Consultation

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DCC Price Control: Regulatory Year 2021/22

Subject	Details
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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[1] (Licence). Price Control arrangements restrict DCC's revenues to ensure that costs incurred are economic and efficient. The arrangements also place incentives on DCC to counter its monopoly position to deliver higher quality services and performance levels.

DCC submitted its Price Control information (based on the published Regulatory Instructions and Guidance (RIGs[2]) for 1 April 2021 to 31 March 2022) on 31 July 2022. On the same day, DCC also submitted proposals for adjustments to its Baseline Margin and External Contract Gain Share values.

This document includes our review of the DCC's costs for the 2021/22 Regulatory Year and outlines the scope, purpose and questions of the consultation and how you

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

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

Contents

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 2020-21 Regulatory Year (RY20/21) described how DCC ensured full service continuity during the Covid-19 pandemic. In RY21/22, installations of SMETS2 meters returned to almost pre-pandemic levels, with 4.1m SMETS2 meters installed over the Regulatory Year, compared to the 2.5m installed in RY20/21. Additionally, 4.6m SMETS1 meters (both dormant and active) were successfully migrated onto DCC's network during the year, bringing the total number of meters operating on DCC's network to 19m by the end of RY21/22.

DCC further progressed its Network Evolution Programme in RY21/22, carrying out activities relating to the reprocurement of the Data Service Provider (DSP) and procurement of 4G Communications Hubs. DCC also began a Business Accuracy and Finance Transformation programme, aimed at improving planning, forecasting and reporting processes. The Centralised Registration Service (Switching) achieved technical go-live on 21 March 2022, enabling full service go-live on 18 July 2022. RY21/22 was also the first year where DCC's contract management and customer engagement were incentivised under the revised Operational Performance Regime (OPR).

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, and also due to disallowed costs from previous Price Control decisions.

Overall, DCC's total reported costs for RY21/22 are £532.55m. This is a 14% increase in total costs compared to last year's forecasts. However, we note that this is partly due to our RY20/21 Price Control Decision to disallow £31.87m of costs forecast for RY21/22 due to

insufficient justification or certainty. Total costs have fallen by 18% compared to RY20/21, where DCC's total reported costs were £650.28m[3]. Over the Licence term (RY13/14-RY25/26), total costs are now forecast to be £4.5b, 12% greater than last year's forecast.

Cost Assessment

DCC's submission for RY21/22 provided reasonable justification for the majority of costs incurred. However, there were more areas than in previous years where more clarity and justification would have been useful, and we reached out to DCC with a number of clarification questions. We 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:

- **Procurement - Compliance with procurement policy -** DCC operates using an outsourced service model, and procurement is core to its role in delivering its services. Under Internal Costs, DCC procures External Services to provide support, for example short-term technical expertise in meeting regulatory requirements. We are concerned, however, that DCC does not consistently follow its internal procurement policy. A significant number of External Services were procured non-competitively in RY21/22, and we do not have assurance that DCC made the necessary assessments to determine a non-competitive route was the most economic and efficient option. We expect DCC to demonstrate that the most economic and efficient route was chosen for procuring External Services within Internal Costs and Relevant Service Capability[4] within External Costs. We note that in the contract management audit under the OPR the auditor noted this as an area of concern, and recommended DCC improves its approach to market engagement when conducting a tender exercise. This will continue to be an area of significant scrutiny.

[3] In current year prices
[4] Condition 1 of the Licence defines Relevant Service Capability as capability procured (or provided from within the Licensee's own resources) in accordance with Condition 16 (Procurement of Relevant Service Capability) for the purposes of securing the provision of Mandatory Business Services under or pursuant to the Smart Energy Code or the Retail Energy Code (as applicable). The Licence can be found here: https://epr.ofgem.gov.uk/Content/Documents/Smart%20DCC%20Limited%20-%20Smart%20Meter%20Communication%20Consolidated%20Licence%20Conditions%20-%20Current%20Version.pdf

- **Procurement - Planning** – As a monopoly company, it is important that DCC ensures it is achieving value for money on the services it procures. We have identified areas where DCC procures multiple services which appear to be related, but do not have evidence that learnings or outputs from previous procurements are consistently carried forward. We are concerned this results in a 'piecemeal' approach to planning, for example in the case of the Business Accuracy Programme, resulting in possible duplications or lost synergies, and do not have assurance these are achieving value for money. We also expect DCC to manage timelines and risks through sufficient up-front planning and engagement.

- **Cost transparency and customer engagement** – For costs that arise as a result of decisions made through DCC's internal governance processes we expect robust evidence of how DCC has taken customer views into account. We have concerns that DCC's customers have not been able to fully scrutinise costs on key DCC programmes to be able to feed into decisions. We therefore question whether engagement on items where there has been a lack of cost transparency could have been sufficient.

- **Quality of regulatory reporting and evidence** – DCC reports Price Control information to Ofgem in accordance with the Regulatory Instructions and Guidance (RIGs), and it is important that DCC's submission is of sufficient quality. We are concerned that DCC has indicated reporting errors in some areas across different Regulatory Years. We also note that DCC was not always able to provide satisfactory documentation as evidence. We expect DCC to improve the quality of regulatory reporting and be able to evidence decisions, and to provide all required documentation to Ofgem as needed under the Price Control.

- **Shared Service Charge** – We expect DCC to actively ensure it is achieving value for money on Shared Services. We are concerned that DCC may be duplicating services which it should be receiving from Capita under Shared Services, either through a separate contract with Capita, or outsourcing as an additional External Service. We will engage with DCC to assess the services it should be receiving as part of the 9.5% Shared Service Charge to Capita, as we are concerned it is no longer delivering value for money. Additionally, as in previous years, for activities which were not fully costed at the Licence Application Business Plan (LABP) stage (eg SMETS1 and Network Evolution Programme) 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.

For the cost assessment itself, subject to further evidence, our position is that £7.91m from DCC's Internal Costs in RY21/22 are Unacceptable Costs.[5] This comprises costs associated with DCC's Business Accuracy Programme; contractor benchmarking; costs related to Electric Vehicles and non-mandated activities; and expenditure on External Services which have not been evidenced as economic and efficient. Additionally, subject to further evidence, our position is that a portion of DCC's External Costs in RY21/22 are Unacceptable Costs, comprising costs associated with DCC's programme delivery. Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed disallowance in External Costs has been redacted. DCC will be provided with details of the proposed disallowance and, as part of the consultation response, will be able to provide further justification. Stakeholders can get in touch with us if they require further information, and we can discuss available options for stakeholders to provide an informed response.

In addition, we are minded to disallow a total of £35.85m in forecast Internal Costs for RY22/23 and RY23/24, and a further £133.82m increase in its baseline forecast Internal Costs over RY24/25 to RY25/26 (the remaining term of the Licence) because DCC has not justified these costs. We are also minded to disallow £38.875m of forecast External Costs in RY22/23, £26.913m in RY23/24 and further £46.830m until the end of the Licence period due to reporting errors and insufficient justifications.

DCC is able to provide further evidence and justification as part of its consultation response and we are open to revising downward the proposed disallowance at the decision stage. Any costs that we ultimately decide were not economically and efficiently incurred may either be excluded from the future calculation of Allowed Revenue or be subject to an undertaking about DCC's future management.

[5] 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.

Performance Incentives

All of DCC's margin is at risk against its performance. This is the fourth year in which DCC's performance is being assessed under the Operational Performance Regime (OPR), and the first year in which both customer engagement and contract management are incentivised against the revised OPR, which came into effect in April 2021. RY21/22 is a transition year for the system performance incentive, and DCC was assessed against the previous OPR on system performance metrics.

We are proposing that £5.36m of DCC's Baseline margin should be retained, out of an available £6.76m. This corresponds to a reduction of £1.40m, and comprises:

- A reduction of £0.53m in system performance. DCC did not meet the SUM1 target (DCC service desk) due to failure in meeting contractual incident timescales, and did not meet the SDM2 target as "service request: Alert performance" did not meet the required target performance level
- A reduction of £0.54m as a result of DCC's performance in customer engagement, corresponding to a total score of 1.42 awarded (out of a possible 3) for the customer engagement incentive
- A reduction of £0.34m due to DCC's performance in the contract management incentive, corresponding to a total score of 1.33 (out of a possible 2) awarded for DCC's performance. DCC's contract management was assessed by an independent auditor against a modified version of the National Audit Office (NAO) contract management framework and the scope set out in the OPR Guidance.[6]

The Baseline Margin Project Performance Adjustment Schemes (BMPPAS) enables the Secretary of State to create incentive regimes for specific projects. In RY21/22, there were no Projects to be assessed under the BMPPAS regime.

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

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 £13.27m adjustment to its Baseline Margin (BM) for increases in the volume and complexity of work, changes to timescales, or increased cost certainty of activities. DCC identified 8 drivers this year, all of which were identified by DCC in previous submissions. DCC did not raise any new grounds this year.

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

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

Taking all of these disallowances into account, we are minded to amend DCC's application to an adjustment of £6.97m between RY21/22 and RY23/24, a decrease of £6.30m from the application. A significant proportion of BM reduction due to cost disallowances is due to forecast cost disallowance for RY22/23 and RY23/24. If these forecast costs are justified in future Price Control submissions, DCC will be able to keep the Baseline Margin associated with these costs.

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 £35.10m across RY21/22 to RY25/26. This adjustment partly relates to the continuation of re-financing arrangements and the financing of Communication Hubs (CHs), and also included savings from DCC's in-house test lab service at Brabazon House. We propose to accept DCC's ECGS Adjustment application of £11.89m relating to re-financing arrangements, most of the savings relating to the financing of CHs, and realised savings from DCC's in-house test lab service. However, we are minded to reject £23.21m of DCC's proposed Relevant Adjustment relating to:

- The forecasted savings expected to be made on the in-house test lab service, as the savings are not yet certain to be achieved
- The proportion of DCC's proposed Relevant Adjustment which stemmed from a temporary increase in the unit price of CHs above what was stipulated in the standard contractual terms, as this has slightly inflated the savings used to calculate the Relevant Adjustment to the ECGS term

Between RY15/16 (DCC's first ECGS Adjustment application) and RY21/22 (including this year's application), DCC has secured cost reductions of £249.40m, relating to savings in in the FSP contracts, CHs financing and DCC's test labs; and brought benefits of £142.2m (c.57% of total cost reductions) to DCC's customers (based on DCC's ECGS applications).

Switching Programme

DCC plays a central role in delivering the Switching Programme, established to improve consumers' 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 RY21/22 as economic and efficient. However, we propose to disallow DCC's forecasts for RY23/24 onwards (£8.636m) as DCC has not provided sufficient justification for these costs. There is also not sufficient information on how these costs align with the costs associated with delivering the new switching arrangements, given the Switching Programme went live in July 2022.

In addition, the fourth of the delivery milestones under the Design, Build and Test (DBT) Phase of the Switching Programme occurred in RY21/22. As this milestone was achieved, we propose that DCC should retain all margin associated with this milestone, which corresponds

to 10% of the total margin at risk against the Switching Programme. The final value this represents will be finalised when all milestones under the DBT phase have been assessed.

Over recovery of revenue

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.

A penalty interest rate regime was introduced in RY16/17 to incentivise DCC to improve the accuracy of its charges to users and deter it from over-recovering. The threshold for over-recovery of service charges is equal to 110% of Allowed Revenue.

For RY21/22, the ratio of Regulated Revenue (£563.9m) to Allowed Revenue (£499.7m) is 113% – above the 110% threshold, for which DCC did not provide enough justification. In accordance with the Licence, we are proposing to apply the penalty interest rate of 3% above the Bank of England base rate against the amount that has been over-recovered.

Next steps

We welcome your views, and will consider them when we make our decision. Please send responses to DCCregulation@ofgem.gov.uk by 29 December 2022. We will publish our decision in February 2023.

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 2021/2022 (RY21/22) 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).[7] Our guidance document, published in July 2022, sets out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient.[8]

1.2. We know that 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 RY21/22.[9] This additional information should be helpful to stakeholders in responding to this consultation.

1.4. A stakeholder meeting will also be held in December 2022 to provide DCC's customers and other key stakeholders an opportunity to explore the issues highlighted in this consultation with both Ofgem and DCC.

[7] DCC's redacted LABP can be found at: www.smartdcc.co.uk/media/6531/redacted-labp-marked-public-151021.pdf
[8] Ofgem (20220), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[9] DCC's redacted Price Control submission can be found at: www.smartdcc.co.uk/about/price-control/

1.5. The content of each section of this document is summarised below, along with the questions to which we are seeking your response.[10]

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 RY21/22, 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), SMETS1 and ECOS service providers, for RY21/22, 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 disallow a portion of External Costs associated with programme delivery?

Question 2: What are your views on our proposal to remove from the forecasts all costs associated with 'CSP-C&S price support' from RY22/23? Do you have any views on the issue of Working Capital Charges?

Question 3: What are your views on our proposal to disallow £108.22m of forecast External Costs?

Question 4: Have you got any other views on External Costs?

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 RY21/22 and DCC's

[10] Please note some figures throughout the document might be revised following further engagement with DCC to quality assure the relevant models for any potential mathematical errors

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

Question 6: What are your views on our proposal to disallow costs associated with non-competitive procurements where we have not received satisfactory justification or evidence?

Question 7: What are your views on our proposal to disallow the costs of the Order Management System, Customer Engagement Portal and the Executive Leadership Programme?

Question 8: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

Question 9: What are your views on our proposals on the Shared Service Charge?

Question 10: What are your views on our proposal to disallow costs associated with the product management team, DCC's work on EVs and additional products?

Question 11: What are your views on our proposal to disallow forecast cost variances in RY22/23 and RY23/24 in the Corporate Management (including Policy and Markets team), Finance & People, and Operations cost centres, and the Network Evolution, SMETS1, and ECoS programmes; and all baseline forecast costs for RY24/25 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. For the first time DCC's contract management and customer engagement has been incentivised by Ofgem under its OPR incentive scheme.

Question 12: What are your views on our proposed position on DCC's System Performance?

Question 13: What are your views on our proposed position on DCC's Contract Management?

Question 14: What are your views on our proposed position on DCC's Customer Engagement?

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

Question 16: 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 fourth incentivised milestone for the Design, Build and Test phase of the programme.

Question 17: What are your views on our proposed position on DCC's costs associated with the Switching Programme?

Question 18: What are your views on our assessment of Delivery Milestone 4 of the Switching Programme?

Section 7: Over-recovery of revenue

1.12. The penalty interest rate regime was introduced in RY16/17 to incentivise DCC to improve the accuracy of its charges to users and deter it from over-recovering. This

section reports on DCC's performance in RY21/22, examines DCC's justifications for over-recovery, and sets out our view.

Question 19: What are your views on our proposal on DCC's over-recovery of revenue?

Related Publications

1.13. 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

1.14. The DCC Regulatory Instructions and Guidance 2022 is at: www.ofgem.gov.uk/publications/data-communications-company-dcc-regulatory-instructions-and-guidance-2022

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

1.16. Last year's Consultation Document is at: www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021

1.17. Last year's Decision Document is at: www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021

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

DCC's summary of RY21/22

1.19. In its submission, DCC provided an overview of its key activities during RY21/22 and the factors which drove the overall level of activity and spending across the organisation.

1.20. In RY21/22, DCC continued to progress in delivering its core programmes including SMETS2, SMETS1, Network Evolution and the Faster Switching programme. DCC highlighted the following achievements during RY21/22:

- Hosting over 19m smart meters in 11m homes across the UK
- Installing 4.1m SMETS2 and migrating 8.4m SMETS1 across the DCC network
- Successfully achieving the Switching technical go-live date and initiating Transition Stage 1
- Progressing procurement activity for the 4G equipment and services under the Network Evolution Programme and Communications Hub and Network
- Reducing Fixed Alt Han Charges for customers down to nil for the final five months of RY21/22
- Delivering contract negotiations with CGI, Capgemini, DXC and Vodafone with a total of over 100 procurement activities

DCC identified a number of key themes in its submission that summarise its work through the year:

- **delivering core services:** DCC state it progressed well with the deliverance of its core programmes and services. DCC recognises it has reached its capacity to migrate 50,000 smart meter installations per day which would benefit end consumers.

- **new products and services:** DCC has developed DCC Boxed which is intended to provide a flexible toolset that can be utilised by different DCC customers. The DCC Test Lab has built new infrastructure allowing users to test the capability within the lab before deploying it to their production Communications Hubs.

- **managing contractors**: For the first time, DCC's contract management approach has been incentivised by Ofgem under its OPR incentive scheme. DCC has stated it is committed to ensuring that the delivery of contractor services is to a high standard whilst taking place in a timely and cost-efficient manner. DCC has set processes and has put in place levers to manage its existing and future contracts.

- **customer engagement:** Over the last 12 months, DCC state to have placed greater emphasis on demonstrating it is actively listening to its customers. It has redesigned the Quarterly Finance Forum and implemented standardised customer engagement processes for DCC change activities. DCC has embedded these changes which should improve the quality and consistency for customers. DCC's customer engagement activities are also directly incentivised by Ofgem under the OPR scheme.

- **prioritising the future:** As outlined in the Business Development Plan, DCC's main priority remains the roll-out of smart meters across Great Britain. DCC states it will continue to support the roll-out while maintaining a stable, reliable, secure and cost-effective service for consumers.

Summary of DCC costs

DCC RY21/22 Costs

1.21. Overall, DCC's total reported costs for RY21/22 are £533m. Excluding pass-through costs,[11] the figure is £508m.

1.22. This is a 14% increase in total costs incurred in RY21/22 compared to last year's forecasts (or a 18% increase with pass-through costs excluded). Table 1.1 shows how the main cost categories in RY21/22 compare to the forecasts of DCC's RY20/21 submission.

[11] 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).

