a Relevant Adjustment to the Baseline Margin values specified in Appendix 1, Condition 36 of the Licence. The adjustment mechanism itself is detailed in Appendix 2, Condition 36 of the Licence.
- 5.2. The Baseline Margin adjustment mechanism was included in the Licence in recognition of the uncertainty of the nature and risks of DCC's Mandatory Business over the Licence term. The adjustment mechanism is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business – including the volume, characteristics, risks and timescales of these activities. Greater detail of the conditions and requirements for a Baseline Margin Relevant Adjustment can be found in the RIGs, and the processes and procedures document<sup>52</sup>.
- 5.3. DCC's Baseline Margin (including adjustments) is subject to DCC's performance regime under which its Baseline Margin may be reduced for poor performance. 100% of the Baseline Margin recovered this year is held to account by the Operational Performance Regime.

### DCC's Application

- 5.4. Alongside its RY20/21 price control submission, DCC has applied for a £15.333m adjustment to its Baseline Margin for work performed in RY20/21, RY21/22 and RY22/23.
- 5.5. DCC has identified eight drivers this year, seven of which were included in previous years' BMA applications and are associated with increased cost certainty or changes to scope, timescales and/or volumes of the activities. Under the New Scope driver, DCC has included three activities that are being raised for the first time.

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<sup>52</sup> Section 4: Baseline Margin Adjustment Section - [https://www.ofgem.gov.uk/system/files/docs/2019/07/2019.06\\_processes\\_and\\_procedures\\_guidance\\_document.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/07/2019.06_processes_and_procedures_guidance_document.pdf)

**Table 5.1: Activities and their corresponding drivers as identified in the Baseline Margin Application**

<b>Change Driver</b>	<b>Activities: Resource and Non-Resource</b>	<b>RY driver first raised</b>
<b>SMETS1</b>	SMETS1 programme – various resource and non-resource activities	RY16/17
<b>Service Standard expectations</b>	Increased Certainty	RY18/19
<b>Network Evolution Programme (NEP)</b>	Increased Certainty Levels on the Development and Delivery Network Evolution Programme	RY19/20
<b>Enduring Change of Supplier (ECOS)</b>	Increased Certainty on the development and delivery of the ECoS Programme	RY18/19
<b>Facilitating Additional Relevant Services</b>	DCC Test Labs	RY18/19
<b>People Transformation</b>	People Transformation	RY17/18
<b>Increase in Security Requirements (Security Driven Change)</b>	Enterprise IT and Transformation of DCC’s Security model	RY19/20, RY17/18
<b>New Scope – Future Activities</b>	Market Wide Half Hourly Settlement (MHHS) DNO Transformation Programme Comms Hub Programme (Mandated GBCS updates)	RY20/21

- 5.6. SMETS1 relates to a combination of slower than forecast migrations by suppliers, undisclosed device technical issues and complexities around testing which led to further delays. DCC is applying for an adjustment of £4.122m due to new activities and increased certainty associated with this driver.
- 5.7. The Network Evolution Programme (NEP), first raised in RY19/20 as a new BMA ground, has led to a material change in scope of DCC’s core business activities. The NEP is specifically aimed at supporting the long-term enhancement of DCC platform, simplifying the network design with greater resilience and enabling faster change. This year’s structure of the programme includes DSP, Communication Hubs & Networks (CH&N), Trusted Services Provider (TSP), Test Automation. DCC is applying for an adjustment of £5.132m for this driver.

- 5.8. Service Standard Expectations relates to investments in DCC's operational capacity. DCC state that there has been growth of the function with the introduction of new services such as NEP, ECoS and MHHS, and the challenges and complexities that these bring in terms of operational requirements that are different to those for the existing services such as SMETS2, SMETS1 and Switching. Also, because of these complexities engagement between DCC and its customers has become much more technical and frequent. DCC also incurred costs on the expansion of the Technical Operations Centre (TOC) function. DCC is applying for an adjustment of £1.361m due to new activities associated with this driver.
- 5.9. DCC applied for adjustment of Baseline Margin for the Enduring Change of Supplier (ECOS) programme in RY19/20. In RY20/21 work in this area has increased and includes issuing RFPs relating to procurements, preparing for the procurement phases – Design, Build Test (DBT) and combined Hosting and Service Management. DCC is applying for an adjustment of £1.002m due to material change in the scope of DCC's work.
- 5.10. Security Driven Change relates to activities enabling the transformation of DCC's security model. A significant variance to the costs in this area in RY20/21 are due to continuation of the work that was initiated in RY19/20 and includes a mix of both dedicated Enterprise IT (EIT) resource costs as well as additional non-resource spend to ensure that the IT infrastructure – including systems, networks and hardware/laptops – are appropriately upgraded and segregated from the rest of Capita's infrastructure. As part of the same transformation, the activities in RY20/21 also focussed on strategic improvements to DCC's security monitoring capability. DCC is applying for an adjustment of £2.185m associated with this driver.
- 5.11. Under the driver Facilitating Additional Relevant Services, DCC is applying for an adjustment of £1.884m due to increased certainty over the costs of DCC's test lab at the Brabazon House. DCC is applying for an adjustment of £0.367m due to increased certainty over the costs for the driver People Transformation.
- 5.12. DCC applied for three activities under First Time Grounds in RY20/21 – Market wide half hourly settlement (MHHS), DNO Transformation Programme and Great Britain Companion Specification (GBCS) compliance.
- 5.13. MHHS mandates electricity suppliers to settle all customers with capable meters (or equivalents) in a half-hourly (HH) capacity. DCC has engaged with Ofgem and the wider

industry to help shape and refine the program's Target Operating Model (TOM). Industry efforts over the course of RY19/20-RY20/21 have mainly focused on the design of the solutions, planning assumptions and the assessment of the overall implementation costs. Activities over the course of RY21/22 are expected to ramp up as the Programme moves into the implementation phase of deploying the technical changes that are required to DCC's network. DCC is applying for an adjustment of £0.331m.

- 5.14. The DNO Transformation Programme addresses the performance gap of services that Distributed Network Operators (DNO) receive. The key pillars of the programme are data reporting, service improvement, strategic engagement, service optimisation and innovation. DCC is applying for an adjustment of £0.441m.
- 5.15. The Great Britain Companion Specification (GBCS) sets out data security and other operational standards for CHs. DCC is mandated by BEIS to develop, test and deploy new firmware to all operational CHs in line with each iterative update of the GBCS. DCC is applying for an adjustment of £0.124m.
- 5.16. To calculate the proposed adjustment, DCC first quantified the change in volume of activities associated with each driver in terms of the number of FTE resources required, as well as the additional external services used in lieu of DCC recruiting more in-house resources. DCC then calculated the Baseline Margin as 15% of the sum of the Baseline Margin and associated costs for each role (this is consistent with previous years and the original Baseline Margin given in the Licence – please see the RY16/17 price control consultation document for more information)<sup>53</sup>.

## **Our View**

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

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<sup>53</sup> The rate of margin is discussed in more detail in paragraphs 4.20 and 4.21 of the RY16/17 price control consultation - [https://www.ofgem.gov.uk/system/files/docs/2017/10/2017.10\\_1617\\_price\\_control\\_consultation\\_document.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/10/2017.10_1617_price_control_consultation_document.pdf).