Table 1.1: RY21/22 reported costs compared to RY20/21 forecast in current year prices

	RY20/21 forecast (£m)	RY21/22 (£m)	Variance (£m)	Variance (%)
Total External Costs	339	378	39	12%
Total Internal Costs (excl. SS)	73	96	23	32%
CRS total costs (excl. SS)	12	25	13	108%
Total Shared Services cost (for Internal Costs and CRS)	6	8	2	33%
Total Costs excl. Pass-Through Costs	430	508	78	18%
Pass-Through Costs	39	25	14	36%
Total Costs	**469**	**533**	**64**	**14%**

1.23. The greatest percentage change in the variance comes from the Centralised Registration Service (CRS) – the Switching programme. The Switching programme increased by 108% between the reported costs in RY21/22 and RY20/21 forecast. The CRS was also the greatest variance percentage change in the previous regulatory year. Notably, total Internal Costs and pass-through costs increased by 32% and 36% respectively between the reported costs in RY21/22 and RY20/21 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 £650m in RY20/21, before decreasing in RY21/22 and rising again towards the end of the Licence term.

Figure 1.1: Trends in DCC's costs (£m, 21/22 prices) in current year prices

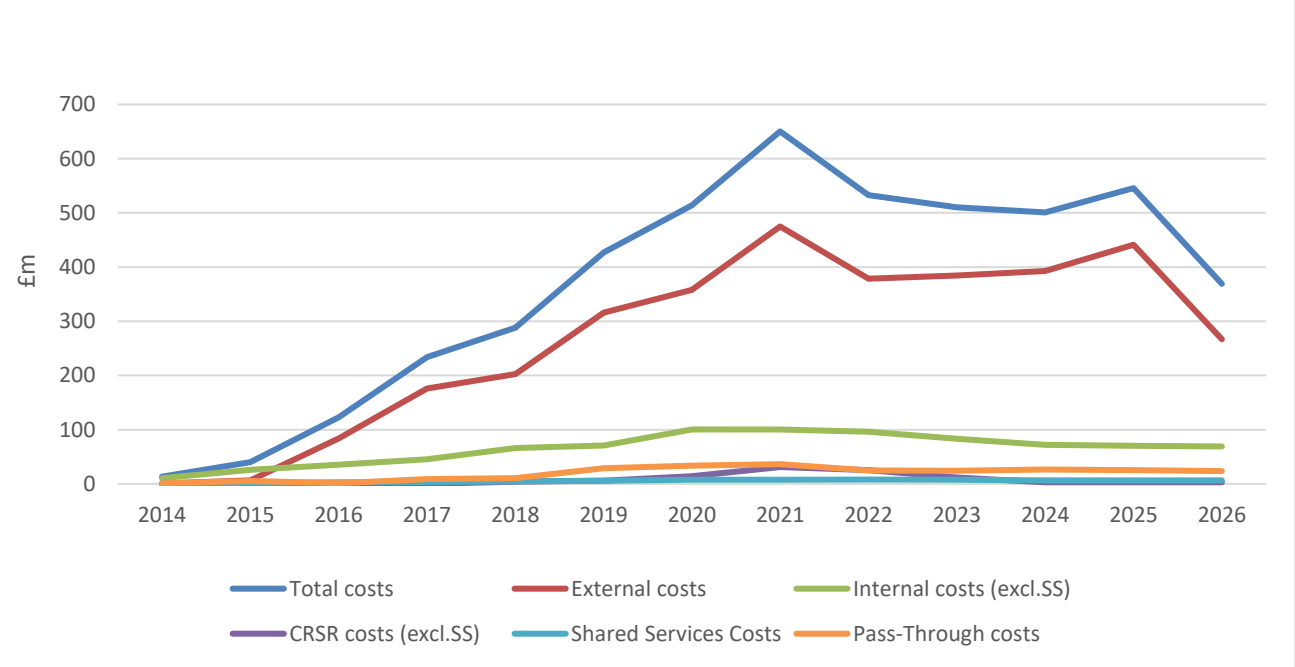


Figure 1.1: Data Table[12]

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Total costs	**13.3**	**40.1**	**123.1**	**233.9**	**288.1**	**426.9**	**513.8**	**650.3**	**532.6**	**510.4**	**501.0**	**545.8**	**368.8**
External costs	0.7	6.7	83.6	176.1	202.3	315.7	358.1	474.9	378.5	384.3	392.9	441.4	267.1
Internal Costs (excl. SS)	10.5	25.9	35.4	45.4	65.8	70.8	100.3	100.3	96.0	83.3	72.2	70.1	69.3
CRSR costs (excl.SS)	-	-	-	-	4.3	5.9	14.2	31.0	25.4	11.5	2.9	2.9	2.8
Shared Services costs	0.8	1.9	2.8	3.5	4.9	5.8	7.7	7.8	7.9	7.4	6.5	6.3	6.2
Pass-Through costs	1.4	5.5	1.3	8.9	10.7	28.7	33.5	36.4	24.7	24.0	26.5	25.1	23.3

[12] Totals may not add up due to rounding

1.25. DCC's latest forecast for total costs over the Licence period (RY13/14-RY25/26), as contained in its submission, is £4.75b. Excluding pass-through costs, its forecast for costs over the Licence period is £4.50b.

1.26. This is a 13% increase in total costs compared to last year's forecasts (and a 14% increase with pass-through costs excluded) over the Licence period. Table 1.2 breaks this down by type of cost, and shows how the costs reported in the RY21/22 submission have changed compared to last year's forecast over the Licence period.

Table 1.2: RY21/22 forecast and variation compared to RY20/21 forecast over the Licence period (RY13/14-RY25/26) in current year prices

	RY20/21 forecast (£m)	RY21/22 (£m)	Variance (£m)	Variance (%)
External - Baseline	1,769	1,849	80	5%
External – New Scope	1,428	1,633	205	14%
Total External Costs	**3,198**	**3,482**	**284**	**9%**
Internal – Baseline (excl. SS)	561	787	226	40%
Internal – New Scope (excl. SS)	59	59	0	0%
Total Internal Costs (excl. SS)	**620**	**846**	**226**	**36%**
CRS (excl. SS)	71	101	30	42%
Total Shared Services cost (for Internal Costs and CRS)	50	69	19	38%
Total Costs excl. Pass-Through Costs	**3,938**	**4,498**	**560**	**14%**
Pass-Through Costs	271	250	-21	-8%
Total Costs	**4,210**	**4,748**	**538**	**13%**

1.27. External Costs over the Licence period have increased by 9% compared to the RY20/21 forecast to £3.482b. 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 excluding Shared Services have increased by 37% over the Licence period compared to last year's forecast, from £620m to £846m. This is largely

driven by increases in additional Baseline Costs, Corporate Management and Operations 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 in 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. The LABP comparison also allows us to ensure costs are economic and efficient.

1.30. Figure 1.2 shows how the main cost categories in RY21/22 compared to the forecast at LABP. In aggregate, costs are £2.594b, or 120% higher over the Licence term compared to DCC's forecast as part of the bid.

Figure 1.2: Comparison of RY21/22 costs to LABP in current year prices

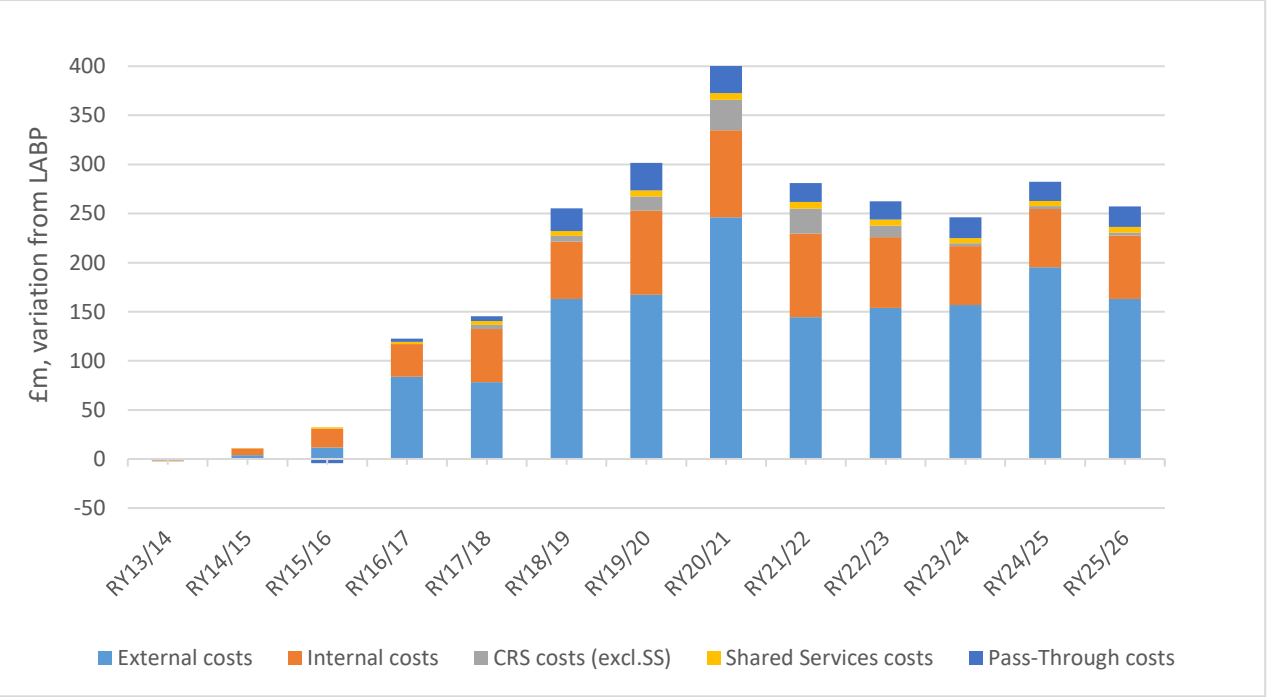


Figure 1.2: Data Table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
External costs	0.7	3.8	11.8	83.8	78.4	162.9	167.2	246.3	144.6	153.9	156.7	195.3	162.9
Internal Costs	(1.7)	7.0	19.3	33.3	53.9	58.6	85.8	88.7	84.9	72.2	60.1	59.2	64.8
CRS costs (excl.SS)	-	-	-	-	4.3	5.9	14.2	31.0	25.4	11.5	2.9	2.9	2.8
Shared Services costs	(0.2)	0.1	1.3	2.3	3.8	4.6	6.3	6.7	6.8	6.3	5.3	5.2	5.8
Pass-Through costs	(0.4)	(0.1)	(4.3)	3.3	5.1	23.2	27.9	30.8	19.1	18.4	21.0	19.5	21.0

Comparison to last year's forecast

1.31. Figure 1.3 shows how the main cost categories in RY21/22 compare to the forecast created as part of DCC's RY20/21 submission.

1.32. Overall, costs are £538m higher over the Licence term compared to the forecasts in DCC's RY20/21 submission.

Figure 1.3: Comparison to RY20/21 forecast in current year prices

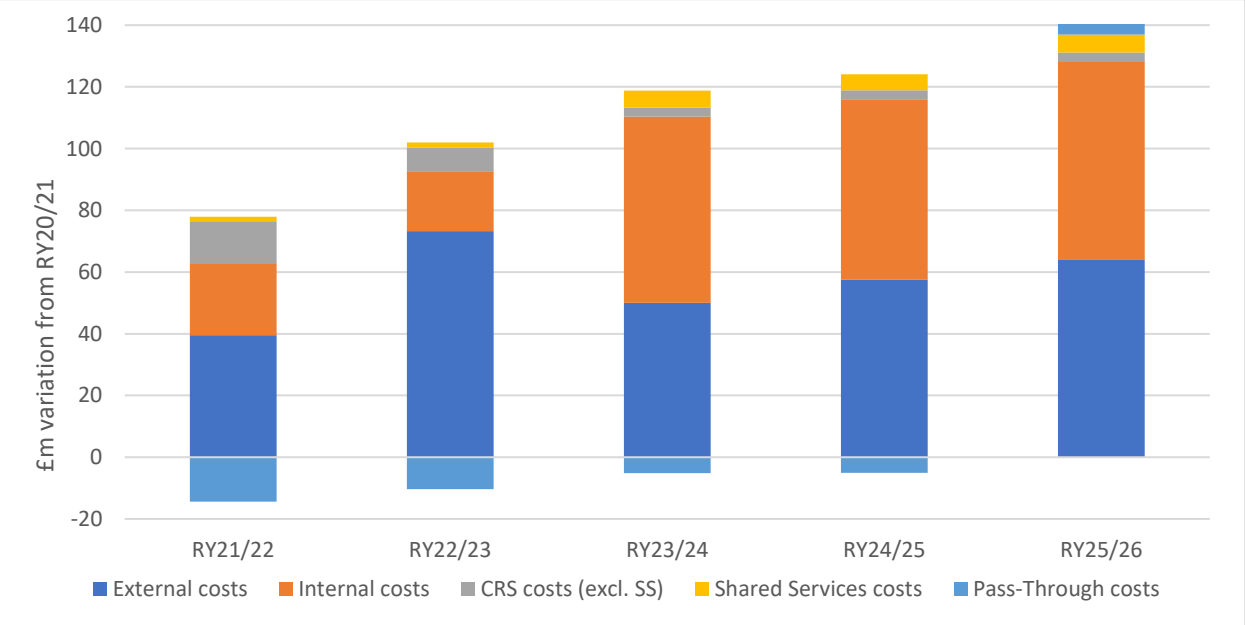


Figure 1.3: Data table

£m	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
External costs	39.6	73.2	50.0	57.5	64.0
Internal Costs	23.3	19.3	60.4	58.4	64.4
CRS costs (excl. SS)	13.6	7.8	2.9	2.9	2.8
Shared Services costs	1.4	1.7	5.5	5.2	5.8
Pass-Through costs	(14.4)	(10.3)	(5.2)	(5.1)	13.1

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.[13] Detailed information on Allowed Revenue, Regulated Revenue, and DCC's Charging Statement can be found in the RY15/16 Consultation Paper.[14]

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.[15] 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.

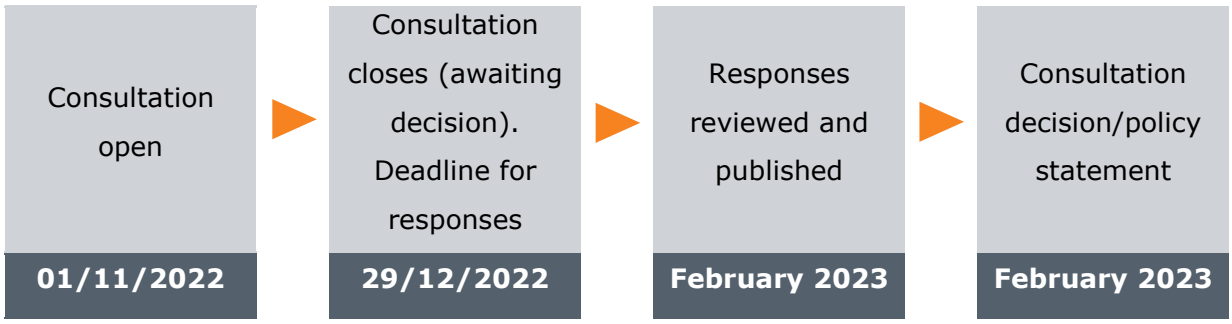
1.35. DCC over-recovered revenue from customers by 113% in RY21/22, which is above the 110% threshold. In RY20/21, DCC over-recovered revenue by 108%. In RY19/20, the over-recovered revenue value was 109%.

[13] See LC 36.4
[14] Ofgem (2016), DCC Price Control Decision: Regulatory year 2015/16. www.ofgem.gov.uk/publications-and-updates/dcc-price-control-decision-regulatory-year-201516
[15] Modification of the Smart Meter Communication Licence (2016): www.ofgem.gov.uk/system/files/docs/2016/05/decision_to_modify_smart_meter_communication_licence_for_dcc_penalty_interest_rate_web_version.pdf

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.

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

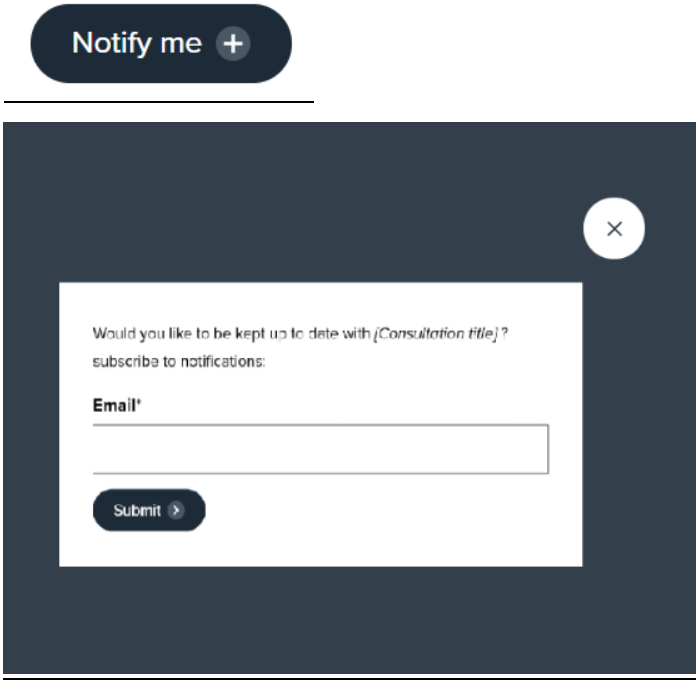
1.44. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

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?

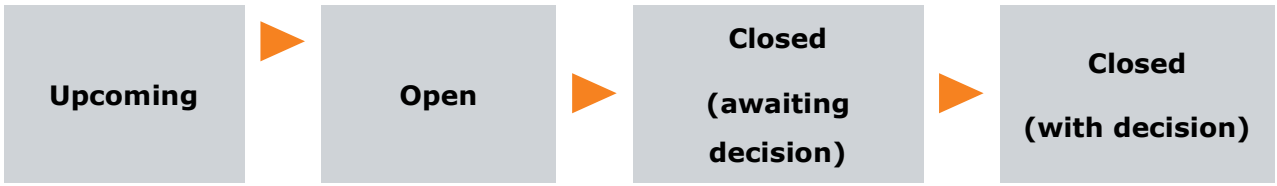
Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

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



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



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 ~71%. This chapter provides an overview of DCC's External Costs in RY21/22, both incurred and forecasted, and our assessment of DCC's submission and justification.