- 5.18. We are minded to reject the resource and non-resource activity related to the drivers - Operational Resilience, Moving beyond ITIL and Scope of Support - as DCC has not provided any justification for the proposed adjustment to BM. This is a proposed reduction of £0.202m.
- 5.19. The DNO Transformation Programme addresses the performance gap of services that Distributed Network Operators (DNO) receive. The Smart Energy Code (SEC) Section H3.14(g) states that Alerts must be sent to the User within 60 seconds, measured from when the Alert is communicated to or generated by the Communications Hub. This requirement includes Power Outage Alerts (POAs) and Power Restoration Alerts (PRAs). The Communication Service Provider (CSP) contracts were developed in parallel with the SEC during the early stages of the Smart Meter Implementation Programme, and the CSP contracts do not include the same POA and PRA definitions and requirements that are specified in the SEC. It is our view that the need to address this performance gap of services has remained fairly constant, and that DCC has begun to meet this demand only recently. We therefore do not view this as a material change in scope or volume. Moreover, since there was always an expectation to address this performance gap, we do not believe that the grounds, if any, for adjustment to Baseline Margin were first identified in RY20/21. We are therefore minded to reject the adjustment proposed for the DNO Transformation programme as we do not view this as a material change in scope or volume and DCC has also missed the 'Application Window'. This is a proposed reduction of £0.441m.
- 5.20. BEIS continuously reviews and updates the GBCS and DCC is mandated to provide firmware updates to all CHs when required. We do not believe that the grounds for adjustment to Baseline Margin were first identified in RY20/21 as DCC originally set out plans to achieve GBCS 2.1 compliance in the North by April 2019 for Single-band CHs and South and Central by March 2020 for Single-band CHs. We are therefore minded to reject the adjustment proposed for the GBCS work as DCC has missed the 'Application Window'. This is a proposed reduction of £0.124m.
- 5.21. When determining any Relevant Adjustments to DCC's Baseline Margin, the Licence Condition 36.A10 (b) requires us to have regard to DCC's expected rate of return on its activities over time. As in previous price controls, we considered a 15% margin to be acceptable given: DCC's ex-post regulatory framework; that the activities are similar in nature to those included with the LABP; DCC's limited fixed and intangible assets; and

that this is the same margin as that agreed at bid, and as such was established through a competitive tender.

- 5.22. **For RY20/21 we regard 15% to be an acceptable margin** given that DCC's position and characteristics relevant to earning margin have not substantially changed since last year.

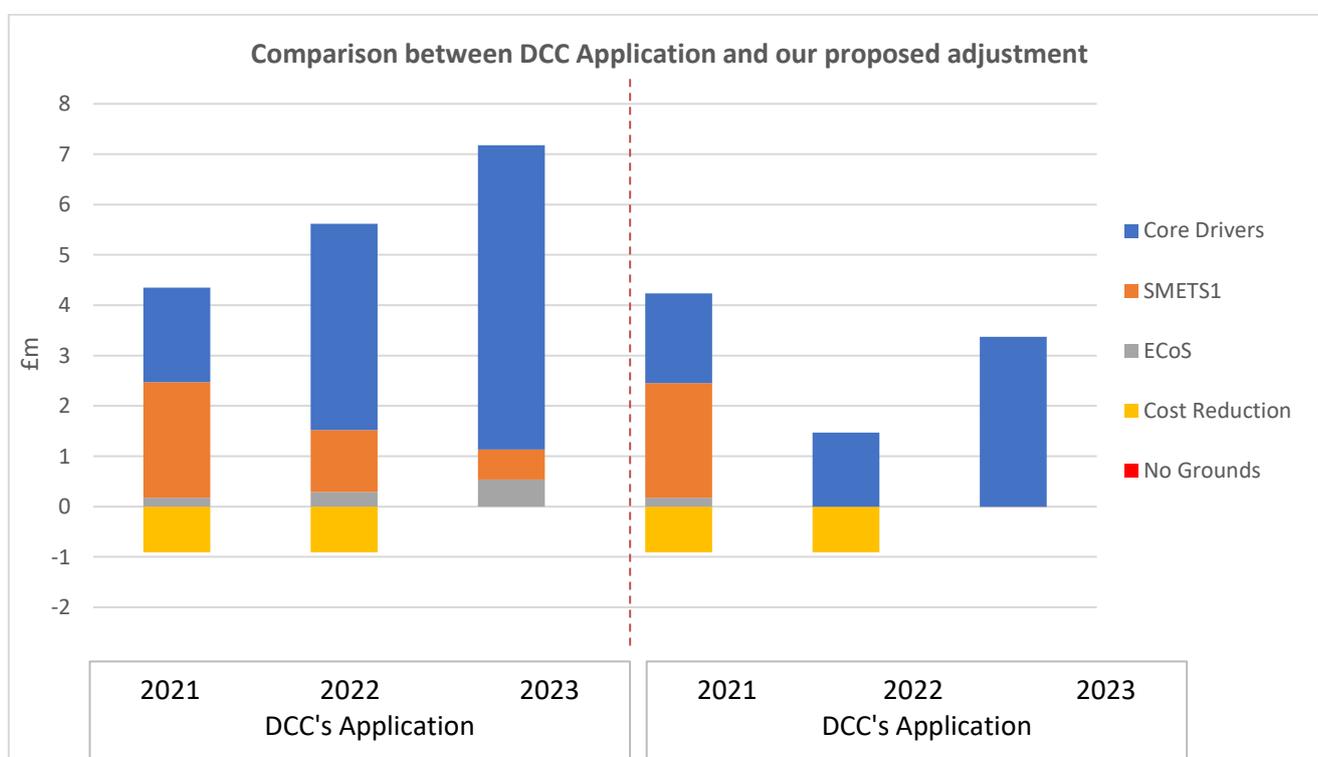
*Other Reductions and Proposed BM Adjustment*

- 5.23. DCC cannot receive a Baseline Margin adjustment on costs that are not economic and efficient. We calculate the effect of the proposed disallowances in the cost assessment on the Baseline Margin application to be £7.26m.
- 5.24. A significant proportion of BM reduction due to cost disallowances is due to forecast cost disallowance for RY21/22 and RY22/23. DCC will be able to reapply for the Baseline Margin associated with these forecast costs. If these forecast costs are justified in future Price Control submissions, DCC will be able to keep the Baseline Margin associated with these costs.
- 5.25. Due to the ex-post nature of the price control, the Baseline Margin adjustment is recovered by DCC after the year in which the work on which it is based was performed. The years to which we are proposing the adjustment is made to are RY22/23, RY23/24 and RY23/24.
- 5.26. Taking all of these disallowances into account, **we propose reducing the adjustment by £8.08m, therefore amending DCC's application to an adjustment of £7.26m between RY22/23 and RY24/25**, as shown in Table 5.2.

**Table 5.2: Proposed Baseline Margin compared to Baseline Margin as of the RY19/20 Price Control decision**

Baseline Margin (£m)	RY22/23	RY23/24	RY24/25	Total
Baseline Margin as of RY19/20 decision	7.375	6.840	2.191	<b>16.406</b>
Adjusted by RY20/21 application (Difference from RY19/20)	10.817 (3.442)	11.551 (4.711)	9.371 (7.180)	<b>31.739</b> <b>(15.333)</b>
Adjusted by RY20/21 consultation proposal (Difference from RY19/20)	10.700 (3.325)	7.397 (0.557)	5.565 (3.374)	<b>23.663</b> <b>(7.257)</b>

**Figure 5.1: Comparison between DCC’s application and our proposed adjustment**



**Figure 5.1: Data Table**

Driver	Application			Proposal		
	RY20/21	RY21/22	RY22/23	RY20/21	RY21/22	RY22/23
Core Drivers	1.881	4.100	6.046	1.779	1.467	3.374
SMETS1	2.293	1.231	0.599	2.280	0.000	0.000
ECoS	0.177	0.290	0.535	0.175	0.000	0.000
Cost Reduction	-0.909	-0.910	0	-0.909	-0.910	0.000
No Grounds	0	0	0	0.000	0.000	0.000
<b>Total</b>	<b>3.442</b>	<b>4.711</b>	<b>7.180</b>	<b>3.325</b>	<b>0.557</b>	<b>3.374</b>