We propose to disallow a portion of External Costs associated with programme delivery. At present, we do not view these costs as being justified as 'economic and efficient'.[16]

We propose to reject a portion of DCC's External Contract Gain Share (ECGS) application associated with the price increase in communications hubs owing to a 'price support' agreement DCC concluded with CSP-C&S. We also propose to remove from the forecasts all costs associated with the price support from RY22/23.

Furthermore, we are minded to disallow £108.22m of forecast costs on the grounds of insufficient evidence and uncertainty.

Through our analysis we have identified a number of issues of concern and areas for improvement, including: a drop in the quality of DCC's regulatory reporting, ongoing issues in programme delivery, effective contract management, customer engagement, and driving effective competition. We expect DCC to make improvements across the board.

[16] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed disallowance has been redacted. For more information please see paragraph 2.44 in chapter 2.

Questions

Question 1: What are your views on our proposal to disallow a portion of External Costs associated with programme delivery?

Question 2: What are your views on our proposal to remove from the forecasts all costs associated with 'CSP-C&S price support' from RY22/23? Do you have any views on the issue of Working Capital Charges?

Question 3: What are your views on our proposal to disallow £108.22m of forecast External Costs?

Question 4: Have you got any other views on External Costs?

What are External Costs?

2.1. External Costs form a part of DCC's Allowed Revenue (~71% of total costs in RY21/22). These costs are incurred by DCC's Fundamental Service Providers (FSPs) as well as other service providers delivering more recent SMETS1, Switching and Enduring Change of Supplier (ECoS) programmes. DCC's key role is to effectively manage these service providers under its contracts to derive value for money and quality service for its customers.

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

2.3. The SMETS1 service comprises several components provided by a number of providers:

- SMETS1 Service Providers (S1SPs) translating DCC format service requests into a format that SMETS1 meters can understand (in effect acting as upgraded SMSOs[17])

- Dual Control Organisation (DCO) software enhancing security arrangements of the SMETS1 solution

- Communications Service Providers (S1 CSPs) whose network allows DCC to communicate and control the SIMs in each comms hub

- In addition, the Commissioning Party service enables smart metering systems, which have been successfully migrated to DCC, to be set up as 'commissioned'

2.4. In RY21/22 two new service providers were appointed following a competitive bidding process run by DCC to be responsible for the following roles in the ECoS programme:

- Design, build and test of the ECoS arrangements and their integration into the DCC system including communication with the CSS[18]

- Hosting services and service management

Table 2.1: Overview of DCC's new contracts with ECoS service providers

Role + Capacity	Provider	RY of contract
Technical Application Service	CSW	21/22
Hosting Services and Service Management	Accenture	21/22

2.5. Table A1.1 in Appendix 1 provides an overview of DCC's main contracts with the FSPs, SMETS1 and ECoS service providers, their roles and the years of their contract.

[17] Smart meter system operators
[18] Centralised Switching Service

How have External Costs changed?

2.6. Over the course of RY21/22, DCC incurred approximately **£398.9m** in External Costs. Table 2.2 shows a breakdown for each programme.

Table 2.2: Breakdown of External Costs incurred in RY21/22

Programme	Costs incurred in RY21/22 in [£m][19]
SMETS2 – core	282.6
SMETS1	94.3
Switching	20.1
ECoS	1.9
TOTAL	**398.9**

2.7. In this chapter we focus on FSPs, SMETS1 service providers and ECoS service providers, which together incurred **£378.49m** in External Costs. This represents a **20% decrease** on last year. RY21/22 is the first year in which the total External Costs have decreased compared to the total External Costs incurred in the previous year. Nevertheless, as set out in table 2.3, External Costs have **increased**, both in RY21/22 and over the full Licence term, **relative to RY20/21 and LABP forecasts**.

2.8. Compared to the forecast accepted under last year's Price Control adjusted for inflation, External Costs are 12% higher in RY21/22 and 9% 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 68% higher in RY21/22 and 82% higher over the full Licence term.

Table 2.3: External Costs variance compared to RY20/21 and LABP forecasts (adjusted for inflation)

	Variance in RY21/22		Total variance over the full Licence term	
	£m	%	£m	%
From RY20/21 forecast	39.56	12%	284.29	9%

[19] Please note that these are approximate values and may not add up due to rounding.

From LABP forecast	144.57	62%	1,568.15	82%

2.9. The variance of 9% in total External Costs across the Licence period translates into a growth of over £284m. Figure 2.1. shows the variance in forecast External Costs per RY.

Figure 2.1: External Cost Variance across the whole Licence period

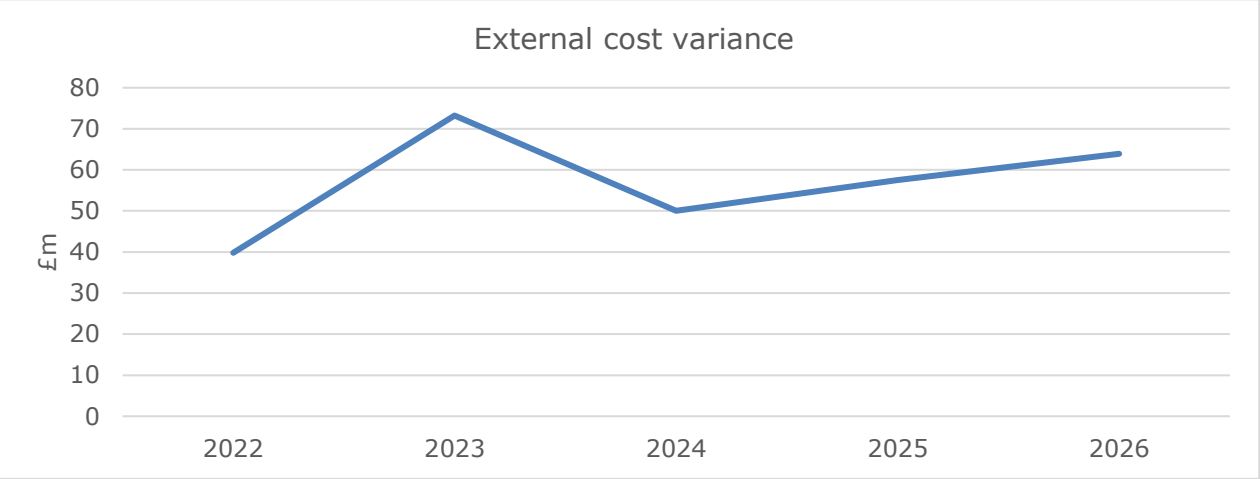


Figure 2.1: Input table

Reg. year	21/22	22/23	23/24	24/25	25/26
Variance (£m)	39.56	73.23	50.01	57.54	63.95

2.10. As illustrated in Figure 2.2, the relative increase in External Costs in RY21/22 on last year's forecast is driven mainly by DSP costs, which account for c.80% of the total variance. There were also increases in the projected CSP costs and the costs of SMETS1 service providers. Together with the new ECoS costs, these accounted for the remaining 20% of the total variance.

Figure 2.2: External Cost variance breakdown in RY21/22

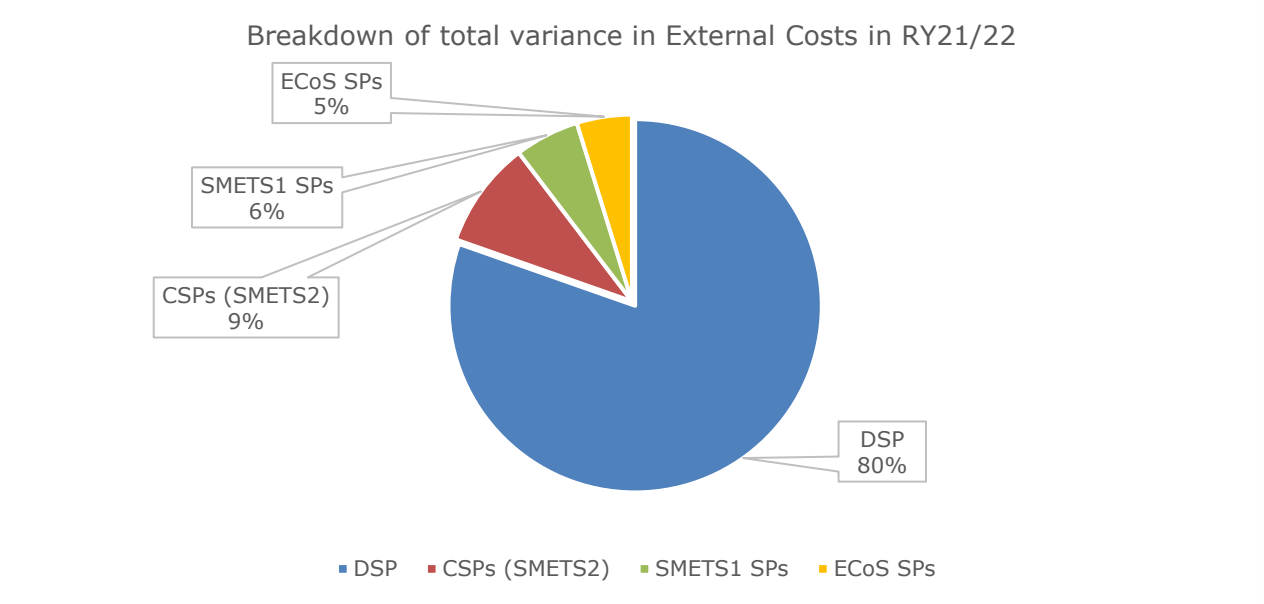


Figure 2.2: Input table

	DSP	CSPs (SMETS2)	SMETS1 SPs	ECoS	Total
Variance from RY20/21 in [£m] (inflation adjusted)	31.792	3.665	2.212	1.887	39.556
As % of total variance	80%	9%	6%	5%	100%

2.11. Table 2.4 provides further details on how costs have changed for DSP, CSP and SMETS1 service providers, compared to last year's forecast (adjusted for inflation). In RY21/22, the biggest increase was in the DSP costs at c.55% increase on last year's projection.[20]

Table 2.4: Cost variation by FSPs and SMETS1 SPs compared to RY20/21 forecast (adjusted for inflation)

Service providers	Variance in RY21/22	Over the Licence term
DSP	55%	20%
CSP-N	3%	3%

[20] Note that while ECoS variance has been included in Figure 2.2 [pie chart] to illustrate total variance for RY21/22, it has been excluded from table 2.4 as it is a new External Cost category for RY21/22 and thus had no specific forecast in DCC's submission for RY20/21 to compare against.

Service providers	Variance in RY21/22	Over the Licence term
CSP-C	-3%	1%
CSP-S	6%	3%
SMETS1	3%	19%

2.12. When looking at the variance in forecast costs to the end of the Licence term, we observe a 20% increase in DSP costs, closely followed by a 19% increase in SMETS1 costs. Figure 2.3 shows how DSP, CSPs, SMETS1 and ECoS service providers contribute to the forecast variance in External Costs in each year. While DSP costs are expected to continue to be the principal driver of change in External Costs in RY22/23, from RY23/24 DCC forecasts that the costs of SMETS1 service providers will have a more significant impact on cost variation. We discuss the main drivers of these costs in turn below.

Figure 2.3: External Cost variance across the whole Licence period

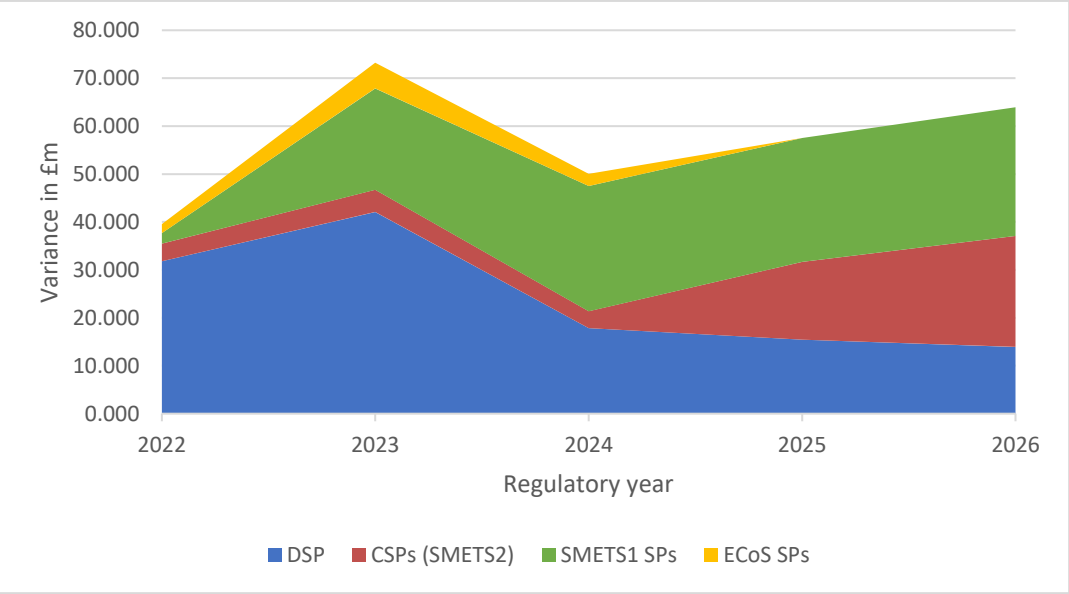


Figure 2.3: Input table

Variance in each reg. year in [£m]	21/22	22/23	23/24	24/25	25/26	Total variance
DSP	31.792	42.063	17.819	15.472	13.936	**121.081**
CSPs (SMEST2)	3.665	4.661	3.537	16.173	23.157	**51.192**
SMETS1 SPs	2.212	21.121	26.159	25.900	26.860	**102.252**
ECoS SPs	1.887	5.384	2.495	-	-	**9.766**
Total variance	**39.559**	**73.228**	**50.011**	**57.545**	**63.952**	**284.292**

DSP costs

2.13. DSP costs drive the majority of variance in both a year-on-year comparison and the forecast for the remainder of the Licence. New DSP costs in RY21/22 were driven primarily by:

- Newly justified material SMETS2 change requests and project requests relating to the DSP role in testing services, November 2021 SEC Release, SI Release Management and DSP extension[21]
- Newly justified SMETS1 change and project requests[22]
- Switching programme costs[23]
- Renegotiated costs for ongoing operational support for all DSP change
- A financial adjustment in the cost of sales following findings of an internal audit
- Other costs below the materiality threshold, including variance on previously justified CRs and PRs, the impact of indexation on Fixed Operational Charges and updated costs of User Integration Testing (UIT), among others

2.14. In addition to the year-on-year increase, the variance over the full Licence term is driven primarily by:

- Forecast costs reported under CRs and PRs from RY22/23 onwards totalling £38.37m[24]
- Forecast of further SMETS1-related CR/PR costs totalling £11.47m

[21] For more information on the individual SMETS2 CRs and PRs, please see Appendix 1, paragraphs A1.3-A1.20
[22] For more information on the individual SMETS1 CRs and PRs, please see Appendix 1, paragraphs A1.21-A1.31
[23] Switching programme costs are assessed separately and are discussed in more detail in chapter 6 of this document.
[24] Of these costs, £7.89m are attached to newly justified material CRs and PRs

- Updated User Integration Testing costs of £25.89m
- The impact of indexation on operational costs of £12.01m

CSP costs

2.15. Changes in the CSP costs were comparatively smaller. When compared to last year's forecast adjusted for inflation, CSP-N costs grew by £2.04m (translating into a variance of 3%). CSP-C costs fell slightly by £2.25m (-3%) and CSP-S costs increased by £3.38m (6%).[25]

2.16. CSP cost increases in RY21/22 were primarily driven by CRs/PRs related to Testing Services and November 2021 SEC Release, which are set out in table 2.6 further below.

2.17. Over the Licence term, CSP costs are expected to increase by £51.19m with CSP-N costs increasing by 3%, CSP-C costs by 1% and CSP-S costs by 3%. These costs are expected to manifest themselves mostly in RYs 24/25 and 25/26 and are driven primarily by indexation and revised comms hubs costs.

2.18. Comms hub charges impact CSP costs both in RY21/22 and in the forecast from RY22/23. Figure 2.4 below shows the total variance in comms hubs costs in each RY. It can be seen that the charges are projected to decrease over RYs 22/23 and 23/24 and increase again from RY24/25. Taking into account all fluctuations, following this year's increase by £5.77m, DCC forecasts a total variance of –£2.51m between RY22/23 and the end of the Licence term. DCC reported the following key changes to their forecast assumptions:

- Indexation assumptions revised to reflect latest inflation data
- Volumes of comms hubs expected to be installed in future years

[25] Please note that in real terms costs of all CSPs have increased on last year. CSP-C costs increased by £0.415m (>1%) but this increase disappears when compared to an inflation-adjusted forecast.

2.19. Comms hub costs for CSP-C&S have also been impacted by DCC's agreement to provide a temporary price support. We discuss this issue in more detail below (see paragraphs 2.52-2.60).

Figure 2.4: Total variance in comms hub charges per RY

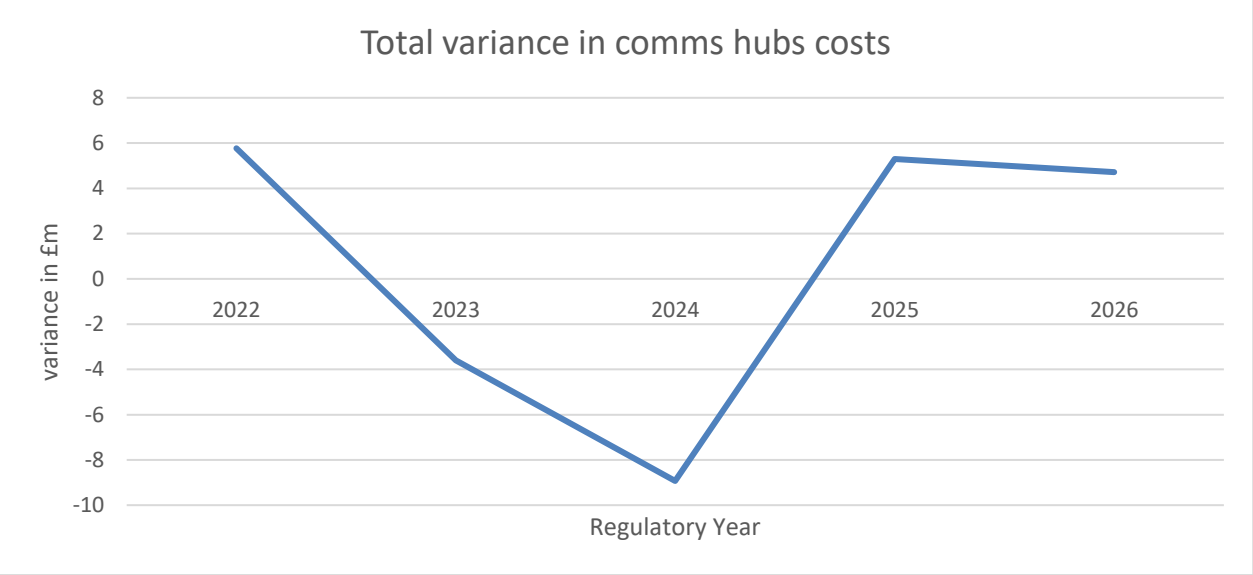


Figure 2.4: Input table

Reg. year	21/22	22/23	23/24	24/25	25/26	Total
Variance (£m)	5.77	-3.60	-8.93	5.30	4.72	**3.25**

Costs of SMETS1 service providers

2.20. Similar to the overall External Costs, the total costs of SMETS1 service providers in RY21/22 decreased by approximately 17% (£16.43m) compared to RY20/21.[26] However, when compared to an inflation-adjusted forecast from RY20/21, there was combined variance of £2.21m, or 3%. Table 2.5 below shows the variance for each service provider. It can be observed that five service providers (highlighted) saw increases in incurred costs. These were driven primarily by:[27]

[26] Please note that this is different to the total External Costs of the SMETS1 programme due to a portion of these costs being incurred by DSP.
[27] Further information can be found in Appendix 1. DCC's justification of incurred costs is discussed in the following section.

- Delivery of Final Operational Capability (FOC), comprising three release uplifts between March and October 2021
- Extension of the Commissioning Party Service
- Device Model Combination Testing
- Extension of the Application Network Security Organisation (ANSO) contract

2.21. Some of this variance has been offset by a decrease in operational costs reported by the SMETS1 Communications Service Providers, as well as the service provider for MOC. The reduction in operational costs for these three providers is principally due to delays in the SMETS1 programme leading to slower meter migration. As such, costs are deferred until future years as the enrolment process completes.

2.22. The SMETS1 forecast over the Licence period has increased by £102.25m, or roughly 19%, largely driven by:

- Reforecasting of previously disallowed S1SP_3b costs and the inclusion of certain additional services into its contract
- ANSO contract extension with S1_DCOa
- Deferred charges associated with the migration of MOC meters

Table 2.5: Cost variances for SMETS1 service providers compared to RY20/21 forecast (adjusted for inflation)

	Variance in RY21/22	Variance over the Licence-term
S1SP_1	29%	11%
S1_CSP_1	-59%	-7%
S1SP_2	-29%	22%
S1_CSP_2	-65%	-57%
S1SP_3a	92%	5%
S1SP_3b	14%	103%
S1_DCOa	143%	39%

	Variance in RY21/22	Variance over the Licence-term
S1_DCOb	80%	-4%
Total variance in [%]	**3%**	**19%**
Total variance in [£m]	**2.212**	**102.252**

ECoS costs

2.23. External Costs related to the ECoS Programme are new for RY21/22. As such, there are no variances from RY20/21 to report this year. The programme costs are explained in the next section.

General cost justification

2.24. DCC has to justify its External Costs as 'economic and efficient'. DCC typically does this by reporting and justifying material contractual variations agreed with its service providers – change requests (CRs) and project requests (PRs). This year DCC justified 16 material programme or project-related CRs/PRs. Material CRs/PRs are understood as those with a 'life value' that exceeds £1m.

2.25. DCC justified individual material CRs/PRs through a narrative submission linked to its 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. 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, seeking efficiencies through standardisation of processes, renegotiating the terms of agreement where contracts were up for renewal, or opting for financing on a 'time and materials' basis as opposed to 'fixed price' where scope was uncertain.

SMETS2

2.26. DCC reported that in RY21/22 the SMETS2 programme consisted of 4 key project areas of material cost increases: Testing Services, November 2021 SEC Release, SI[28] Release Management, and DSP Extension. As set out in table 2.6 below, DCC justified 9 new CRs/PRs with the total combined life value of £49.33m. Of these, 6 were raised with DSP, accounting for £19.86m. The remaining 6 were raised with the CSPs and had the total value of £29.47m.[29]

2.27. The largest proportion of the new SMETS2 costs (51%) relates to the delivery of November 2021 SEC Release, in particular:

- Activities beyond Pre-Integration Testing (PIT) including Systems Integration, User Integration Testing (UIT), transition to operations activities, go-live and subsequent operational support[30]

- Implementation of SECMP007 (Firmware updates to IHDs and PPMIDs)

2.28. Testing Services accounted for 38% of the newly justified SMEST2 costs. These comprised two DSP CRs and one PR extending UIT and Production Support Testing services driven by the DSP contract extension, and two CRs with CSP-C&S extending its test environments and delivering an enduring UIT solution.

2.29. One PR was raised with DSP to provide a 12-month cover for the SI Release Management Services and one CR was justified under DSP Extension to provide cover for a tech refresh of the expiring technology within DSP until March 2022.

[28] System Integrator
[29] 2 of the 9 new CRs/PRs affected multiple service providers. Taking each instance of the same CR affecting multiple providers as its own CR, there are a total of 12 new CRs/PRs.
[30] More information on the scope of these activities and on November 2021 SEC Release can be found on the SEC website here: https://smartenergycodecompany.co.uk/november-2021-sec-release/

Table 2.6: Costs incurred on newly justified CRs/PRs within the SMETS2 Programme

SMETS2 Programme Area	# of new CRs/PRs over £1m	Cost (£m)	% of new costs (within programme)	Σ (£m)
Testing Services	5	18.70	38%	49.33
November 2021 SEC Release	5	25.24	51%	
Other	2	5.39	11%	
Split between DSP & CSPs				
DSP	6	19.86	40%	49.33
CSPs	6	29.47	60%	

SMETS1

2.30. Four new material SMETS1 CRs/PRs with the total combined value of £11.03m were justified across 3 areas: Final Operating Capability (FOC), Dual Control Organisation (DCO) & Commissioning Party (CP), and Device Model Combination Testing (DMCT).

2.31. In RY20/21 FOC suffered significant delays to the agreed timeline under the Joint Industry Plan (JIP) due to defects identified during a late SIT stage. DCC explained that a new plan had been developed based on releasing functionality in multiple drops. This resulted in additional releases ('Uplifts') required to deliver capability changes and defect fixes throughout 2021. DCC justified two CRs delivering Uplift 2.1 (July 2021) and Uplift 2.2 (October 2021) with DSP in its SMETS1 capacity. Additionally, DCC clarified that FOC service providers and the DCO were also impacted by the delivery of these Uplifts, contributing to the cost variances presented in table 2.5.[31] However, DCC confirmed that FOC experienced further delays with the original re-plan timeline missed and costs incurred for additional activities.

2.32. Another key driver behind the SMETS1 costs was an extension of the DCO service to end-October 2024 and the CP service to end-July 2022. The cost of this CR was justified for the S1_DCOb provider. DCC explained that it sought to renegotiate the terms of the agreement to secure value for money.

[31] For more information on the scope of Uplifts 2.1 and 2.2, please see Appendix 1, table A1.4.

2.33. A further DSP PR was justified covering additional DMCT for MOC Secure and FOC meters and testing for outstanding IOC devices to make them eligible for migration. Similar to last year, DCC opted for a 'menu-based' pricing based on testing in tranches, affording it better control over what testing was needed to be performed against which set.

2.34. Finally, DCC justified a contract renewal with S1_DCOa for the provision of the Application Network Security Organisation (ANSO). DCC explained that the contract was extended until end-2024 on substantively the same terms with improvements around performance requirements and the inclusion of some additional services.[32] DCC explained that this new contract accounts for the variance in the S1_DCOa costs presented in table 2.5.

ECoS

2.35. DCC justified a procurement of two new service providers for the delivery of the ECoS party service. The resulting costs of the ECoS programme are split between two phases of work: the initial design, build, and test (DBT) phase (plus ongoing support); and hosting & service management.[33]

2.36. In RY21/22, DCC incurred an initial £1.89m. DCC also forecasted an additional £7.89m in committed spend over RY22/23 and RY23/24. However, DCC clarified that the actual contract values of both workstreams are higher as they span the full extent of the anticipated work in the programme. Those costs will be forecasted once their certainty threshold has been reached.

[32] These include: DCO service uplift for the MOC and FOC cohorts, hosting for the CP migration service, and hosting of the Primary Key Interface Software provided by another service provider.
[33] Further details on the procurement of, and work within, each phase of work, can be found in Appendix 1.

Our assessment

2.37. We apply consistent methodology and principles in our cost assessment. These are set out in our Price Control Guidance, which is updated periodically and published on Ofgem's website.[34]

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

2.39. However, when compared to previous years, we consider that DCC's submission was not of the expected standard. There were errors in the regulatory reporting and missing information, including justification for some material variances[35] in incurred costs, details of the contract renewal with S1_DCOa and a general lack of justifications for forecast costs. We therefore found it necessary to ask over 70 clarification questions to obtain further evidence and justification.

2.40. While on this occasion we consider that the additional evidence provided by DCC was sufficient for our assessment of External Costs, we are particularly concerned that important information was omitted from the initial submission and only provided at a late stage of our cost assessment process. We strongly advise DCC to make significant improvements in its regulatory reporting in future years. We remind DCC that if no or insufficient justification or evidence is provided on how economic and efficient a cost is,

[34] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[35] 'Material variance' is understood to be over an agreed £1m threshold.

it is likely to be considered to be unacceptable. We cannot assume costs are economic and efficient; the burden of evidence is on DCC.[36]

2.41. To help DCC improve the quality of its Price Control submissions, we would like to draw attention to the following improvements which we would expect in future RYs:

- A clear explanation of any material cost variances reported in the RIGs. To manage regulatory and reporting burden, the material variance for External Costs is £1m. This applies to the life value of change request and projects requests as well as other reported variances in distinct RIGs categories, for example 'enduring costs' of service providers. In line with our guidance, if we have significant concerns with the justification provided or process in place for controlling costs it is likely that we will have to ask more questions and potentially require a more granular approach of explanation in order to complete our analysis of those costs.[37] This may include requiring justification for some costs below the materiality threshold.

- Alignment between the costs reported in the RIGs and the narrative submission. This includes ensuring that there is a direct and clearly traceable link between the reported individual costs or cost variances and the accompanying written submission.

2.42. We are happy to engage with DCC further to discuss improvements in its future submissions to make the Price Control process more time and resource efficient.

2.43. In addition to cost justification and regulatory reporting, we have concerns in a number of areas which we discuss in turn below.

[36] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, paragraph 2.60. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022
[37] Ibid, paragraph 2.43

Programme delivery

Background

2.44. Please note that due to commercial sensitivity and confidentiality reasons, certain details have been redacted from this section. This includes the amount of our proposed disallowance. DCC will be provided with details of the proposed disallowance and, as part of the consultation response, will be able to provide further justification. Stakeholders can contact us should they require further information on this proposed disallowance and the reasons for redacted information. We can discuss available options for stakeholders to provide an informed response.

2.45. After experiencing technical issues and delays in previous years, DCC carried out a programme replan and focused on delivery in successive stages throughout 2021. This included capability changes and necessary fixes. Nevertheless, the programme delivery was again affected by delays and increased costs in RY21/22.

2.46. DCC explained that the issues were caused primarily by multiple defects in the releases by a service provider which were discovered at a later testing stage. As a direct consequence of these defects, DCC confirmed that the programme schedule was delayed and significant additional testing was required.

DCC's justification

2.47. DCC reported and sought to justify a variance in this service provider's incurred costs with the following main drivers:

- Extension of the programme support due to issues and defects
- Delivery of a maintenance release with delays
- Payments of operational charges
- Cost of impact assessments

Our view

2.48. It is DCC's responsibility to hold its service providers to account through effective contract management to ensure value for money and quality service on behalf of its customers. Last year we said that we were concerned about the level of risk borne by DCC's customers for issues in programme delivery and urged DCC to strengthen its contingency-planning and demonstrate more robust risk sharing.[38] DCC customers have likewise repeatedly expressed concerns over the programme costs and the impact of delays.

2.49. There is clear evidence that the service provider's failures led to material impact on the delivery of the programme, both in terms of delaying the programme and leading to additional costs associated with testing and fixes to remedy identified defects. By DCC's admission, the issues also constituted a failure on the part of the service provider to meet its contractual obligations. At present, **we therefore do not view the full cost variance as 'economic and efficient' and propose a partial disallowance**.

2.50. We recognise that DCC may have the option to recover the costs associated with the service provider's failures under its contract. In the event that DCC is able to recover such costs at a later date, we would expect DCC to return those costs to customers while being allowed to retain up to the amount of any final disallowance in this area. For avoidance of doubt, this approach would only apply where costs have been disallowed under our Price Control determination. We also invite further evidence from other stakeholders on this issue. Stakeholders can contact us directly if they require further information. If we receive other evidence of material impacts on costs directly attributable to this service provider's failures, we may modify the proposed disallowance to more accurately quantify the proportion of uneconomic costs.

2.51. Additionally, we note that, to progress changes in the programme, DCC again employed Urgent Work Orders (UWOs) as a temporary financial cover for work in

[38] Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, para 2.43. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021.
Ofgem (2022), DCC Price Control Decision Regulatory Year 2020/21, para 2.29. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021

progress while negotiations on the scope of the changes were being finalised. Over the past two years, we expressed concerns over DCC's potential overreliance on temporary funding measures, such as UWOs.[39] While DCC previously gave assurances about its policy and controls in place, we are concerned that the continued use of UWOs may be symptomatic of a reactive approach to programme delivery, brought about by issues such as those described above. As we previously stated in our RY20/21 Price Control decision, we expect DCC to incorporate important lessons learnt across all current and future programmes and to be able to demonstrate having done so.[40] In addition, we encourage DCC to study the findings of this year's OPR contract management audit report, which found, among other things, that "contract management processes and *risk management* are not embedded across DCC and its service providers".[41] We will continue to apply scrutiny across all programmes.

Effective contract management: CSP-C&S price support

Background

2.52. Communication Service Providers (CSPs) are contracted to deliver communications hubs (comms hubs) to DCC's customers at agreed rates. DCC manages these contracts to ensure value for money for its customers. For example, to date DCC has worked to reduce the financing costs by negotiating lower interest rates.

2.53. In RY21/22 DCC agreed to a contractual amendment to pay additional cost per comms hub to CSP-C&S for a limited period of 12 months from March 2022. However, DCC reported that the impact of this temporary price increase would be spread out over 5 years.

DCC's justification

2.54. DCC sought to justify this temporary increase in the price of comms hubs as a 'price support' to the CSP, triggered by ongoing global supply chain disruptions and an

[39] Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, para 2.31-2.39. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021
Ofgem (2020), DCC Price Control consultation: Regulatory Year 2019/20, para 2.29-2.31. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-201920
[40] Ofgem (2022), DCC Price Control Decision Regulatory Year 2020/21, para 2.29. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021
[41] See paragraph 4.25 of this document

increase in the cost of component parts. Specifically, it responds to fees required by component suppliers at the point of supply to confirm delivery. In DCC's assessment, not providing a price support would lead to a risk to the continued supply of comms hubs with impact on the smart meter rollout.

2.55. To demonstrate the price support represented value for money, DCC provided evidence of its negotiations with the CSP and the resulting agreement. DCC was able to negotiate a deferral of a planned indexation of the comms hub costs in autumn 2022 until the end of the price support regime and a cap on the number of comms hubs the price support would apply to. DCC also confirmed that an expected contractual cost reduction in the cost per comms hub would apply from June 2022, offsetting a portion of the price increase.

2.56. DCC explained that the price support was subject to monthly reviews to assess its enduring need. DCC confirmed it retained the right to terminate the price support early, subject to agreed conditions.

Our view

2.57. Following our assessment of evidence provided by DCC, including additional requested materials and clarification questions, we are minded to accept DCC's reasoning that a form of price support was likely needed to protect the supply of comms hubs and avoid disruption to the smart meter rollout. We are also minded to accept the negotiated cost per comms hub, insofar as it is mitigated by the deferral of the indexation and the contractual cost reduction. However, we remain concerned about the controls in place and the duration of the price support. DCC has not provided sufficient evidence of its monthly reviews or details of conditions under which it would seek to terminate the price support at an earlier date. We also lack assurances about the risk of further price support after end-2022. Therefore, **we are minded not to accept *ex-ante* any price support with an effect in RY22/23[42] and propose to remove these costs from the forecasts.** Instead, we ask DCC to justify the actual cost of the price support after

[42] ie from 1 April 2022

it has come to an end. We expect DCC to be able to demonstrate how it controlled the spend over time and justify its end-point.