**Table 5.3: Proposed Baseline Margin adjustment compared with DCC’s Application**

Driver	Application			Proposal		
	Ry21/22	Ry22/23	Ry23/24	Ry21/22	Ry22/23	Ry23/24
Increased Certainty on the development and delivery of the SMETS1 Service	2.293	1.231	0.599	2.280	0.000	0.000
Increased Certainty Levels on the Development and Delivery Network Evolution Programme	0.840	2.149	2.143	0.821	0.000	0.000
Increased Certainty on the development and delivery of the ECOS Programme	0.177	0.290	0.535	0.175	0.000	0.000
Facilitating Additional Relevant Services	0.402	0.318	1.165	0.402	0.288	1.094
Increased Certainty in Security Requirements (Security driven change) - Transformation of DCC’s Security model	0.335	0.309	0.473	0.335	0.309	0.473
Increased Certainty in Security Requirements (Security driven change) - Enterprise IT	0.125	0.475	0.468	0.118	0.475	0.468
Increased Certainty Service Standard Expectations	0.061	0.310	0.990	0.061	0.274	0.984
People Transformation	0.044	0.062	0.262	0.040	0.062	0.262
New Scope - MHHS	0.002	0.175	0.155	0.002	0.058	0.093
New Scope – DNO	0.011	0.242	0.189	0.000	0.000	0.000
New Scope - Comms Hub Programme (Mandated GBCS updates)	0.062	0.063	0.000	0.000	0.000	0.000
Operational Resilience – Early Life Support	0.000	0.000	0.073	0.000	0.000	0.000
Ops - Moving beyond ITIL	0.000	0.000	0.055	0.000	0.000	0.000
Ops - Scope of Support	0.000	0.000	0.074	0.000	0.000	0.000
No Grounds	0.000	0.000	0.000	0.000	0.000	0.000

Driver	Application			Proposal		
	R Y21/22	R Y22/23	R Y23/24	R Y21/22	R Y22/23	R Y23/24
Cost Reduction	-0.909	-0.910	0.000	-0.909	-0.910	0.000
<b>Total</b>	<b>3.442</b>	<b>4.711</b>	<b>7.180</b>	<b>3.325</b>	<b>0.557</b>	<b>3.374</b>

## External Contract Gain Share

### Background

5.27. The formula for DCC’s Allowed Revenue includes an External Contract Gain Share (ECGS) term, which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the FSP contracts<sup>54</sup>. This is so that DCC has an incentive to seek and achieve cost savings in the FSP contracts. This term is zero unless DCC applies for a Relevant Adjustment to this term.

### DCC’s Application

5.28. DCC has applied for a £14.53m Relevant Adjustment to its ECGS term for RY20/21 to RY25/26 on the basis of £43.16m savings to industry as a whole, reflecting a reduction in External Costs.

5.29. DCC has applied for a Relevant Adjustment for the continuation of re-financing arrangements; these are previously renegotiated and approved interest rates, which have generated a further ECGS saving of £4.4m across both CSPs from RY20/21 to the end of the contracts. These savings are a continuation of reduction in financing costs across the various components and fundamental service providers of the SMIP. This year’s application does not include any further refinancing of CGI set-up charges. £1.44m<sup>55</sup> of the total Relevant Adjustment is related to the continuation of these re-financing arrangements based on £4.4m savings and £2.5m being returned to customers.

<sup>54</sup> The terms and conditions through which DCC is able to apply for an adjustment under the ECGS is set out in Condition 39 of the Smart Meter Communication Licence.

<sup>55</sup> DCC’s gain share is 25%-37.5% for the CSPs.

- 5.30. As in RY19/20, DCC successfully managed to secure alternative, value for money, funding arrangements for the financing of Tranche 2 Comms Hubs. A significant reduction in interest rates for both CSPs have resulted in £13.39m savings in RY20/21. This financing relates to Tranche 2 CHs which represent approximately 85% of all CHs. DCC applied for a Relevant Adjustment of £5.02m (37.5% gain share) on the basis of £13.39m of total savings to industry relating to CHs financing covering RY20/21 to RY25/26. Last year DCC applied for 25% gain share on the assumption that some gain share would be paid to Telefonica. DCC has since noted that there is no contractual obligation to share these savings with TEF or ARQ. DCC therefore has proposed to split the savings with 62.5% being returned to DCC customers and 37.5% being retained by DCC.
- 5.31. In RY20/21 DCC has also managed to lower the interest rates for the financing of the Tranche 1 Comms Hubs. This has yielded a net savings of £16.3m from RY20/21 to the end of the Licence. In contrast to Tranche 2 Comms Hubs, savings against Tranche 1 Comms Hubs are drawn from a refinancing ie lowering of interest rates and financing costs of existing Tranche 1 Comms Hubs orders. These savings stem from DCC's work with its Service Providers who are negotiating these contracts. DCC proposed that for the RY20/21, £8.16m is returned to DCC customers and a Relevant Adjustment of £4.08m (25% gain share) to its ECGS<sup>56</sup>.
- 5.32. DCC argue the savings realised in RY20/21 are a direct result of the efforts of its commercial team to secure financing at competitive rates, as well as through the relationship DCC has built with investors over the last few years through meeting payment obligations.
- 5.33. This year as part of the ECGS application, DCC has included the savings made from in-house test lab service DCC is providing at the Brabazon House. The provision of testing services originally sat within the FSP contracts. The design, build and operation of the in-house test lab service in 2018 has made it possible for DCC to provide a fully integrated end-to-end test facility that better meets customers' needs, at a cost cheaper than the testing services that were initially provided by the CSPs. Net savings of £9m have been

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<sup>56</sup> DCC has used the same methodology for set-up cost refinancing, where the FSP qualifies for a 25% share.

achieved until the end of RY20/21. DCC has applied for a gain share of £4m<sup>57</sup> in RY20/21 and beyond (c.£4.5m each year until the end of licence) as they have saved on Testing Service charges which DCC customers would otherwise have paid to FSPs for until the end of the licence.

- 5.34. DCC provided justification of its proposed distribution of the savings, which included benchmarking against comparable gain share arrangements in other regulated industries.

### **Customer's Benefits**

- 5.35. ECGS is a mechanism which incentivises DCC to identify and secure reductions in the costs of the FSP contracts. The reduction of such costs brings benefits to DCC's customers in the form of savings from lower contractual interest rates on financed milestones.
- 5.36. Between RY15/16 (DCC's first ECGS Adjustment application) and RY20/21 (including this year's application), DCC has secured cost reductions of £114m in the FSP contracts, £33.24m relating to CHs financing and £9m relating to DCC's test labs and brought benefits of £91.1m (c.60% of total cost reductions) to DCC's customers (based on DCC's ECGS applications).

### **Our View**

- 5.37. We are minded to accept the Relevant Adjustment related to the continuation of re-financing arrangements. We consider the Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence.
- 5.38. We are minded to accept the Relevant Adjustment related to the financing of Tranche 1 and Tranche 2 CHs. We consider that DCC's application is duly made and that DCC has provided sufficient evidence that it was instrumental in the arrangement. DCC's

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<sup>57</sup> DCC proposed a gain share of 37.5% for any savings that are realised against the original business case. For any savings in excess of what was forecasted in the baseline business case, DCC proposed a 50%-50% split

application justified that the overall saving from the refinancing and financing arrangements would not have been achieved without DCC's involvement.

5.39. We are minded to reject the Relevant Adjustment related to the savings made from DCC's in-house test lab service. Although we welcome DCC's role in consolidating testing facilities we do not believe the following criteria for Relevant Adjustment have been met:

- Licence Condition 39.A4 (a) explicitly states: in order for Ofgem to approve any ECGS adjustment, DCC must "*set out how the costs associated with the activities that are the subject of the proposal were included in the original External Service Provider Contract (or Contracts)*". In response to our cost visit question DCC has confirmed that the testing services offered by DCC Test Labs are more wide-ranging than those offered in the FSP contract and therefore the comparison is not like-for-like. DCC further stated that there is a high degree of complexity in separating out individual costs and assumptions would be required to compare the costs on like-for-like basis. It is therefore our view that Licence Condition 39.A4 (a) has not been met as the DCC test lab services for which DCC has applied for an ECGS adjustment are different from those included in the original External Service Provider Contract.
- Licence Condition 39.A5 (b) explicitly states: in order for Ofgem to approve any ECGS adjustment, the Relevant Adjustment notice "*must be served within the first Application Window after the date on which the grounds for proposing the Relevant Adjustment first arose*". The new test lab was built in September 2018 and is fully operational since 1 April 2019. DCC submitted the costs of the new test labs under the 2018/19 Price Control Submission. The grounds, if any, for proposing the Relevant Adjustment for ECGS therefore first arose in the regulatory year 2018/19 and so the first Application Window was July 2019 when the notice should have been served.

5.40. For this reason, we are minded to reject ECGS Adjustment application of £3.98m which is based on the savings related to DCC's test labs.

5.41. Apart from the Test labs related ECGS Adjustment application, we consider that DCC's application is duly made. We also consider that DCC's proposed distribution of the savings between its customers, the FSPs and DCC is consistent with previous years and

appropriate based on the evidence provided by DCC, and regulatory precedent in the industry.

- 5.42. **We therefore propose to reduce the Relevant Adjustment to the ECGS term by £3.98m, therefore amending DCC’s application to an adjustment of £10.55m between RY20/21 and RY25/26.**

## 6. Switching Programme

### Section summary

This section provides our assessment of DCC's costs associated with the Switching Programme in RY20/21 and the forecasts to the end of the licence period. We find that the costs incurred in RY20/21 are economic and efficient. We propose to disallow DCC's forecast costs of £7.053m for RY23/24 onwards as DCC has not provided any justifications for these costs.

This section also gives our view on the second and third incentivised delivery milestones of the Design, Build and Test phase of the Switching Programme: Delivery Milestone 2 (DM2) and Delivery Milestone 3 (DM3). This year all associated milestones (DM2 and DM3) were achieved. We therefore propose that DCC should retain all margin associated with these milestones.

### Questions

**Question 14: What are your views on our proposed position on DCC's costs associated with the Switching Programme?**

**Question 15: What are your views on our assessment of Delivery Milestone 2 and Delivery Milestone 3 of the Switching Programme?**

## Switching costs

### Context

- 6.1. The Switching Programme has been established to improve consumer's experience of switching between energy suppliers. DCC plays a central role in delivering this programme.
- 6.2. The costs and performance of the Switching Programme are dealt with separately from the rest of DCC's business.

### DCC's justification

- 6.3. DCC submitted costs for the Switching Programme until the end of the licence period. DCC incurred total costs of £29.903m in RY20/21, which is broken down into £5.676m of internal costs and £24.227m of external costs.
- 6.4. DCC forecast a total cost of £22.027m from RY21/22 until the end of the licence period, which is broken down into £5.615m of internal costs and £16.413m of external costs. DCC only provided justification for forecast costs in RY21/22 and RY22/23 which totals to £14.974m.

### Our view

- 6.5. Due to the lack of justification for the forecast costs, **our minded-to position is to disallow all forecast costs beyond RY22/23 to the end of the Licence period, £7.054m. We also propose to disallow the corresponding margin (which is calculated as a percentage of internal costs), an additional £0.031m.**

## Switching Performance

### Context

- 6.6. We published our decision on an updated incentive regime for DCC's role in the Design, Build and Test (DBT) Phase of the programme in May 2019.<sup>58</sup> Please note, this is a separate regime from the Operational Performance Regime and Baseline Margin Project Performance Scheme (discussed in chapter 4).
- 6.7. The first of the delivery milestones under the DBT Phase occurred in RY19/20. The second and third of the delivery milestone occurred this year in RY20/21. Delivery Milestone 2 (DM2) required DCC to successfully complete the initial pre-integration testing of the CSS (Centralised Switching Service). Delivery Milestone 3 (DM3) represented the successful completion of the planning and preparation activities for SIT (System Integration Testing).

### DCC Submission

- 6.8. DCC provided evidence of DM2 and DM3 completion. Evidence included Test Completion reports which detailed each individual milestones' achievement date and the various phases of the testing stages. DCC also produced minutes of meetings with external stakeholders verifying the completion of the milestones.
- 6.9. All margin on Internal Costs relating to the successful delivery of the DBT phase is at risk against the DBT milestones, with 20% and 25% of the margin at risk against DM2 and DM3 respectively. The final values that this represents in terms of margin retained will be finalised when all delivery milestones under the DBT phase have been assessed.
- 6.10. DCC submitted evidence that it should retain all associated margin as it had achieved all its milestones.

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<sup>58</sup> Decision on margin and incentives for DCC's role within the Design, Build and Test Phase of the Switching Programme: <https://www.ofgem.gov.uk/publications-and-updates/decision-margin-and-incentives-dccs-role-within-design-build-and-test-phase-switching-programme>

### **Our view**

- 6.11. This year there was no independent view from any external bodies. We are satisfied with the evidence DCC has provided on the completion of its delivery milestones.
- 6.12. **In light of the above, we propose that DCC should retain 20% and 25% of margin associated with DM2 and DM3, respectively.**

## Appendices

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## Appendix 1 – External Costs Assessment

### Key material variances

A1.1. In this Appendix to Chapter 2 (External costs), we provide further context for the drivers of new material costs which DCC justified through its submission. Specifically, these are changes and projects of value over £1m which DCC progressed within the SMETS2 and SMETS1 programmes.

### SMETS2

A1.2. DCC's Fundamental Service Providers (FSPs) comprise the Data Service Provider (DSP) and two Communication Service Providers (CSPs), operating across three communication regions; together, they provide the core communication infrastructure for smart metering across GB and enable DCC users to send and receive message to and from smart meters. The FSP contracts were procured by the government on a competitive basis and are managed by DCC. In RY20/21, DCC incurred £363.8m in FSP costs. DCC justified 10 new material CRs/PRs.<sup>59</sup>

### Release 2.0 (R2.0)

A1.3. Activities undertaken as part of Release 2.0 encompass changes to support the testing and rollout of Dual Band Communications Hubs (DBCHs), and changes to the Technical Specifications and GB Companion Specification (GBCS), which sets out data security and other operational standards for CHs.

A1.4. DCC raised PR1170 with DSP to restart DIT<sup>60</sup> for DBCH between December 2019 and July 2020 that had been paused as a result of limited availability of working devices. This project request followed from PR1089, which had been justified in RY19/20.

A1.5. This project request was also raised with the CSP for the central and south region ("CSP (C&S)") to provide commercial cover for testing of meters from meter manufacturer 2 (MM2).

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<sup>59</sup> For cost breakdown, see Table 2.8 in Chapter 2.

<sup>60</sup> Device Integration Testing

DCC had previously raised PR1153 with CSP (C&S) during a temporary hold on testing of MM2 devices in RY19/20 to ensure resources and knowledge were not lost from the teams and to provide coverage for critical tasks.

A1.6. Under R2.0, DCC also raised CR1407 with the CSP for the north region (“CSP (N)”) to implement an update to GBCS, issued in November 2019 (version 3.2). DCC is required to deliver firmware updates to all comms hubs in line with the GBCS revisions. Under this change, the Service Provider (SP) was required to: design, develop, unit test by comms hub supplier; develop pre-integration testing cases; and support system-integration testing of the latest ‘issue and change resolution proposals’ (modifications to the GBCS), which are listed in Table A1.1 below.

A1.7. DCC incurred £12.46m on R2.0 CRs/PRs, the largest proportion of which was attributed to CR1407.

**Table A1.1: Overview of newly justified CRs/PRs within R2.0**

Material CR/PR	Description	Service Providers Affected
<b>PR1170</b>	Covers R2.0 Dual Band DIT Re-entry validation, testing and associated activities for all 3 Comms Hubs WNC, TOSH and EDM I from the 1st of December 2019 till the end of DBDIT Phase.	<b>DSP CSP (C&amp;S)</b>

Material CR/PR	Description	Service Providers Affected
<b>CR1407</b>	<p>Provides commercial cover for the most recent mandated update to GBCS version 3.2. The new Issue and Change Resolution Proposals (IRP) (CRP) included:</p> <ul style="list-style-type: none"> <li>• <b>IRP514</b> to restrict Future Dated commands being operated by parties other than the Supplier (security requirement)</li> <li>• <b>CRP535</b> to correct the assumed capability of the SMETS2 service that HAN devices can be reintroduced after being removed from that HAN</li> <li>• <b>CRP540</b> to ensure that the HAN network key is updated after a change to any individual HAN (security requirement)</li> <li>• <b>IRP569</b> to set out how comms hubs should handle Network Key changes</li> <li>• <b>IRP538</b> to addresses an anomaly within the ZigBee Cluster Library specification</li> <li>• <b>IRP511</b> to introduce a new event code in the P&amp;C software</li> </ul>	<b>CSP (N)</b>

**November 2020 SEC Release**

A1.8. DCC is required to implement system changes (modifications) to the Smart Energy Code (SEC). DCC raised CR1294 with DSP and CSP (N) to accommodate changes required under the November 2020 SEC Release.