2.58. Using the comms hubs financing model submitted to us under the ECGS application, we calculated the relevant forecast costs to be £4.40m between RY22/23 and RY25/26 as set out in table 2.7 below. We invite further evidence from DCC to help us refine those estimates.

Table 2.7: Estimated forecast costs of the CSP-C&S price support to be disallowed

	RY22/23	RY23/24	RY24/25	RY25/26	TOTAL
CSP-C	0.257	0.758	0.734	0.720	**2.469**
CSP-S	0.199	0.593	0.575	0.564	**1.932**
TOTAL	**0.456**	**1.352**	**1.309**	**1.284**	**4.400**

2.59. DCC has been previously awarded External Contract Gain Share (ECGS) on the reduced costs of comms hubs thanks to refinancing. The intended effect of the application of the ECGS term in the Price Control is to provide for an upward adjustment of DCC's Allowed Revenue that reflects a cost reduction that DCC helped to bring about.[43] The consequence of the temporary increase in the cost of comms hubs during the price support regime would be an increase in the amount of ECGS DCC earns due to the total costs of comms hubs being higher. **We are therefore minded to reject the proportion of ECGS associated with the temporary price increase.** We discuss the impact of this proposal in chapter 5 in the relevant section on ECGS.

2.60. Going forward, we expect DCC to exercise effective contract management to ensure value for money for its customers. When considering contractual amendments such as a temporary price support to a fundamental service provider, we expect DCC to carry out, and demonstrate, a thorough assessment of the requester's ability to absorb costs under its existing contract and margins. We also expect DCC to be able to agree set conditions for a termination of any temporary price increases.

[43] LC 39.3

Working Capital Charges

2.61. DCC incurs Working Capital Charges (WCC) on the cost of some change requests and project requests. DCC explained that the rationale of WCC is to enable service providers to recover the working capital cost of work in progress. DCC also explained that their application varies between service providers, with some service providers not applying specific WCC. Upon request of a sample, DCC reported values of WCC between 1.64% and 2.72% of the total value of affected CRs/PRs.[44]

2.62. We have concerns about the magnitude of the WCC and DCC's exposure to these charges in certain circumstances.

2.63. Firstly, we note that DCC has the option to avoid WCC applied by DSP on CRs by paying monthly for work in progress. DCC explained that its payments are typically tied to achieved milestones, whose schedule depends on the nature of work. While we accept that milestone-based payments may be suitable in some circumstances, at minimum, we invite DCC to consider aligning its milestones closely to the monthly payment schedules to minimise the amount of WCC incurred – in particular where DCC negotiates a 'fixed price' for a particular CR/PR.

2.64. Secondly, we are aware that there may be instances when WCC can be applied in case of DCC's failure to meet a payment deadline. We previously expressed concern over such charges.[45] While DCC confirmed it was subject to no such penalty charges in RY21/22, **we may not consider WCC incurred in this manner as economic and efficient in the future.**

2.65. We accept DCC's explanation for WCC in RY21/22. Nevertheless, **we may consider including WCC in the scope of the RY22/23 OPR contract management audit.**[46] We also expect DCC to make improvements in this area, work to minimise exposure to WCC, and report to us and justify WCC incurred in RY22/23.

[44] New CRs/PRs over the value of £150k in RY21/22, proportions vary for service providers.
[45] Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, para 2.40-42. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021
[46] For more details on the OPR contract management audit, please refer to paragraphs 4.20-4.40.

Advance payments

2.66. DCC reported a variance of £4.45m in the incurred enduring costs of one of its service providers. DCC explained that £4.2m of variance was driven by early payments of operational charges for 'budgetary and financial reasons'.

2.67. We have concerns about DCC's decision to make these advance payments. We accept that it may be appropriate for DCC to amend its payment schedule, for example where this helps to achieve better value for money. However, DCC did not explain why it considered early payments of operational costs to be necessary or beneficial in this instance. We also lack assurances that the amount of early payments would not be at risk of loss; in particular as these payments have been made to a provider with previous record of poor performance. We ask DCC to provide further information and assurances in these areas. We also expect DCC to reflect the impact of this decision in its next year's Price Control submission and will continue to monitor the issue.

Customer engagement in the SEC change process

Background

2.68. In this year's submission DCC sought to justify costs associated with the implementation of SEC Modification Proposal SECMP007 under November 2021 SEC Release.[47] As of RY21/22 DCC's negotiations with the DSP and CSPs produced the combined cost of £27.5m, although DCC reported an expected increase above £28m in RY22/23 with the inclusion of a deferred change request implementing GBCS 4.1 in the CSP-C&S solution.

2.69. As part of the code change process, which took place in 2020, DCC submitted a final impact assessment (FIA) detailing the costs of implementation, estimated to be £20.8m.[48] In its conclusion report, while recommending the SEC mod for Ofgem's approval, the Change Board then unanimously expressed concerns over the high

[47] SECMP007 change enables suppliers to send firmware updates to PPMIDs and HCALCS via the DCC. It was approved by the Authority in October 2020. More details can be found on the SEC website here: https://smartenergycodecompany.co.uk/modifications/firmware-updates-to-ihds-and-ppmids/

[48] DCC (2020), Full Impact Assessment (FIA), p.54. Accessible at: SECMP0007 Firmware updates to IHDs and PPMIDs, Modification documents: 'SECMP0007 DCC Impact Assessment'. https://smartenergycodecompany.co.uk/modifications/firmware-updates-to-ihds-and-ppmids/

implementation costs for the modification.[49] The current costs are £6.7m (or c.32%) higher than those which provided the basis for the SEC mod's approval.

DCC's justification

2.70. DCC explained the increase from the estimated to the true costs primarily by the inclusion of 'in-life charges' which had not been accounted for in the FIA. These in-life charges account for c.£5.7m between the CSPs and cover additional messaging and network resources, costs to measure and report a new service credit measure for the new type of devices on the network, and negotiated early life conditions.

2.71. DCC also noted that its FIA included a caveat stating that costs 'may not be truly reflective of what the test costs or programme duration might look like'.

Our view

2.72. In general, we are minded to accept DCC's justification of the implementation costs, including the in-life charges. DCC was able to demonstrate the rationale for these charges, options considered and their negotiation with the service providers. However, we are concerned about the quality of information provided by DCC during the code change process. It is important that customers have accurate information on costs relating to implementation of a proposed modification so they are able to participate in the code change process. This includes any enduring costs that may arise. We remind DCC that its cost estimates form the basis for the SEC Panel's recommendation to Ofgem for approval of SEC mods. It is DCC's responsibility to ensure accuracy of its impact assessments and we expect transparency in explaining any significant variations. We also remind DCC that evidence of good customer engagement as an important aspect of cost justification.

2.73. This year's OPR contract management audit found that DCC consistently does not meet required timescales for producing impact assessments for SEC mods.[50] As demonstrated by the example of SECMP007, there are reasons to also be concerned

[49] SEC (2020), Conclusions Report – version 1.0, p.4. Accessible at: SECMP0007 Firmware updates to IHDs and PPMIDs, Modification documents.
https://smartenergycodecompany.co.uk/modifications/firmware-updates-to-ihds-and-ppmids/
[50] See para 4.35 of this document

about the quality and accuracy of the impact assessments. To incentivise DCC to do better in this area, **we will consider including 'quality of impact assessments' into the scope of the next year's OPR audit**.

2.74. We will also continue to monitor costs associated with the implementation of SECMP007 and expect DCC to provide satisfactory justification for any further cost increase.

Driving effective competition: procurement of the ECoS party

2.75. In RY21/22 DCC awarded two contracts for the provision of the Enduring Change of Supplier (ECoS) service. Following a competitive tender process, both of these contracts were awarded to existing DCC service providers.[51]

2.76. While we consider that on this occasion DCC provided sufficient justification for the procurement process and the resulting costs of the ECoS programme, we will continue to closely monitor future procurement processes. We would remind DCC of its obligations under the Licence to drive fair, transparent and effective competition.[52] In particular, DCC should ensure incumbent providers do not receive any undue competitive advantage in bidding on future contracts. We also expect DCC to be able to provide assurance of sufficient ringfencing, both security and commercial, when service providers work with DCC across multiple areas.

2.77. In future, we would also welcome further details on competitive procurements in DCC's submission. This includes key dates of events such as requests for proposals or submission deadlines, internal assessment criteria and impact assessments, as well as how lessons learnt from other programmes have been applied. DCC provided this information with regards to the ECoS procurement in response to our clarification questions.

[51] For more details, please see Appendix 1
[52] For example under the Second Enduring General Objective, set out in LC 5.10, or principles for procurement of relevant service capability, set out in LC 16

Forecast costs

Background

2.78. DCC's forecast External Costs (ie over 4 years from RY22/23 to the end of the Licence term) have increased by £244.74m.[53] Our Guidance sets out the principles for updating forecasts.[54] In general, forecast costs should only contain economic and efficient costs and be significantly more likely than not to occur. If DCC fails to justify any forecast costs as being economic and efficient we may remove them from the forecasts as part of the determination.

2.79. There are a number of areas where DCC's submission did not provide justification for forecast costs, both in terms of their economy and efficiency and meeting the certainty threshold. These costs are set out in table 2.8 below. We asked DCC for additional evidence as part of our cost assessment.

DCC's justification

2.80. In three instances, CR4305, PR7151 and DSMS, DCC clarified that the forecasts were included in error or that the change request had been withdrawn.

2.81. DCC provided the following justification for queried CRs and PRs:

- With respect to CR4349, DCC explained that the costs relate to the DSP tech refresh delivery but a recently agreed replan is yet to be reflected in the financial forecasts

- DCC justified PR7077 as providing a cover for SI Release Management services for the period between April 2021 and the end of October 2021

[53] When compared to last year's forecasts adjusted for inflation
[54] For more information, see: Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022, paragraphs 2.18-2.24. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

- For PR7092, DCC explained that while not yet raised with the service provider, the forecast costs were *likely* included as contingency against a further extension of a related project request (PR7062)

- Forecast costs in the category of 'Other' DSP PR costs were reported as relating to an unrecognised category of resource costs

- For CR1047, DCC explained that it had 're-raised' this change request with the service provider as CR1407, justified in RY20/21

- In one case, PR7143, DCC did not provide any justification or evidence in response to our clarification question

2.82. For the forecast in S1SP_1's enduring costs, DCC pointed to its justification for the variance in this service provider's incurred costs on account of extending migration support for IOC and MOC meters to March 2022, provision for UIT testing for 1 year and additional AWS environments for testing.

2.83. DCC confirmed that the variance in S1SP_3b forecast enduring costs are 'largely identical to the prior year's forecast' but include additional fixed operational charges for new services.

2.84. Finally, the variance in the enduring and Commissioning Party Service costs of S1_DCOa were explained as driven by a renewed contract with that service provider and reflecting additional contracted services.

Our view

2.85. We note DCC's clarification around forecast costs included in error. We propose to make relevant adjustments to remove these costs from the forecast. We are concerned that these errors amount to £13.8m over the Licence period and urge DCC to improve the quality assurance of its regulatory reporting going forward.

2.86. At present we do not view DCC's explanations as sufficient to justify the remaining forecast DSP and CSP-N costs for the following reasons:

- We received no details in relation to the agreed re-plan for CR4349 to explain forecast costs in RY22/23

- DCC's justification for PR7077 is acceptable for costs incurred in RY21/22 but lacks explanation for any costs beyond October 2021

- DCC's explanation for inclusion of forecast costs under PR7092 does not provide assurance that these costs are more likely than not to occur, nor does it speak to the magnitude of the forecast costs

- We received no explanation for the forecasts associated with the 'Other' category or PR7143; we are therefore unable to assess these costs as meeting either the certainty or efficiency threshold

- While we recognise that CR1407 was justified in RY20/21, we note that its costs remain in DCC's reporting in the current RY. DCC's justification does not explain the additional forecast under CR1047

2.87. We also lack satisfactory justification for the SMETS1 forecast costs for S1SP_1, S1SP_3b and S1_DCOa:

- Similar to PR7077, while DCC's explanation provided satisfactory justification for the variance in S1SP_1's incurred costs in RY21/22, it lacks details of any forecast costs from RY22/23

- With respect to S1SP_3b, last year DCC explained that its contract with this service provider was due to expire in July 2022. We said that a contract expiry should provide DCC with the opportunity to renegotiate these costs and provide a more accurate forecast.[55] We received no additional information, either in DCC's response to our RY20/21 consultation, or as part of RY21/22 Price Control submission. We are therefore minded to maintain our decision from last

[55] Ofgem (2021), DCC Price Control consultation: Regulatory Year 2020/21, para 2.46-47. www.ofgem.gov.uk/publications/dcc-price-control-consultation-regulatory-year-202021

year that these costs cannot be viewed as sufficiently certain or economic and efficient without further evidence

- Similarly, DCC omitted details of its contract renewal with S1_DCOa from its Price Control submission. Its additional evidence did not justify any forecast costs under this contract

2.88. We therefore **propose to disallow and remove the following costs from the forecast:**

- **£13.785m of forecast costs** on account of incorrect reporting
- **£94.432m of forecast costs associated with DSP, CSP-N and three SMETS1 service providers** on account of insufficient justification

2.89. We invite DCC to provide additional evidence in support of these costs in its consultation response. We remind DCC that its forecasts should be justified and provide a reasonable baseline against which to compare costs at the next Price Control. They are also important to give customers an accurate picture of expected future expenditure.

Table 2.8: Proposed forecast external cost disallowances per service provider

Service provider	Area	Proposed disallowance in [£m] per RY			
		RY22/23	RY23/24	RY24/25	RY25/26
DSP	CRs/PRs	16.217	4.590	2.131	1.512
CSP-N	CRs/PRs	1.890	1.890	1.832	0.199
S1SP_1	Enduring costs	1.029	1.058	1.135	1.343
S1SP_3b	Enduring costs	12.643	12.902	12.919	13.124
S1_DCOa	Enduring costs	-5.458	-5.458	-5.458	-5.458
	Commissioning Party Service	12.098	10.579	10.479	10.479
TOTAL		**38.419**	**25.561**	**23.038**	**21.199**
GRAND TOTAL					**108.217**

3. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY21/22 and its updated forecasts. DCC has provided sufficient justification for the majority of these costs. However, we propose to disallow **£7.909m** of costs[56] incurred in RY21/22. This is due to inefficiencies in External and Internal Services, the Business Accuracy Programme, Shared Service Charges, contractor benchmarking, and activity relating to Electric Vehicles and innovation given that this is not part of DCC's Authorised Business.

We are minded to disallow **£35.848m** of DCC's forecast costs over RY22/23 and RY23/24 due to a lack of clarity and certainty over forecasts, and in particular forecasts associated with the Network Evolution, SMETS1 and ECoS programmes. We are also minded to disallow **£133.819m** of baseline forecast costs from RY24/25 to the end of the Licence term due to a lack of justification provided by DCC.

[56] 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.

Questions

Question 5: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 6: What are your views on our proposal to disallow costs associated with non-competitive procurements where we have not received satisfactory justification or evidence?

Question 7: What are your views on our proposal to disallow the costs of the Order Management System, Customer Engagement Portal and the Executive Leadership Programme?

Question 8: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

Question 9: What are your views on our proposals on the Shared Service Charge?

Question 10: What are your views on our proposal to disallow costs associated with the product management team, DCC's work on EVs and additional products?

Question 11: What are your views on our proposal to disallow forecast cost variances in RY22/23 and RY23/24 in the Corporate Management (including Policy and Markets team), Finance & People, and Operations cost centres, and the Network Evolution, SMETS1, and ECoS programmes; and all baseline forecast costs for RY24/25 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 ten general ledger (GL) categories: Payroll Costs, Non-Payroll Costs, Recruitment, Accommodation, External Services, Internal Services, Service Management, Transition, IT services, and Office Sundry. Internal Costs are reported by 'cost centres' which cover the main activities where DCC incurs costs. Please see Appendix 2 for more detail.

How have Internal Costs changed?