A1.9. DCC explained that this change covered all activities beyond the completion of pre-integration testing (PIT) to the end of the DSP contract (prior to its extension) in October 2021. These activities included: Systems Integration, Integration Testing, Transition to Operations activities, go-live and subsequent operational support. Table A1.2 provides a list of more granular changes wrapped up by CR1294.

A1.10. In total, DCC incurred 5.27m in new costs as a result of these activities.

**Table A1.2: Overview of Change Requests associated with November 2020, incorporated into CR1294**

CR #	CR Title
<b>CR1088</b>	Production Proving
<b>CR1137</b>	SECMP0062. Alert Storm Protection Part 2 - DUIS Interface Changes
<b>CR1118</b>	SECMP0093. DSP-DUIS Changes for GBCS
<b>CR1145</b>	Auxiliary Proportional Controllers.
<b>CR1233</b>	SECMP078. Multiple IRP Resolution
<b>CR1254</b>	Changes to Support Proportional Load Control
<b>CR1277</b>	Completion of CR1164 Change to Install Code Length in 8.11
<b>CR1355</b>	Introduction of new Remote Party Role code of 'XMLSign'

### Enterprise Change

A1.11. *Enterprise Change* includes a number of CRs/PRs relating to various testing activities, as set out in detail in Table A1.3 below.

**Table A1.3: Overview of newly justified CRs/PRs within *Enterprise Change***

Material CR/PR	Description	Service Providers Affected
<b>CR1209</b>	Implements refreshed B-Stream Test Environments UIT-B and PIT-B based on the new technology being used for the refreshed Production and A-Stream test environments.	<b>CSP (N)</b>
<b>PR1243</b>	Relates to the services supplied by the Production Support Team to support SMETS1 and SMETS2 PST, and SMETS2 Soak Testing as part of the Production Proving Test Approach	<b>DSP</b>
<b>PR1267</b>	Initially the commercials for SMETS1 PST were covered by the release CR or PR but have been included in PR1243 since April 2020. PR1267 provides cover for the six (6) months from 1 October 2020 until 31 March 2021.	<b>DSP</b>

Material CR/PR	Description	Service Providers Affected
<b>CR1321</b>	Over the past two years, DSP Testing Services for UIT was covered by CR279 and subsequently CR1287. This CR includes a continuation of UIT Testing Services CR1287, which is to be extended to cover both SMETS2 and SMETS1 and also include support for Migration Device User System Test (MDUST).	<b>DSP</b>

A1.12. CR1209 covered the extension of B-stream test environments used by CSP (N). DCC explained that the 'B-stream' environments are used to test CRs and complete testing of future releases in parallel with ongoing live production support testing in the 'A-stream' environments. The contracts for two B-stream environments (PIT and UIT) were due to expire at the end of June 2020. DCC explained that, under CR1209, it had opted for a 4-year extension of these environments, taking advantage of a wider tech refresh programme undertaken by the SP in the remaining environments.

A1.13. DCC raised PR1243 with DSP to support SMETS1 and SMETS2 Product Support Testing (PST)<sup>61</sup>, and SMETS2 Soak Testing as part of the Production Proving Test Approach. The initial scope of PST was limited to SMETS2 functionality (CR279, CR1287); however, since IOC go-live date in August 2019, it has also included SMETS1 (PR1145, PR1220). PR1243 further included additional comms hub testing on request from DCC, which explained had been made on the basis of a higher number of comms hubs in the live environment following the completion of the Dual Band SIT and UIT, and the anticipation of SBCH<sup>62</sup> GBCS updates. DCC then raised PR1267 with DSP as a continuation of PR1243 with the additional scope of Informal Operational Confidence Testing with the CSPs and RDP testing. Table A1.4 provides an overview of the CRs/PRs covering PST and associated activities up to RY20/21.

<sup>61</sup> PST covers testing of system updates (software or firmware) where the build for that system is already in the Production environment. PST helps DCC to handle defects or fixes to the system without delays to live operation.

<sup>62</sup> Single-Band Comms Hub

**Table A1.4: Summary of historic CRs/PRs relating to Production Support Testing, SMETS2 Soak testing, and additional comms hubs testing (new PRs highlighted)**

Cohort	CR/PR	Scope	Duration
<b>SMETS 2</b>	CR279	PST	RY18/19 (until March 2019)
	CR1287	PST	April 2019 – March 2020
<b>SMETS 1</b>	PR1145	PST	September 2019 – November 2019
	PR1220	PST	December 2019 – March 2020
<b>SMETS 1 &amp; 2</b>	PR1243	PST, SMETS2 Soak Testing, additional comms hub testing	April 2020 – September 2020
	PR1267	PST, SMETS2 Soak Testing, additional comms hub testing, Informal Operational Confidence Testing, RDP testing	October 2020 – March 2021

A1.14. Finally, DCC raised CR1321 to provide cover for enduring DSP UIT service from April 2020 to March 2021. This change covered both SMETS2 and SMETS1, and included support for Migration Device User System Test (MDUST) service. DCC clarified that, while SMETS1 MDUST service was already provided under CR1195, this change increased it to an ‘enhanced service’ to be comparable to the activities provided to Test Participants for DUST.<sup>63</sup>

A1.15. In total, DCC incurred £16.96m in newly justified costs relating to Enterprise Change, of which nearly 75% were driven by the enduring UIT service and the extension of the B-stream testing environments.

### **SM WAN Coverage Database**

A1.16. Under CR1028, DCC sought changes to Arqiva’s WAN coverage database to provide more granular information on postcodes not meeting 7dB noise rise specifications. DCC raised this as an urgent CR, explaining that both DCC and BEIS wanted to act quickly to enable smart meter installations to proceed where technically feasible [in the North region]. According to DCC, the

<sup>63</sup> Device User System Test

impact of not progressing this change would have been to constrain the rollout in the North region, as only 7dB ESMEs<sup>64</sup> could be installed.

## SMETS1

A1.17. The DCC SMETS1 service went live in August 2019, enabling the start of migration of previously dormant meters in the Initial Operating Capability (IOC) cohort. In October 2019 DCC consulted on amendments to the SMETS1 Delivery schedule under the Joint Industry Plan, which revised the testing and go-live dates for the MOC and FOC cohorts.

A1.18. In line with the accepted changes, the key drivers in the SMETS1 programme in RY20/21 were as follows:

- delivery of the Middle Operating Capability (MOC) by end-June 2020 (completion of testing for, and migration and operation of, Secure meters previously managed through the Secure SMSO);
- delivery of the Final Operating Capability (FOC) by end-July 2020 (completion of testing for, and migration and operation of, L+G meters previously managed through SMSOs operated by NPower, British Gas and Trilliant);
- completion of SIT of IOC Aclara devices, which has been delayed as a result of device specific behaviours;
- completion of Device Model Combination Testing (DMCT) of DMCs not tested during SIT phase of the original go-live of each cohort; and
- delivery of *Core Release 1.1* in May 2020, which included changes to the solution as a result of lessons learnt in user testing and in production. These changes related to: auxiliary load circuits, split supplier ID, file sequencing, and EE roaming.

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<sup>64</sup> Electricity Smart Metering Equipment

A1.19. DCC noted that in agreement with BEIS, the delivery plans were non-contingent. When specific technical issues arose during MOC and FOC SIT and migration, additional changes had to be progressed and resource expended to meet the schedule requirements.

A1.20. The following section provides more details on key drivers of external costs in the SMETS1 programme through newly justified material CRs/PRs (with a life value of £1m) across 4 areas of work: core capabilities, IOC, MOC, and FOC.

### **Core Capabilities**

A1.21. DCC raised two change requests relating to SMETS1 core capabilities – as set out in Table A1.5 below. These CRs together contributed £1.70m to the external cost variance.

A1.22. CR1303 introduced improvements to the SMETS1 Migration Control Centre. DCC argued that failure to make these changes would have caused operational risks across the entire SMETS1 Portfolio, and in particular to migration of IOC devices.

A1.23. CR1195 provided cover for MDUST<sup>65</sup> Service in UIT. DCC explained that during its negotiations, it sought to break down specific requirements to make the execution part of the MDUST a 'transaction type of service' and thus achieve value for money. The overall spend on this change was lower than expected as a portion of the charges was covered by CR1321, which provided enhanced MDUST service from April 2020 (see paragraph A1.14).