3.2. Figure 3.1 shows the distribution of costs by general ledger (GL) code over the Licence period, based on DCC's RY21/22 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 RY21/22 are £96.0m, £23.3m more than was forecasted in 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

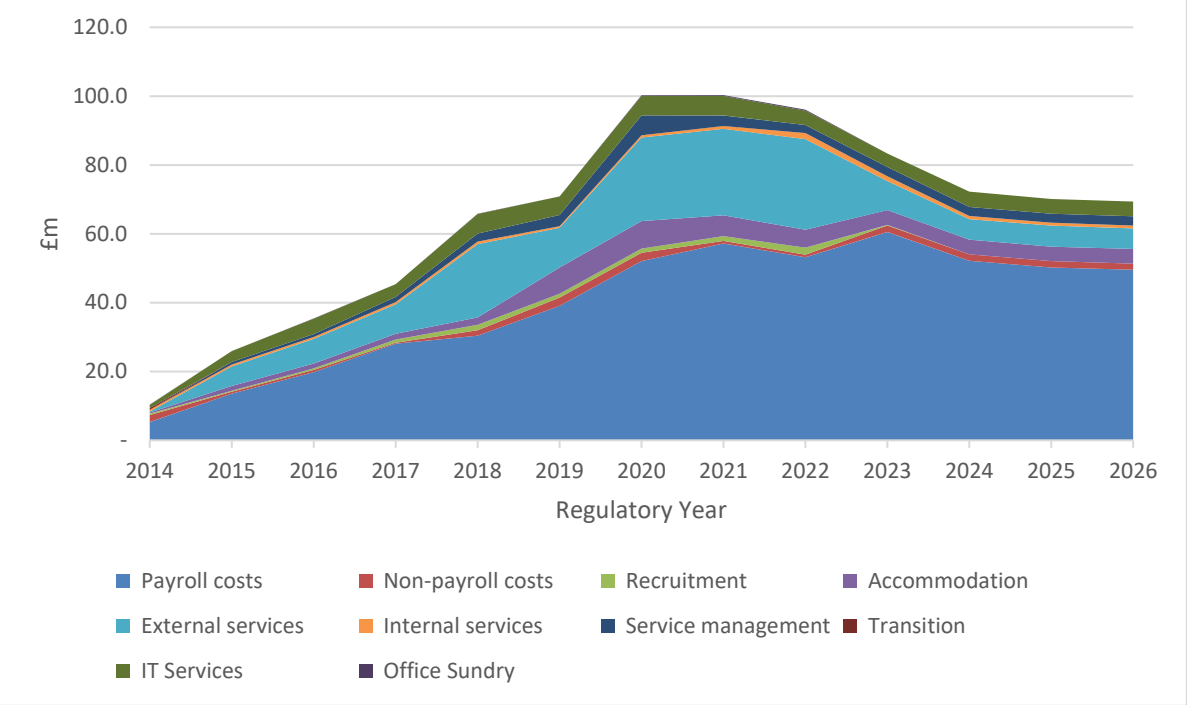


Figure 3.1 data table

£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	5.3	13.6	19.8	28.1	30.4	39.0	52.0	57.2	53.2	60.5	52.2	50.2	49.6
Non-payroll costs	2.0	0.5	0.7	0.3	1.6	2.5	2.5	0.7	0.8	1.9	1.9	1.8	1.8
Recruitment	0.4	0.3	0.5	0.9	1.6	1.0	1.2	1.4	2.0	0.1	-	-	-
Accommodation	0.3	1.3	1.4	1.6	2.1	7.7	8.0	6.1	5.2	4.3	4.3	4.2	4.2
External Services	0.3	5.7	7.2	8.5	21.3	11.5	24.2	25.2	26.3	8.5	6.0	6.1	6.0
Internal Services	0.5	0.5	0.6	0.7	0.8	0.5	0.7	0.8	1.8	1.4	0.8	0.8	0.8
Service management	-	0.8	0.8	1.5	2.3	3.3	5.7	3.0	2.3	2.7	2.7	2.7	2.7
Transition	0.5	0.0	-	-	-	-	-	-	-	-	-	-	-
IT services	1.0	3.1	4.5	3.7	5.7	5.3	5.7	5.7	4.2	3.9	4.4	4.3	4.3
Office sundry	0.0	0.1	0.1	-	0.1	0.0	0.2	0.2	0.2	0.0	0.0	-	-

3.3. Figure 3.2 shows the distribution of Internal Costs. Additional Baseline, Corporate Management and Operations cost centres continue to be the three largest cost drivers in RY21/22.

Figure 3.2 Internal Costs by cost centre in current year prices

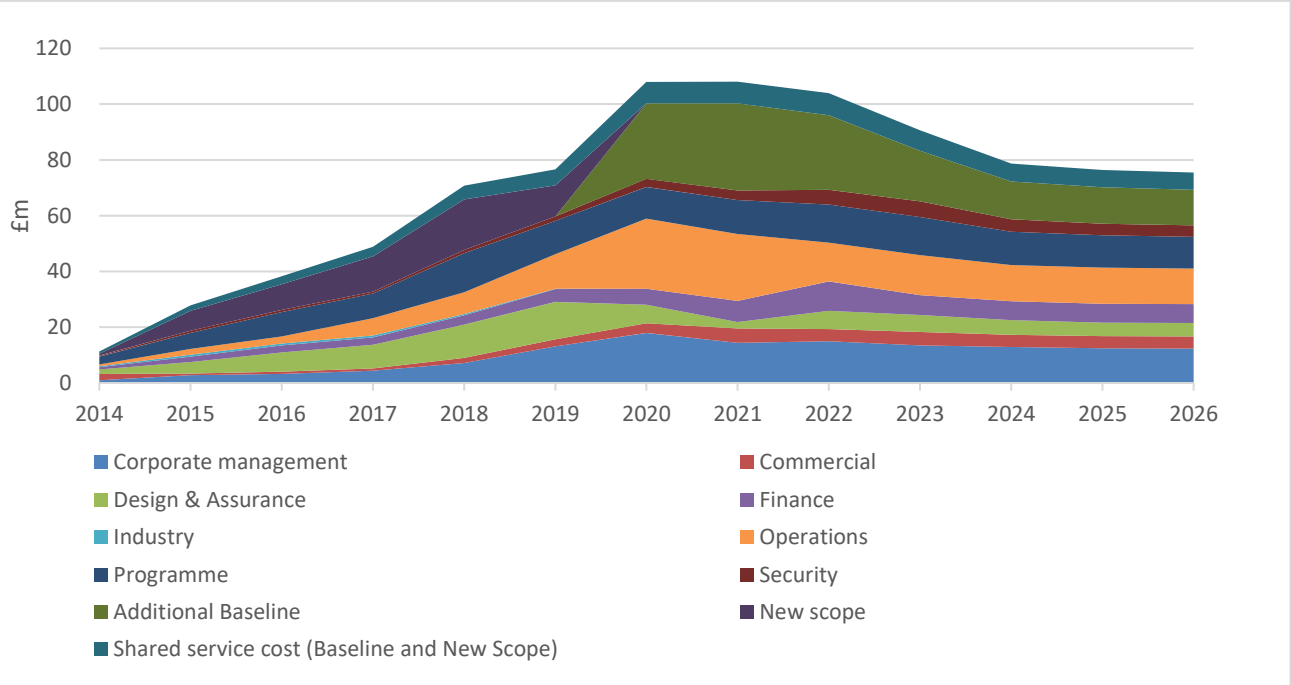


Figure 3.2 data table

£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	2.8	3.3	4.4	7.1	13.1	17.9	14.4	14.9	13.5	12.9	12.5	12.3
Commercial	2.3	0.6	0.7	0.8	1.9	2.5	3.5	5.2	4.4	4.8	4.4	4.4	4.4
Design & Assurance	1.6	4.1	6.9	8.5	11.9	13.5	6.6	2.3	6.5	6.2	5.2	4.8	4.8
Finance	0.8	2.0	2.5	2.6	3.4	4.6	5.8	7.6	10.5	7.1	6.8	6.7	6.7
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	2.1	2.6	6.1	7.8	12.5	25.1	24.0	13.9	14.3	13.1	13.0	12.8
Programme	2.8	5.7	8.7	8.9	14.0	12.0	11.4	12.1	13.8	13.6	11.9	11.6	11.4
Security	0.3	0.8	0.8	0.7	1.1	1.6	3.0	3.5	5.2	5.7	4.4	4.2	4.2
Additional Baseline	0.0	0.0	0.0	0.0	0.0	0.0	27.1	31.3	26.8	18.2	13.5	13.0	12.8
New Scope	0.6	7.2	9.3	12.6	18.2	11.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shared Service Costs	0.8	1.9	2.8	3.5	4.9	5.8	7.7	7.8	7.9	7.4	6.5	6.3	6.2

Variance on last year's forecast

3.4. In RY21/22 Internal Costs, excluding Shared Services, were £96.0m. This is £23.3m (32%) higher than forecast in RY20/21 and £84.9m higher than the LABP forecast. Over the remainder of the Licence period, Internal Costs are forecast to increase by a further £225.8m relative to the RY20/21 forecast, and by £686.0m compared to the LABP.

3.5. Figure 3.3 shows the variance in costs by GL code compared to the RY20/21 forecast. Payroll costs account for the greatest proportion of the variation in Internal Costs over all forecast years. However, in both RY20/21 and RY21/22, External Services accounted for the largest proportion of the variation. In RY21/22, the proportion of the External Services variation was 85% followed by IT services at 7%. The majority of the variance in External Services is attributed to the SMETS1 programme, the Network Evolution programme and the Finance cost centre, which accounts for over 60% of the External Services variance.

Figure 3.3 Internal Cost variance by GL code relative to RY20/21 forecast (excluding Shared Services) in current year prices

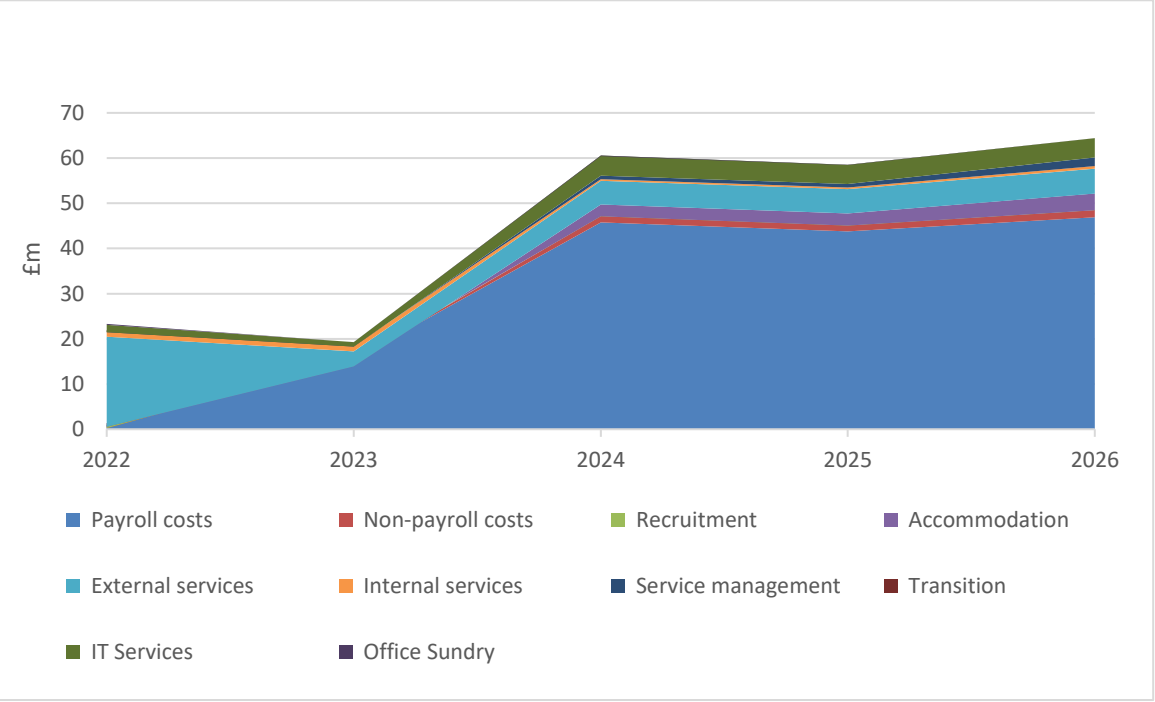


Figure 3.3 data table

£m	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Payroll costs	1.4	15.4	45.8	43.8	46.9
Non-payroll costs	(1.1)	(0.1)	1.4	1.4	1.6
Recruitment	0.8	0.1	(0.1)	(0.1)	(0.0)
Accommodation	(0.4)	(1.5)	2.6	2.7	3.7
External Services	19.9	3.3	5.3	5.4	5.5
Internal Services	1.4	1.2	0.3	0.3	0.6
Service management	(0.4)	(0.1)	0.8	0.8	1.9
Transition	-	-	-	-	-
IT services	1.7	1.0	4.4	4.3	4.3
Office sundry	0.2	(0.0)	(0.1)	(0.1)	(0.0)

Payroll

3.6. DCC has applied for the payroll costs shown in Table 3.1. Payroll costs incurred in RY21/22 are more than forecasted in RY20/21 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)	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
RY20/21 accepted forecast	51.8	45.1	6.4	6.4	2.7
Variation proposed in RY21/22	1.4	15.4	45.8	43.8	46.9
Total	**53.2**	**60.5**	**52.2**	**50.2**	**49.6**

Headcount

3.7. Figure 3.4 shows that DCC's staff headcount has increased from 605 full time equivalents (FTEs) in RY20/21 to 643 FTEs in RY21/22. This is a slight increase of 6% compared to last year's forecasts for RY21/22. The number of permanent staff has increased from 480 FTEs to 510 FTEs. This is a 15% decrease compared to last year's forecast of 598 FTEs for RY21/22. The number of contractors marginally increased from 131 in RY20/21 to 133 in RY21/22. This is a 10% increase over last year's forecast for RY21/22.

3.8. Headcount is expected to increase for permanent staff to 602 FTEs and decrease for contractors to 66 in RY22/23. DCC did not provide forecasts for its headcount beyond RY22/23.

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

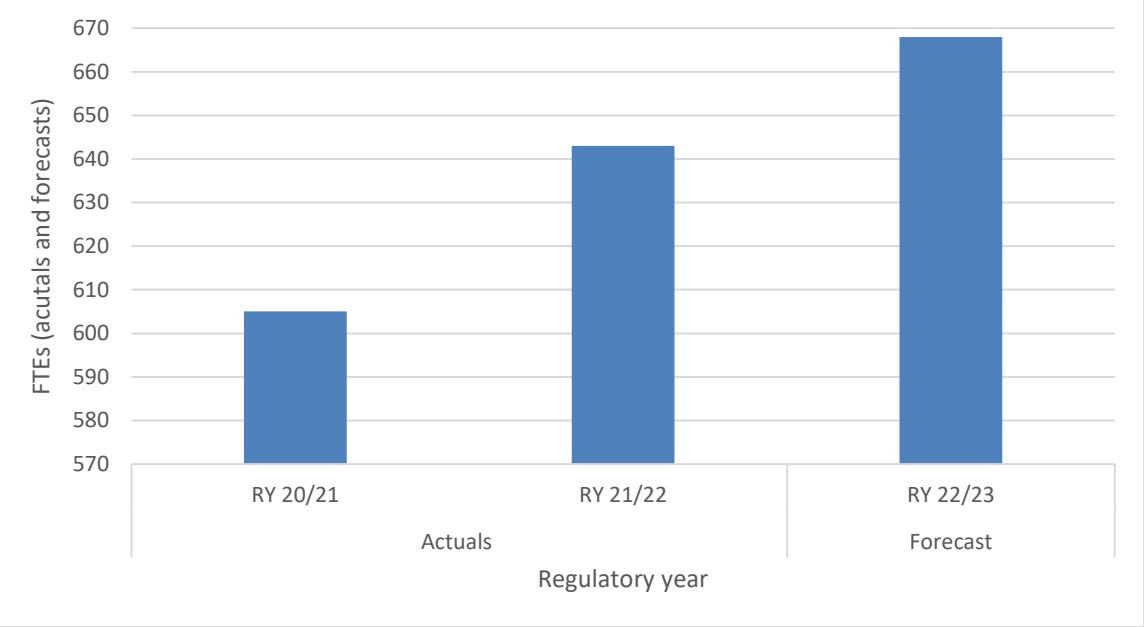


Figure 3.4: data table

	Actual RY20/21	Actual RY21/22	Forecast RY22/23
FTEs	605	643	668

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 reduced to 22% contractor to 78% permanent staff. In RY20/21, the ratio remained consistent at this level with 21% contractor to 79% permanent staff. In RY21/22 the ratio remained identical to last year.

Benchmarking

Context

3.10. We expect DCC to recruit staff at economic and efficient remuneration levels. Similar to seven previous Price Controls, DCC provided evidence of this for permanent staff

through a benchmarking exercise that compared base salaries to equivalent roles in the wider employment market, using Korn Ferry's (formerly Hay) "PayNet" Benchmarking salary database. It is worth noting that this benchmark does not include non-base salary benefits such as bonuses and car allowances. These benefits are discussed in paragraphs 3.23 to 3.26 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. As noted above, DCC excludes non-base salary benefits from its main permanent staff benchmarking methodology, which we identified as an area of concern in RY18/19 and RY19/20. In response to our feedback, in RY20/21 DCC carried out an initial analysis of the wider benefits package against that of comparable sectors and organisations. In RY21/22 DCC has undertaken further benchmarking exercises of the wider benefits package.

3.13. Following our feedback from previous years, in RY20/21 DCC changed their approach for contractors so that it would be more aligned with the approach for permanent staff. It also expanded the benchmarking dataset with data from two additional recruitment specialists, and only used comparable market salaries drawn from a minimum of 20 data points. In RY21/22 DCC has repeated this process.

3.14. Finally, there has been a shift in DCC's approach to reporting some consultant resource contracted from Capita. In particular, contingent IT labour under the MSA and procurement specialists under the Intercompany Framework Agreement (IFA). According to DCC, in RY20/21 this type of resource was reported to us under Payroll, and benchmarked together with the rest of payroll contractors. However, this year DCC has reported most of this resource under Internal Service (IS) instead of Payroll. This means that most of these Capita consultants were excluded from the benchmark exercise discussed in this section.

DCC's justification

Benchmarking process

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

- before the role is launched;
- before DCC chooses to interview a candidate; and
- prior to agreeing a remuneration package with a candidate.

3.16. In response to our feedback from previous years, this year DCC has submitted further information setting out the salary approval process, and stated that it has improved the governance in this area. For example, DCC explained that any proposal to offer above the salary range must be referred to CPO, CFO and CSRO with an accompanying business case, on an "as needs" basis. In addition to this, while approval would be virtual (eg by email, telephone or video call), and no formal panel meeting would be required, the outcomes must be recorded for Price Control purposes.

3.17. Finally, as in previous years, 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.

Permanent staff

3.18. Korn Ferry's PayNet Benchmarking database includes a comprehensive range of job families, roles, and levels across different industries in the different regions of the UK. The database produces benchmarks based on percentiles from a distribution of salaries of comparable roles. To reach the benchmark for a specific role the database draws data from dozens of companies and hundreds of individuals within these companies. In

addition, DCC's use of PayNet has 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.

3.19. 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 HR Business Partner. If the salary is in excess of this, a business case is required for approval.

3.20. As part of its submission, DCC presented a comparison of the remuneration of permanent members of staff against Korn Ferry's Benchmark, showing how it differs (in aggregate and against each cost centre) from both the 50P and 50P + 10% margin (50P10). The information is presented in a way that sets out both the net outcome[57] of the results as well as the marginal overspend against the 50P10 benchmark.[58]

3.21. This year DCC reported recruiting approximately 7 roles in RY21/22 with a salary above the 50P10 benchmark, representing approximately 4% of the total benchmarked roles. DCC calculated that this resulted in an overall marginal cost of £0.020m. Note this figure assumes that all staff were hired at the beginning of RY21/22, whereas staff might have only commenced employment midway through the regulatory year. This results in an over-estimate of the incurred cost to DCC.