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<sup>65</sup> MDUST = migration device user system test, a requirement under the Migration Test Approach Document (MTAD), needed to allow completion of E2E migration process

**Table A1.5: Overview of CRs/PRs associated with Core Capabilities**

CR/PR #	Description	SP affected
<b>Core Capabilities</b>		
<b>CR1303</b>	Covers Migration Control Centre improvements and mitigate operational risk across the SMETS1 Portfolio, specific to the IOC Service Providers.	<b>S1SP_1</b>
<b>CR1195</b>	Responds to the request for the DSP to stand up and provide support for a MDUST service in the UIT Environments.	<b>S1SP_1</b>

### IOC

A1.24. Three new change and project requests with the total value of £6.65m were justified under IOC. The costs were driven mainly by CR1181 providing enduring BAU IOC in-life service from the go-live date in August 2019. To secure value for money, DCC explained that during negotiations with the SP, it focused on ensuring that the DSP Asset Register accurately reflected the assets purchased under previous changes in the run up to the go-live date.

A1.25. Secondly, on account of slow migration of the IOC cohort, DCC raised CR1382 to extend 4 migration services: Enhanced Migration Support Service, Requesting Party Service (RPS), Extended cloud-based application support environments, and SMSO Support Service. This extension was initially agreed for 7 months with the option of further extensions on a monthly basis, if required.

A1.26. Thirdly, under PR1134, additional device model combination testing in tranches was provided for DMCs of meters, comms hubs and IHDs, which had been left out of the initial IOC SIT. DCC sought value for money by developing a menu-based pricing, which allowed a time and material charge to be calculated based on the number and type of DMCs that would be tested in each tranche. DCC further clarified how the composition of each tranche changed based on actual requirements, resulting in savings against the originally agreed scope.

**Table A1.6: Overview of CRs/PRs associated with IOC**

CR/PR #	Description	SP affected
<b>IOC</b>		
<b>CR1181</b>	Covers for enduring SMETS1 IOC Service from the first full month of SMETS1 IOC live running	<b>S1SP_1</b>

CR/PR #	Description	SP affected
<b>CR1382</b>	Covers the extension of ending IOC support for a further 7 months, up to and including the end of February 2021, with the option to extend all or any of these services beyond that on a month-by-month basis.	<b>S1SP_1</b>
<b>PR1134</b>	Provides commercial cover for the execution of Device Model Combination Testing (DMCT) and Pending Product Combination Testing (PPCT) for three specific IOC DMC tranches.	<b>S1SP_1</b>

## MOC

A1.27. The MOC area likewise saw three new material CRs/PRs, which together amounted to £4.33m. The costs were driven mainly by CR1196 covering execution of MOC-Secure SIT between January and June 2020, in line with the revised SMETS1 delivery schedule.<sup>66</sup> This change also included a portion of charges agreed under PR1231 that addressed a high number of defects identified during the initial SIT stage by executing two additional end cycles on SIT-B between May and July 2020. DCC argued that additional testing environments were necessary to prevent delays to the completion of SIT exit for the MOC Secure meter cohort by July 2020.

**Table A1.7: Overview of CRs/PRs associated with MOC**

CR/PR #	Description	SP affected
<b>MOC</b>		
<b>CR1196</b>	Responds to the request for DSP to perform detailed execution of System Integration Testing (SIT) for SMETS1 MOC-Secure covering the MOC-Secure meters device cohort.	<b>S1SP_1</b>
<b>PR1231</b>	Cover for MOC Secure Migration Solution Testing, Dormant Meter Readiness Testing and SIT including End of Cycle 1 (EOC1), EOC2 and post TAB work-off activity.	<b>S1SP_1</b>
<b>CR1214</b>	Facilitates PAN card disablement feature support in S1SP to enable Retail Network Service Providers (RNSP) to continue to send messages and maintain and operate that channel for an additional 336 (or x) hours after the device has been migrated.	<b>S1SP_2</b>

<sup>66</sup> MOC-Secure test execution was originally due to commence in May 2019 but was rescheduled due to extended IOC SIT testing and the delay in the availability of the Secure meter cohort.

## FOC

A1.28. The FOC cohort was the most significant driver behind new costs incurred in the SMETS1 programme. DCC raised 8 material change and project requests with a number of providers, with the total combined value of £12.61m. The costs were driven by:

- delays to FOC SIT execution and its subsequent extensions (CR1123, PR1230, PR1232), which together amounted to £5.53m;
- extension of existing support functions on amended timelines, including DCO and SIM migration (PR1160, PR1244), costing £3.06m; and
- need for additional bespoke service, including FOC-specific Private Key Infrastructure and L2 Application Support (PR1225, CR1177), accounting for additional £3.30m.

A1.29. DCC explained that, in comparison to earlier cohorts, FOC is significantly more complex, comprising five DMCs in scope of SIT and an additional DMC in Migration Solution Testing (MST). Due to technical issues arising from these complexities, FOC SIT execution was initially delayed from September 2019 until January 2020 with go-live date re-schedule for 31 July 2020. However, as a result of a high number of defects being detected, DCC elected to move away from a fixed price contract and progressed two extensions on a time and material basis (PR1230, PR1232). The extensions sought to enable the programme to deploy some FOC devices into Production before the end of 2020.

A1.30. Furthermore, the migration design failed for two key FOC SPs. DCC explained its solution which required splitting the FOC delivery work up into the Minimum Viable Product (MVP) and subsequent releases 2.0 and 2.1 covered by new CRs and PRs.

**Table A1.8: Overview of CRs/PRs associated with FOC**

CR/PR #	Description	SP affected
<b>FOC</b>		
<b>CR1123</b>	Covers for the test execution of System Integration Testing (SIT) for FOC.	<b>S1SP_1</b>
<b>PR1230</b>	Cover for FOC SIT testing and associated support, for remaining tests in FOC Stages 1, 2 and 3.	<b>S1SP_1</b>

CR/PR #	Description	SP affected
<b>PR1232</b>	Covers the second extension of FOC SIT (following on from PR1230) and seeks to enable the Programme to deploy some FOC devices into Production before the end of 2020.	<b>S1SP_1</b>
<b>PR1225</b>	Enduring PKI Solution	<b>S1SP_3b</b>
<b>PR1109</b>	Covers for the DSP to support SMETS1 FOC Pre-User Testing Service (UTS).	<b>S1SP_1</b>
<b>CR1177</b>	Covers the Level 2 applications support DXC will be providing in support of FOC	<b>S1SP_3b</b>
<b>PR1160</b>	Provides cover for FOC DCO for the extended delivery timescales as a result of the LC13 re-plan, to July 2020.	<b>S1_DCOa</b>
<b>PR1244</b>	Provides cover for SIM migration for the FOC extended timelines.	<b>S1_DCOa</b>

## Appendix 2 – Internal Costs Assessment

A2.1. DCC’s internal Baseline costs are reported by cost centre. DCC reports separately on Additional Baseline and New Scope costs.<sup>67</sup> Table A2.1 gives an overview of the types of costs associated with each cost centre.

**Table A2.1: Overview of costs associated with each cost centre**

Cost Centre	Functions Include
Corporate Management	<ul style="list-style-type: none"> <li>• Regulatory Affairs.</li> <li>• Corporate Affairs.</li> <li>• Business Improvement and Internal Audit.</li> <li>• Accommodation and Test Labs.</li> <li>• Price Control support for DCC.</li> </ul>
Commercial	<ul style="list-style-type: none"> <li>• Commercial Operations.</li> <li>• Procurement.</li> <li>• Vendor Management.</li> <li>• Contract management.</li> <li>• Relationship management of contracts in DCC’s strategic supply chain.</li> <li>• Meet Price Control needs.</li> </ul>
Finance	<ul style="list-style-type: none"> <li>• Financial Reporting, including responding for producing statutory accounts, price control data, managing annual audit.</li> <li>• Commercial Finance activities, including responsibility for producing and managing financial plans and forecasts of the business.</li> <li>• Regulatory Finance and Pricing activities, including preparing and publishing annual charging statements and indicative budget documents.</li> </ul>

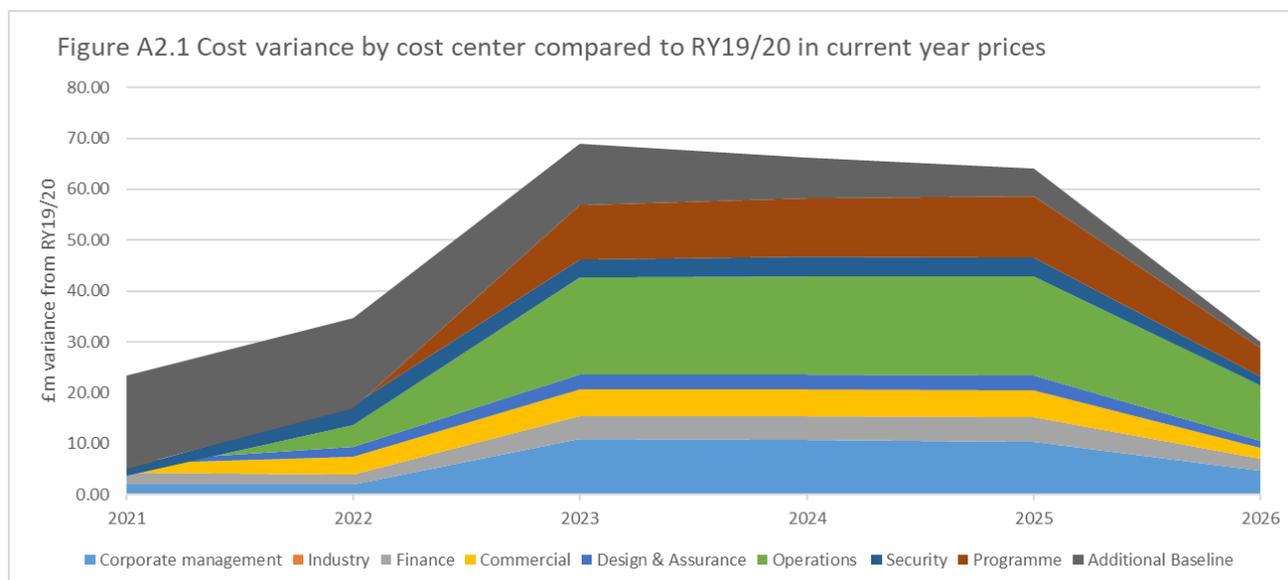
<sup>67</sup> Additional baseline refers to any costs that are associated with requirements that the Licensee was expected to deliver at the time of the licence award, but were not fully costed in the LABP. New scope refers to activity associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence award. The Centralised Registration Service is considered new scope.

Cost Centre	Functions Include
	<ul style="list-style-type: none"> <li>• Finance Transformation and Business Operations activities, including responsibility for ensuring DCC reporting system is maintained and modified, and introducing systems to automate finance processes.</li> <li>• People Team, including ensuring DCC attracts and acquires the talent and expertise required.</li> <li>• Legal team, including supporting DCC with in-house Legal resource and managing relationships with external law firms.</li> </ul>
Operations	<ul style="list-style-type: none"> <li>• Delivers reliable and repeatable service, at scale.</li> <li>• Reports operational performance to DCC’s Customers and Regulatory Parties.</li> <li>• Supports DCC’s focus on customers.</li> <li>• Delivers quality and consistency in Design and Testing Services.</li> <li>• Supports the prioritisation of activity and development effort for DCC through customer insight, process measurement and Industry engagement.</li> <li>• Improves the solutions proposed by DCC through early and effective engagement in the design process.</li> <li>• Protects the margin and reputation of DCC through a focus on service.</li> </ul>
Design and Assurance	<ul style="list-style-type: none"> <li>• Designs the Enterprise Architecture for the DSP re-procurement and Network Evolution comms Hubs.</li> <li>• Works with DCC customers to improve existing ways of working and maximise benefits to be delivered by NEP.</li> <li>• Reviews existing practices, technology and tooling and defines new ways of working to incorporate technology that maximises testing efficiency and quality of deliverables.</li> <li>• Responsible for the design of technical solutions that address new SEC Modifications and Customer-led changes.</li> </ul>

Cost Centre	Functions Include
	<ul style="list-style-type: none"> <li>Responsible for ensuring DCC executes key services and operates to the standards required by DCC’s licence and customers.</li> </ul>
Security	<ul style="list-style-type: none"> <li>Assures the security of all DCC systems.</li> <li>Ensures the platform and new programmes being added to it are secure and meet with Licence and code requirements.</li> <li>Addresses the changing threats to the systems through a risk-based approach in line with industry and regulatory guidance.</li> <li>Provides security assurance to the regulators and DCC customers.</li> </ul>
Service Delivery	<ul style="list-style-type: none"> <li>Accountable for programme delivery, and professional practices of Business Analysis, Test Assurance and Programme and Project Management that support delivery of the change portfolio for DCC.</li> <li>Delivers DCC’s inventory of Programmes.</li> <li>Improves Service Delivery Practice Capability and resourcing approach</li> <li>Increases the maturity and effectiveness of the business analysis capability to support the evolution of the DCC total system.</li> <li>Increases the maturity and effectiveness of the Test Assurance practice.</li> <li>Drives PM performance management via engaging and supportive approach, with clarity of R&amp;R across Programme and Practice.</li> </ul>

A2.2. Figure A2.1 shows the variance over the licence period in Internal Costs by cost centre compared to the RY19/20 forecast, including the Additional Baseline cost. This shows that the increase in costs over the licence period compared to last year’s forecast are concentrated in the Operations, Corporate Management, and Programme cost centres, and Additional Baseline.

**Figure A2.1 Cost variance by cost centre – compared to RY19/20 in current year prices**

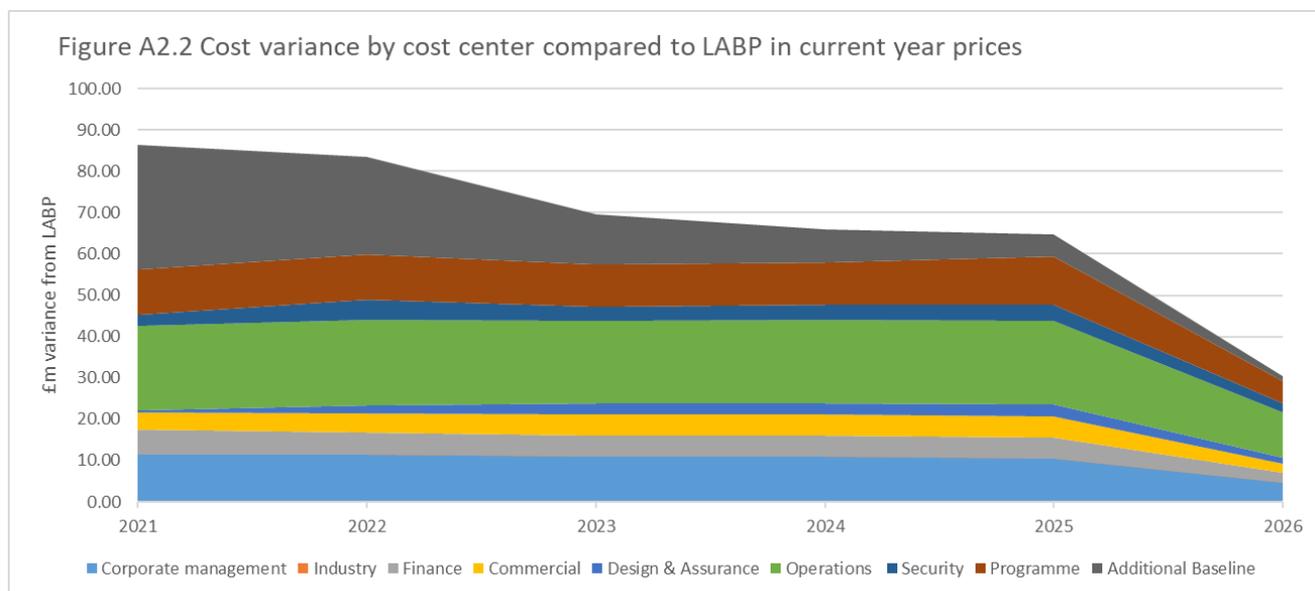


**Figure A2.1: data table**

£m	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	1.97	1.93	10.89	10.75	10.42	4.73
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Finance	2.25	1.90	4.55	4.71	4.74	2.34
Commercial	1.79	3.51	5.15	5.24	5.28	2.20
Design & Assurance	0.42	2.10	2.92	2.87	2.97	1.34
Operations	-2.65	4.13	19.15	19.36	19.38	10.82
Security	1.34	4.01	3.42	3.79	3.78	1.83
Programme	0.26	-0.65	10.89	11.54	12.10	5.59
Additional Baseline	18.06	17.68	11.94	7.87	5.32	1.14

A2.3. Figure A2.2 shows the variance over the licence period in Internal Costs by cost centre compared to the LABP. This shows that the forecast cost variances over the licence period compared to the LABP are concentrated in Operations and closely followed by Corporate Management, and Programme.