3.22. In its submission, DCC gave some justifications for the individual roles recruited above the 50P10 benchmark.

Permanent staff – wider benefits

3.23. The Korn Ferry's PayNet database to benchmark permanent staff used by DCC during the hiring process is based on salary only. DCC has previously explained it chose this

[57] Sum of all positive and negative cost variances against the benchmark
[58] Sum of adverse cost variance to the relevant benchmark only (ie only variances *above* the 50P10 benchmark are counted) for each role.

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.

3.24. In response to our feedback in previous Price Controls, in RY20/21 DCC provided some benchmarking of bonuses, pension and annual leave. Following our feedback from last year, in RY21/22 DCC has undertaken further benchmarking exercises including pension, life cover and car allowance. This involved calculating the cash value and % over salary for each benefit for a sample of 97 DCC roles, and compare it against market comparators using Korn Ferry data. This data includes a wide range of organisations that are comparable or have comparable roles to DCC.

3.25. DCC argued that this analysis showed its benefits and allowances are below the market average. However, it is important to note that this further benchmarking exercise did not include bonus because this item was not included in Korn Ferry's benefits data.

3.26. DCC currently allocates a discretionary bonus, linked to both corporate and individual performance and based on percentage of annual salary. According to DCC, previous benchmarking in RY20/21 indicated that DCC's bonus opportunity was in line with market comparators.

Contractors

3.27. A total of 186 contractors were in scope of RY21/22 benchmarking analysis, with a total cost of £11.7m. For comparison, in RY20/21 these figures were 218 contractors with an associated cost of £16.2m. Approximately 80% of contractors and their associated expenditure fell within the Programme and Operations cost centres.

3.28. As part of its submission, DCC presented a calculation of the net and marginal costs associated with all contractors benchmarked in RY21/22 against the 50P10 benchmark. This resulted in a net negative variance[59] of £3.3m and a total marginal cost[60] of

[59] 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.
[60] 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.

£0.069m, based on 172 roles hired under and 14 roles hired over the relevant benchmark. This shows that 93% of contractors were paid below the 50P10 benchmark, which is an improvement from the 76% figure in RY20/21 and 66% in RY19/20. In its submission DCC reiterated the argument raised in previous years 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.

3.29. 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.

3.30. When questioned about the change in relation to the Capita consultants reported under IS, DCC explained that in the past Capita consultants were inaccurately included under Payroll and benchmarked due to the quality of the data not allowing them to identify the recruitment route for some members of staff. However, this year they were able to identify them and confirm those that are contractors (and should sit under Payroll), and those that are Capita consultants (and should sit under IS).

3.31. DCC explained that the reason why Capita consultants were preferred over other contractors was the duration of the contracts: the activities that DCC sought to resource through Capita typically required short term contracts of six weeks to three months. According to DCC, this would not be well suited to contractors who typically look for contracts of at least 6 months. When asked how DCC ensured that the consultant fees were economic and efficient, DCC argued that Capita Procurement consultants under the final impact assessment (FIA) represented good value for money.

Our view

Permanent-contractor staff ratio

3.32. 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

3.33. This year DCC's permanent staff FTE increased from 605 FTEs in RY20/21 to 643 FTEs in RY21/22. 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.

3.34. We welcome that in RY21/22 DCC has continued applying its internal process to hire staff at salaries below the 50th percentile + 10% (50P10) benchmark. While the overall marginal cost has slightly increased compared to last year (£0.021m in RY21/22 compared to £0.018m in RY20/21), the ratio of roles hired above the margin to the number of new roles has kept improving (3.7% in RY21/22 compared to 5.5% in RY20/21).

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

3.36. As such, and in line with our decision last year, our minded-to position is not to make a disallowance in this area for RY21/22. If we decide to proceed with this minded-to position we will continue to review the area in upcoming Price Controls to ensure continued improvement.

3.37. We encourage DCC to continue improving and applying its hiring policies for permanent staff rigorously going forward.

Permanent staff – wider benefits

3.38. We welcome the additional information around the non-base salary benefits shared by DCC in this year's submission. In our view, it improves the quality of the analysis initiated in RY20/21, and shows that the majority of non-base salary benefits are economic and efficient. We note, however, that this is presented as a one-off benchmarking exercise. We encourage DCC to ensure these costs keep being economic and efficient going forward.

3.39. In relation to the bonus, we are disappointed that no further work has been carried out in this area. We would like to reiterate our position from last year that a remuneration

up to the median of the benchmark is the economic and efficient approach, while DCC's bonus appears to sit above the average and median quartile, albeit below the upper quartile, across all staff categories.[61] However, we recognise that more work might be required to properly assess the efficiency of the bonus package.

3.40. In light of the above, we do not propose any disallowance of permanent staff benefits costs in RY21/22. However, we would encourage DCC to review its bonus package to ensure it is economic and efficient going forward. This will remain an area of scrutiny.

Contractors

3.41. We welcome that DCC has continued using their reviewed approach to benchmark contractors based on the 50P10 benchmark. This has resulted in a significant improvement in the cost efficiency of contractors hired in RY21/22 compared to previous years. We encourage DCC to continue to apply this approach consistently going forward.

3.42. However, some contractors (14) were paid above the 50P10 benchmark during RY21/22, including 9 contractors hired in RY21/22. 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.

3.43. As we have said in previous years, 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 most of 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, or a simple job description. Notably, through the approval of a business case, which we note is DCC's policy for hiring above the 50P10 benchmark.

[61] DCC allocates bonus based on annual salary (as a proxy for seniority) using three bonus categories: 10% bonus (category 3), 20% bonus (category 2), and 30% bonus (category 1)

3.44. Accordingly, we requested DCC to submit to us the business case for a sample of contractors hired above the 50P10 benchmark. DCC did not submit any business case for the requested roles, although it did provide further justification for some of these. It is, however, disappointing that DCC has not submitted any business case or similar document showing it has followed its own hiring policy. Particularly when in this year's submission DCC claimed to have improved the governance in this area, with the declared intention to be able to provide better justification for the Price Control submission.

3.45. In relation to the Capita consultants reported under IS, we are disappointed that DCC was not able to provide material evidence of how the Capita consultant rates compare in the market, especially since they were benchmarked last year. It is also of concern to us the fact that the only criteria to decide whether to use Capita consultant resources seems to be the duration of the contract. We expect DCC to ensure, and to be able to prove, that all contracted resources – including Capita consultant resources - are economic and efficient.

3.46. For future Price Control submissions, we would encourage DCC to set out a clear set of criteria it follows when deciding whether to hire payroll contractors, or to bring in Capita consultants, which ensures an economic outcome. We also expect DCC to provide material evidence that the Capita consultant rates are economic and efficient. For example, through the use of benchmarks or similar methodology that shows how these rates compare in the market.

3.47. Finally, we disagree with DCC's argument that salaries paid below the 50P10 benchmark should be considered as "savings". As we explained in last year's decision, 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.

3.48. As a result of the above, we are minded to disallow some costs where they fall above reasonable market rates and were not properly justified. To calculate this inefficiency, we have followed the same methodology we applied in RY20/21: using the 50P10 benchmark based on the expanded dataset, and for all contractors employed during RY21/22. Including all contractors employed during the regulatory year is consistent with our approach since RY18/19.

3.49. In light of the above, we are therefore minded to disallow £0.047m of contractor costs in RY21/22. This year we are not proposing disallowance in relation to the IS consultant resource, but we would encourage DCC to provide better evidence of how these costs are economic and efficient going forward.

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

3.51. We expect to see DCC consistently applying its approach to recruiting contractors, and to be able to provide evidence of its decision-making. Finally, we expect DCC to ensure all its recruiting costs are economic and efficient. This includes contractors and Capita consultants.

External and Internal Services

Context

3.52. DCC uses External Services to provide support such as short-term technical expertise in meeting regulatory requirements. Costs associated with these services include costs of third-party suppliers such as consulting fees, legal fees, and bank charges.

3.53. DCC also sources IT and other professional services directly from the Licensee's parent group. These services are referred to as Internal Services and are exclusive of the Shared services, and the costs for these services are charged directly to DCC.

3.54. The use of External Services has steadily increased in recent years, peaking in RY21/22 at a cost of £26.3m, proportionally making up 27% of the total Internal Cost excluding Shared Services. In comparison, the aggregate cost of External Services in RY18/19 amounted to £10.8m, which is 16% of the Internal Cost excluding Shared Services. These costs further increased to £23.2m and £24.2m in RY19/20 and RY20/21 respectively, representing 24% and 25% of the total Internal Costs excluding Shared Services. This year's cost is £20.1m (331%) higher than what was forecasted

in RY20/21 (£6.1m).[62] Figure 3.5 below shows the evolution of External Services costs over time.

Figure 3.5: External Services costs by RY, in £m, nominal prices

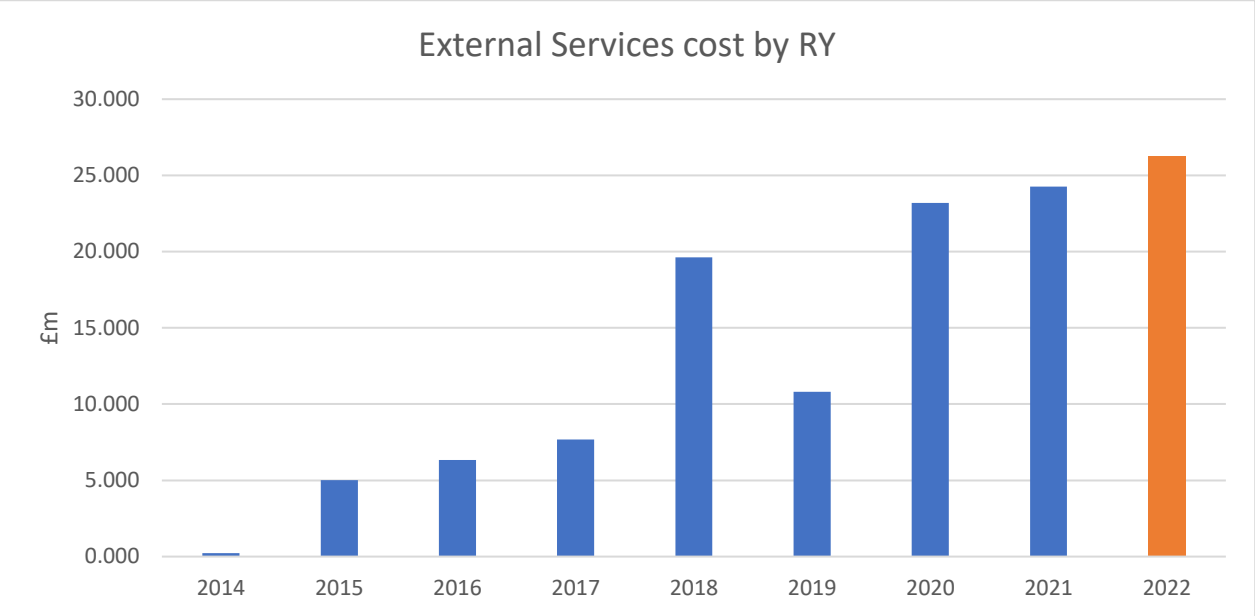


Figure 3.5: data table

RY	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22
Inc. Cost (£m)	0.229	5.012	6.336	7.673	19.632	10.806	23.189	24.264	26.298

3.55. The use of Internal Services has remained relatively stable over time, however costs in RY21/22 show a material increase against last year's forecast of £1.3m. Figure 3.6 below shows the evolution of Internal Services costs over time.

[62] For the avoidance of doubt, the £6.1m External Services forecast for RY21/22 represents Ofgem's final Price Control determination for that year.

Figure 3.6: Internal Services costs by RY, in £m, nominal prices

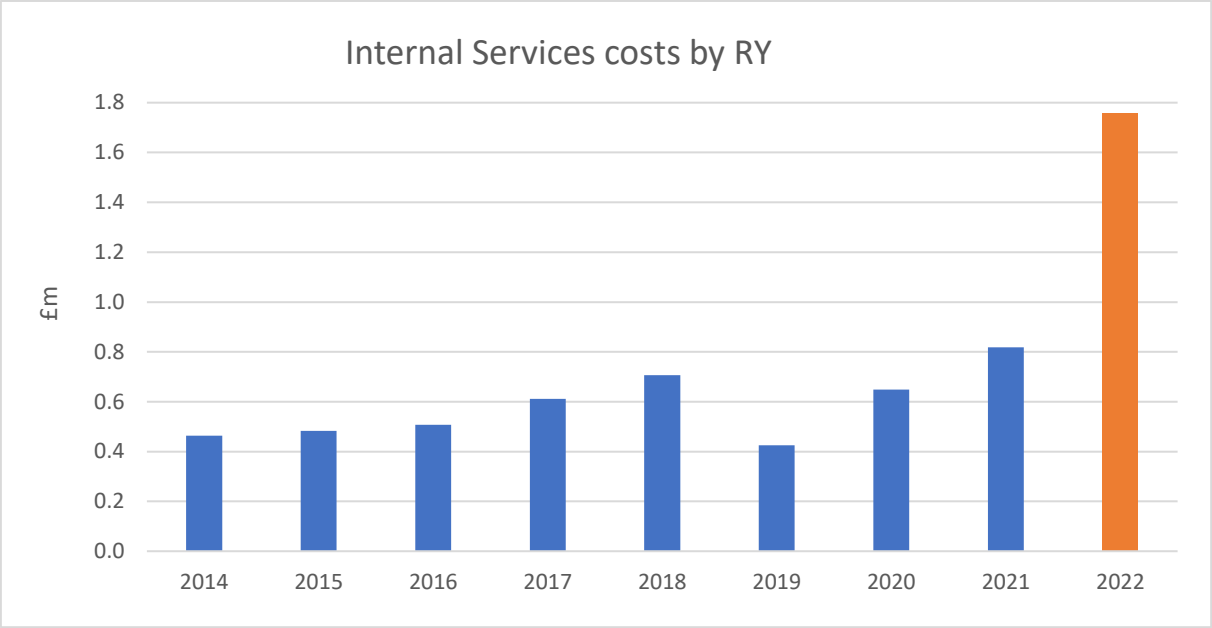


Figure 3.6: data table

RY	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22
Inc. Cost (£m)	0.464	0.482	0.507	0.611	0.706	0.425	0.649	0.819	1.759

Procurement

3.56. Through our analysis we identified that a significant proportion (57%) of External Services in RY21/22, with a material value of £150k[63] or greater, were sourced non-competitively. Of those procurements, we noted that 15% were procured directly through DCC's parent company, Capita Ltd.

3.57. To obtain a greater understanding in this area, we asked DCC during the clarification process to provide a sample of 15 non-competitive procurements (NCP) and evidence of how it had followed its own internal procurement procedures. DCC's procurement policy restricts the use of NCPs to exceptional circumstances only, and where it can be demonstrated that this approach is economic and efficient.

[63] For the ease of regulatory reporting, Ofgem requires DCC to justify all procurements with a minimum variance of £150k.

3.58. During the clarification questions and the Cost Visit, we have also asked DCC to explain the process whereby it ensures that the parent company does not receive any undue advantage in the contract award process.

3.59. Of the selected sample, six contracts were directly procured through Capita Ltd. Five of the fifteen procurements can be categorised as either an extension or a call-off to an existing contract framework agreement, either for bringing in specialised contingency labour for specific projects, or for the provision of hardware and software services.

Planning

3.60. As part of this year's cost assessment, we have identified multiple procurements that appear to share similarities to activities that were carried out previously, and where it is unclear to what extent there is an overlap in terms of scope between them.

3.61. To obtain more clarity, we asked DCC through clarification questions to specify the steps it takes before planning and scoping a piece of work, and how it ensures that outputs of previous work is optimised and costs are not duplicated.

3.62. As part of our analysis, we have also noted the unfinished status of the Customer Engagement Portal (CEP) and the Order Management System (OMS). Both projects incurred costs in RY21/22 and were justified by DCC and approved by Ofgem in previous years. Whilst both projects were paused as a result of rising costs, project difficulties and customer feedback, it should be noted that costs continued to be incurred in RY21/22 and that further costs are forecast in future years.

3.63. The proposal to implement an online customer portal was first initiated in RY19/20. At the time, the procurement of the online platform formed an integral part of DCC's new customer engagement approach to help boost transparency and better respond to customers' needs. Over the course of RY20/21 it became apparent that the portal would require significant investment to deliver the full functionality that customers required. A decision was taken in RY20/21 to pause the rollout of the portal, and to review further options. The CEP previously incurred a total cost of £0.289m over the course of RY19/20 and RY20/21. An additional cost of £0.089m was incurred in RY21/22 with a further forecast cost of £0.39m in RY22/23 and RY23/24.

3.64. The Order Management System (OMS) is DCC's strategic tool set for the forecasting, ordering, returning, and tracking of assets. The OMS is presently split into three instances, with one in the North and two covering South and Central. A project was launched in RY19/20 to consolidate the OMS functionality into a single portal. This project was first justified and explained by DCC as part of the RY19/20 Price Control submission. We note however that the project had been paused in January 2021, as a direct result of rising costs, project difficulties and customer feedback. The OMS project previously incurred a total cost of £1.522m over the course of RY19/20 and RY20/21. The incurred cost of the OMS project in RY21/22 was £0.537m.

Executive Leadership Programme

3.65. DCC procured a service for the provision of additional learning and development resources for its senior leadership team. The Executive Leadership Programme is expected to provide bespoke training and provide DCC's senior leaders with greater support in development of strategies and mitigating risk in decision-making, reducing the time to make business critical decisions with cost reductions and operational efficiencies.

3.66. The Service Agreement was originally owned by Capita and aimed at DCC technical staff, and has now transferred to DCC with an increase in requirements including extending the service to DCC executives.