**Figure A2.2: Cost variance by cost centre – compared to LABP in current year prices**



**Figure A2.2: data table**

£m	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	12.92	13.04	12.49	12.35	11.91	5.26
Industry	-1.52	-1.48	-1.46	-1.46	-1.46	-0.61
Finance	6.11	5.33	4.97	5.13	5.16	2.51
Commercial	4.24	4.58	5.06	5.15	5.19	2.16
Design & Assurance	0.52	2.02	2.83	2.78	2.88	1.30
Operations	20.33	20.53	19.82	20.04	20.11	11.15
Security	2.71	4.97	3.53	3.71	3.96	2.02
Programme	10.90	10.94	10.24	10.15	11.52	5.34
Additional Baseline	30.15	23.43	12.20	8.14	5.59	1.32

A2.4. Payroll costs are a major driver of Internal Costs across the different cost centres. Table A2.2 summarises DCC’s headcount from RY19/20 to RY20/21 as measured in full time equivalents (FTEs) by cost centre. In RY20/21, there is a 6.8% decrease in FTE compared to the RY19/20 forecast.

**Table A2.2: FTEs by cost centre**

<b>Cost centre</b>	<b>RY20/21</b>	<b>RY19/20 forecast for 20/21</b>
Corporate Management	63.25	67.55
Industry	0.00	0.00
Finance	47.71	48.36
Commercial	34.71	36.73
Operations	178.62	210.98
Design and Assurance	11.90	17.39
Security	19.99	15.70
Programme	77.50	101.56
Additional Baseline	128.97	33.58
New Scope	0.00	0.00
Centralisation registration service	42.32	38.15
<b>Total</b>	<b>604.99</b>	<b>570.00</b>

## Appendix 3 – Proposed Allowed Revenue

Table A3.1. Proposed Allowed Revenue for each year to the end of the Licence term, in £m

Regulatory Year	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
LABP (20/21 prices)	240.269	244.796	241.416	248.234	256.303	108.404
Previous year (20/21 prices)	485.414	441.189	368.480	407.094	448.185	255.969
Submitted AR RY20/21	<b>595.499</b>	<b>454.315</b>	<b>453.073</b>	<b>479.893</b>	<b>511.365</b>	<b>269.582</b>
<b>Cost Disallowances</b>						
<b>External costs</b>						
S1SP_3b enduring costs	0.000	0.000	-5.831	-9.103	-9.332	-9.537
DSP UIT	0.000	-5.600	-12.500	-12.500	-12.500	-12.500
<b>Internal costs</b>						
Baseline forecast internal costs	0.000	0.000	0.000	-66.123	-63.994	-29.984
CRS forecast internal costs	0.000	0.000	0.000	-2.367	-2.367	-2.319
Benchmarking	-0.430	0.000	0.000	0.000	0.000	0.000
Recruitment Costs	-0.279	0.000	0.000	0.000	0.000	0.000
SMETS1 costs RY21/22 and RY22/23	0.000	-6.905	-2.888	0.000	0.000	0.000
Network Evolution costs RY21/22 and RY22/23	0.000	-8.891	-4.155	0.000	0.000	0.000
ECOS costs RY21/22 and RY22/23	0.000	-2.048	-2.072	0.000	0.000	0.000
Product Management team costs	-0.167	-0.491	-0.491	0.000	0.000	0.000
EV Engagement costs	-0.192	-0.280	0.000	0.000	0.000	0.000
Commercial costs	0.000	-1.551	-2.152	0.000	0.000	0.000
Corporate Management costs	0.000	-0.870	-0.407	0.000	0.000	0.000
Finance costs	0.000	-0.209	-0.722	0.000	0.000	0.000
Operations costs	0.000	-1.700	-5.534	0.000	0.000	0.000
Service Delivery (Programme) costs	0.000	-0.739	-0.342	0.000	0.000	0.000
Shared Service Charge	-0.311	-1.781	-1.508	-5.768	-5.660	-2.693
<b>Total cost (internal and external) disallowances</b>	<b>-1.379</b>	<b>-31.065</b>	<b>-38.602</b>	<b>-95.862</b>	<b>-93.853</b>	<b>-57.034</b>
<b>Performance Adjustment Reductions</b>						

Regulatory Year	R20/21	R21/22	R22/23	R23/24	R24/25	R25/26
OPR	0.000	0.000	0.000	0.000	0.000	0.000
CRS performance	0.000	0.000	0.000	-0.013	-0.013	-0.006
Consultation AR excluding BM and ECGS adjustments	<b>594.120</b>	<b>423.250</b>	<b>414.471</b>	<b>384.019</b>	<b>417.500</b>	<b>212.542</b>
<b>Baseline Margin and ECGS adjustments</b>						
BM adjustment (20/21 prices)	0.000	0.000	3.325	0.557	3.374	0.000
ECGS adjustment	0.000	0.000	6.929	1.055	1.111	1.456
Consultation AR with BM and ECGS adjustments	<b>594.120</b>	<b>423.250</b>	<b>424.725</b>	<b>385.632</b>	<b>421.985</b>	<b>213.998</b>

Table A3.2. Total Proposed Allowed Revenue across the whole Licence term

Regulatory Year	Total across Licence term (£m, R20/21 prices)
LABP (20/21 prices)	2106.992
Previous year (20/21 prices)	3860.990
Submitted AR R20/21	<b>4218.000</b>
<b>Cost Disallowances</b>	
<b>External costs</b>	
S1SP_3b enduring costs	-33.803
DSP UIT	-55.600
<b>Internal costs</b>	
Baseline forecast internal costs	-160.101
CRS forecast internal costs	-7.054
Benchmarking	-0.430
Recruitment Costs	-0.279
SMETS1 costs R21/22 and R22/23	-9.793

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Network Evolution costs RY21/22 and RY22/23	-13.046
ECOS costs RY21/22 and RY22/23	-4.120
Product Management team costs	-1.149
EV Engagement costs	-0.472
Commercial costs	-3.703
Corporate Management costs	-1.277
Finance costs	-0.931
Operations costs	-7.234
Service Delivery (Programme) costs	-1.081
Shared Service Charge	-17.721
<b>Total cost (internal and external) disallowances</b>	<b>-317.794</b>
<b>Performance Adjustment Reductions</b>	
OPR	0.000
CRS performance	-0.031
<b>Consultation AR excluding BM and ECGS adjustments</b>	<b>3900.175</b>
<b>BM adjustment (20/21 prices)</b>	
	7.257
<b>ECGS adjustment</b>	<b>10.551</b>
<b>Consultation AR with BM and ECGS adjustments</b>	<b>3917.983</b>

## Appendix 4 – Privacy notice on consultations

### Personal data

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

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

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

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

#### **2. Why we are collecting your personal data**

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

#### **3. Our legal basis for processing your personal data**

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

#### **3. With whom we will be sharing your personal data**

We are not intending to share your personal data with other organisations. We are intending to publish non-confidential consultation responses, including any personal data that may be contained within them.

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

Your personal data will be held for six months after the consultation closes.

## **5. Your rights**

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

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 030 3123 1113.

## **6. Your personal data will not be sent overseas**

## **7. Your personal data will not be used for any automated decision making**

## **8. Your personal data will be stored in a secure government IT system**

## **9. More information**

For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)"