3.67. DCC incurred £0.262m on the subscription-based service in RY21/22, which was paid in advance and covers the period from March 2022 to February 2023.

DCC's justification

Procurement

3.68. At the Cost Visit, DCC advised that at all procurements either have a sourcing strategy or a single source procurement authorisation form. We also noted that the procurement approach is audited by DCC's internal compliance officer, and the statement is accordingly posted on DCC's website.

3.69. DCC further advised that it is not always possible to competitively procure an activity due to the nature of the procurement (for example emergencies or requiring unique skills), and that in many cases it is more economic and efficient not to.

3.70. In terms of the contractual relationships with Capita, DCC explained that the main contracts involved the Applications and Hosting contract[64], which was part of the original licence bid process, as well as two main Master Services Agreements, respectively one for IT and contingent labour, and one for recruitment. The latter two were created to replace the provisions in the original Intercompany Agreement which DCC considered unfit for purpose. Beyond these main contracts, DCC noted that Capita can tender for contracts in the same way as other External Service Providers, and that they were treated in the same way as any tenderer.

3.71. As to the evidence that we requested from DCC on how it had adhered to its own procurement policy for the selected sample, DCC provided only partial evidence. To ensure full transparency exists on what and by when a service is being delivered, and whether it represents value for money, the NCP process in the procurement policy requires DCC to complete the relevant paperwork and documentation as if a competitive procurement had taken place. This includes for example an NCP form (ie, internal request for conducting an NCP) together with the relevant approvals, an RFP/RFQ that clearly states the requirements accompanied by evaluation criteria, an award recommendation report, as well as a signed legal contract.

3.72. For two procurements, DCC was able to explain that an NCP approach was appropriate due to the single source of supply nature of that service. Whilst this evidence was provided to us during the clarification process, we would expect DCC, going forward, to share upfront any supporting evidence that demonstrates that there is genuinely a single source e.g. through the provision of market testing, request for information (RFI) outcomes and/or enquiries to other providers.

3.73. For three other procurements, DCC justified that a non-competitive extension was decided on the basis that these services were approaching the end of their life cycle, and that choosing another provider could potentially be disruptive to those services.

[64] The Applications and Hosting contract with Capita IT&N supplies services such as EDAM, S1MRS and SDMR.

3.74. For another procurement, DCC shared evidence that an NCP approach had been chosen for reasons of knowledge and expertise of a particular service provider being critical to the continuity and delivery of a mandated programme.

3.75. For some procurements, DCC stated during the clarification process that the costs and/or consultancy rates of the service provider that was awarded the contract were below that of other potential service providers. However DCC did not provide any justification around how this conclusion was arrived at in the absence of a competitive tender process.

3.76. DCC was unable to provide the complete suite of paperwork and documentation for one single procurement in the selected sample of NCPs. For only five procurements was it able to present a completed NCP form. DCC was unable to share any supporting paperwork at all for one of the procurements.

3.77. In terms of the justification that was provided for conducting an NCP, both as part of the Price Control submission as well as following the Cost Visit, we note that in most cases DCC has listed down "*pressing timescales*" and a service provider's "*understanding of DCC's processes and systems*" as main reasons.

3.78. The justifications given in support of an NCP approach in respect of the contract extensions and call-off contracts mainly revolved around the economic advantages of either extending versus re-procuring a service and the savings DCC was able to realise via Capita's purchase volumes.

Planning

3.79. In terms of the concerns around multiple procurements overlapping in scope, DCC responded that particularly for activities that are focussed on improvements, there will inevitably be overlaps. DCC noted that there may be occasions where procurements need to be split into stages, starting off with a diagnostic stage to help determine a specific problem together with any recommendations for how to address that problem.

3.80. DCC confirmed through the Price Control submission that the new CEP provider was yet to be appointed, and that the projected forecasts relate to the procurement of that provider.

3.81. Through the Price Control submission, we also note that the planned new OMS portal and service had not yet been successfully used. DCC advised us that the material costs in RY21/22 represented pre-agreed contractual costs and that these costs were directly associated with the pausing of the project. DCC did not directly respond to the question as to steps or actions it had undertaken to anticipate and mitigate the added challenges and difficulties that were encountered over the course of this project. Nor did DCC provide evidence on why these costs were unavoidable and how these were managed with the view of keeping them to a minimum.

Executive Leadership Programme

3.82. DCC's submission explains that it has a number of complex programmes underway, and it was determined that its executive team should be provided with greater support to achieve the successful transformation and delivery of business-critical initiatives.

3.83. DCC stated that its chosen provider was best able to offer an executive programme which could support all aspects of DCC's business and support its transformational activities. The service would enable its staff to stay on top of technological developments.

3.84. At the Cost Visit, DCC explained that in addition to operational efficiencies, this programme would enable reduced spend on consultants.

3.85. We questioned why DCC had taken this contract on from Capita. DCC explained while it was originally a Capita contract, DCC had always paid for the service. We also questioned what assessments DCC had made prior to procuring this service, and requested evidence of such assessments, for example the expected reduction of spend and/or cost/benefit analyses.

3.86. Following the Cost Visit, DCC provided evidence of payment for the Capita contract dated May 2021. However, DCC did not provide evidence of payment for previous Regulatory Years, and did not provide further evidence of cost/benefit analysis or value for money (VFM) assessments.

Our View

Procurement

3.87. We recognise that there may be exceptional circumstances where an NCP is justified. However, both the Licence and DCC's own procurement policy clearly stipulate that the use of a single bid approach is only permitted where the value of the procurement is either immaterial or where it can be evidenced that it is the most economic and efficient option.

3.88. As a monopoly, DCC has an obligation to ensure that it does not restrict, prevent, or distort competition.[65] An NCP approach should therefore not be used to avoid competition or in circumstances where a decision to procure a particular service has been postponed or managed inefficiently.

3.89. For the avoidance of doubt, these obligations equally apply to contract extensions. A previous Price Control decision not to disallow costs associated with a contract in a particular year should not be taken as a default approval of any future extensions to that contract. We would expect DCC to continue to justify why it considered that an NCP approach for an extension was the most economic and efficient option.

3.90. We would also like to note that, where costs for a particular project were approved in a previous year, this does not constitute a default approval of new costs against that project going forward. For any new costs incurred, including those as a result of an extension, delays, change in contract terms, we would expect DCC to separately justify these as economic and efficient.

3.91. We would also like to remind DCC that the relevant licence obligations around competition and procurement also extend to any procurements that involve Capita. These obligations are complemented by the fact that in no circumstances Capita affiliates or any other organisation should be given preferential treatment.

3.92. Given the number of NCPs in this year's submission, we are concerned that DCC is not consistently complying with its own procurement policy nor with the relevant

[65] LC 11.3 – Part A: General requirement in relation to competition

procurement obligations in its Licence.[66] Going forward we expect DCC to adhere to the relevant steps that are set out in its own procurement policy, and justify accordingly any circumstances that may constitute or require a single bid award.

3.93. Considering all evidence received, we are of the view that not all costs can be justified as economic and efficient for those procurements where we have not received any satisfactory justification or evidence. **For that reason, we are minded to disallow the total cost of £3.095m that is associated to those procurements in RY21/22, and £1.264m associated with the procurements in RY22/23 and RY23/24.**

3.94. However, should we receive additional evidence of the circumstances, as laid out in DCC's own procurement policy, that justify an NCP approach for those respective procurements we may reduce the proposed disallowance accordingly. We welcome views and evidence from all stakeholders on this issue.

Planning

3.95. Whilst we agree that a procurement may need to be split into different phases, we would like DCC to provide greater assurance that the planning and scoping of a project is carried out in an economic and efficient way. Going forward, where a project is split into different procurements, we would like DCC to give more clarity on how these procurements/phases fit together in terms of scope and outputs. Also, for the avoidance of doubt, where the cumulative cost of a set of procurements, that form part of the same overarching project, exceed the agreed materiality threshold, we would expect DCC to justify the totality of these costs.

3.96. We would also like to remind DCC that, where costs for a particular project were approved in a previous year, this does not constitute a default approval of new costs against that project going forward. For any new costs, including those as a result of an extension, we would expect DCC to separately justify these as economic and efficient.

[66] LC 16.6 – Part A: Requirements that are imposed on procurement activities.

3.97. As to the OMS and CEP project, DCC provided no satisfactory explanation of what it had done to mitigate or prevent the risk of these projects being paused. Given that these projects have continued to incur costs however failed to deliver the planned benefits to customers, we are of the view that these are not economic and efficient.

3.98. **We are minded to disallow the costs that are linked to the OMS. The total proposed disallowance cost associated to the OMS and OMS analytics projects is £0.537m in RY21/22 and £0.005m in RY22/23 and RY23/24.**

3.99. **We are also proposing to disallow the costs that are linked to the CEP in RY21/22 (£0.089m) together with the forecasts for RY22/23 and RY23/24 (£0.39m).**

Executive Leadership Programme

3.100. We acknowledge that DCC's staff should be able to access learning and development opportunities. We note that DCC has increased its people team, adding roles that provide training, and learning and development for staff. We also note that DCC has existing access to basic learning services from Capita under the Shared Service Charge.

3.101. However, it is not clear what value the Executive Leadership Programme is adding over DCC's existing learning offerings. We do not have sufficient justification that DCC assessed its requirements for senior learning prior to taking this service on from Capita and expanding its remit to include executive leaders. We also do not have assurance that DCC fully considered its options for senior learning and ensured that this service would deliver value for money.

3.102. **We are therefore minded to disallow the incurred cost of the Executive Leadership Programme, amounting to £0.262m in RY21/22.**

Business Accuracy Programme

Context

3.103. One of the key business activities in RY21/22 were the initiation by DCC of the Business Accuracy Programme (BAP). According to DCC, the BAP seeks to deliver

robust process, system, and data improvements across key functions including Finance, Commercial, Portfolio and Risk. DCC justified that the driver of this programme follows the company's rapid growth in recent years, requiring the business to upgrade its internal capabilities so that it can cope with the increased scope and complexity of its activities in the future.

3.104. The projected aims and benefits of this programme are:

- transparency of performance for key stakeholders, based on clear and accurate data
- predictability and accuracy of delivery and costs, and risk management
- process efficiency and focus on benchmarking to deliver cost efficiencies and reduce customer cash contingency balance
- improvement in staff engagement, and efficiency, through easier ways of working and collaboration
- quicker and more agile ways of working across the business

3.105. The total incurred cost directly associated with the programme in RY21/22 was **£2.56m**. DCC further advised us through the submission and the Cost Visit that the financial forecast of the programme's total spend is **£6.04m**. The efficiency gains according to DCC are circa **£11.8m** over the period post implementation to RY25/26. Circa £1.8m of direct savings are expected to be realised because of automation and the subsequent reduction of resource costs; DCC notes that circa £10m of indirect efficiencies will be achieved through improved benchmarking of suppliers' costs, performance, and processes. The programme is expected to result in a net present value (NPV) saving to customers of £2.3m before the end of the licence.

3.106. As part of our cost assessment, we have asked DCC to share with us the analysis that supports the presented costs and benefits, together with additional evidence of how customers were kept informed of the programme's scope and costs.

3.107. Through our analysis we also identified that DCC had carried out a range of activities, other than the BAP, that shared a similar focus on making improvements to internal

systems and processes, including to finance, business planning and change management. We asked DCC to explain to what extent there is an overlap between the BAP and these activities, and where appropriate, explain how outcomes from previous procurements were taken forward and absorbed into the BAP work.

3.108. Finally, we also asked DCC to explain to what extent certain areas of focus under the BAP, such as for example the optimisation of SAP and business planning, are already paid for by the Shared Services Charge (SSC).

DCC's justification

3.109. Further information was shared by DCC both during and after the Cost Visit. In particular, DCC provided evidence of regular updates on the BAP to customers at three consecutive quarterly finance forums between the end of 2021 and mid-2022. As part of this, DCC also shared some examples of how it had used customer feedback to partially help shape up the scope and requirements of the BAP. DCC did not however provide any explicit evidence of customer support for the programme, nor did the customer updates provide full detail and transparency around the costs and benefits of this programme.

3.110. During the Cost Visit, DCC indicated that the indirect cost savings as a result of improved benchmarking capabilities, could not be directly attributed to the BAP. Following the Cost Visit, DCC provided the analysis that supports the programme's financial forecast of costs and benefits. We reviewed the analysis and determined that there is insufficient evidence to demonstrate how the presented benefits, both direct and indirect, are calculated and arrived at.

3.111. At the Cost Visit, DCC also gave an overview of the different activities that were procured outside the core BAP work, and clarified which of them had a direct or indirect interface into the BAP. As part of that update, DCC explained what outputs had been taken forward and used as part of the core BAP. DCC did clarify that the costs of these procurements (estimated at circa £0.4m-£0.5m over the course of RY20/21 and RY21/22) were separate to the BAP cost benefit analysis.

3.112. In response to what extent there is an overlap between specific BAP activities and the SSC, DCC noted that the BAP is adding bespoke changes to its finance and wider processes, data models and reporting to reflect updates in its business model.

Our view

3.113. As a monopoly, we welcome DCC's efforts to deliver cost efficiencies and provide greater predictability and accuracy around the forecast costs of its different programmes and activities. Whilst we welcome such changes and improvements, we expect that any investments to that effect are supported by robust cost benefit analysis.

3.114. In respect of the BAP specifically, we note that the analysis presented to us provides insufficient evidence on how the programme's benefits will be realised. For that reason, we consider that we do not have sufficient certainty that these costs are justified as being economic and efficient.

3.115. We also welcome DCC's regular customer engagement on the BAP, and their efforts to take on board any feedback and adjusting the scope of the programme accordingly. Given the magnitude of the programme's spend we are of the view that it would have been preferable for customers to be consulted on earlier in the process to ensure that they have full visibility and transparency of the cost benefit analysis that supports this investment. Instead, we note that only indicative costs and benefits, were shared with customers.

3.116. As to the multiple services that were procured alongside the core BAP, we are concerned that the outputs of each of these activities may not have necessarily been coordinated and adopted in the most optimal way, risking therefore a possible duplication of costs. We also note that by not including the costs of these additional activities into the overall business case, the actual cost benefits analysis is being misrepresented.

3.117. Finally, we also remain concerned about the potential overlap between certain workstreams under the BAP and areas of DCC that are already paid for by the Shared Services Charge (SSC). We have not received sufficient evidence from DCC, nor during the clarification questions process, nor at the Cost Visit, that shows to what extent some of these improvements sit outside or form part of the SSC framework.

3.118. Considering the evidence received, **we are minded to disallow all costs that are directly associated to BAP for RY21/22. The total disallowance cost amounts to £2.560m.**

Shared Service Charge

Context

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

3.120. In the RY16/17 Price Control decision, we decided that in future years we would not require further justification for the SSC associated with Baseline Activity for Price Control purposes.[67] For New Scope Activities, DCC must provide full justification to demonstrate that any SSC relating to these activities is economic and efficient.[68]

3.121. DCC does not apply SSC on External Services procured for Additional Baseline activities.[69] DCC has previously also opted not to apply SSC on some other components such as the costs associated with Brabazon House.

3.122. DCC is required through the RIGs to report information on the SSC, including how it has been calculated and how it provides value for money. As part of this year's cost assessment however, we have identified a few areas and activities where it is unclear to what extent some of these should be paid for under the SSC framework. One of these activities, for example, is the work that is part of the BAP and that is linked to the optimisation of data, including making improvements to DCC's financial reporting system. We understand that such improvements or upgrades form an integral part of DCC's accounting/general ledger services. Another area, for example, where it is unclear how costs are covered under the SSC framework, is recruitment services. This is particularly the case in the context of DCC's new resourcing model that was

[67] Ofgem (2018), DCC Price Control Decision: Regulatory Year 2016/17. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201617
[68] 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
[69] Additional Baseline activities are associated with requirements that the Licensee was expected to deliver at the time of the Licence Award, but which had not been fully costed in the LABP. For example, SMETS1 enrolment and adoption costs are considered Additional Baseline.

introduced in mid-2021, as opposed to the original recruitment services supplied by Capita.

3.123. As per our positions in previous years, we would like to re-iterate the importance for DCC to ensure that there is no cross-subsidisation across affiliates or related undertakings.[70] Given the growing concerns in this area, we expect DCC, going forward, to provide greater assurance that the SSC paid to Capita provides value for money. In its response to the RY17/18 consultation DCC proposed to that effect that it would "undertake an in-depth review of Capita Shared Services" and "ensure also that there is no 'double counting' between services provided by DCC and those same equivalent services that should be provided under the SSC".[71]

DCC's justification

3.124. This year, DCC applied the SSC at a rate of 9.5% on Baseline costs, which amounted to £7.897m in RY21/22 and £26.328m in forecast costs to the end of the Licence term.

3.125. As per previous years, DCC did not apply for SSC for New Scope Activities, such as the Switching Programme. Nor did DCC apply for SSC 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 and SMETS1-IT, SMETS1-OS.

3.126. DCC did apply for SSC on costs incurred for Network Evolution Programme (NEP), notably on activities such as NEP-IS, NEP-IT and NEP-OS. This year's application also included SSC on costs that are linked to the test lab operator.

Our view

3.127. As in previous years, we accept the 9.5% SSC associated with the baseline costs of DCC's core smart metering service.

[70] This is a requirement under Licence Condition 11 of the Smart Meter Communication Licence.
[71] Ofgem (2019), DCC Price Control Decision: Regulatory Year 2017/18. www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-201718

3.128. 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 SSC related to these activities are economic and efficient.

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

3.130. The decision to apply for an SSC on IS, IT and OS services for NEP is inconsistent with DCC's approach in previous years where it chose to exclude SSC on non-resource costs for additional baseline activities such as SMETS1. DCC has not provided any justification on why NEP non-resource costs should be treated differently from other additional baseline activities' non-resource costs. **We are therefore minded to disallow the SSC on these costs, which amount to £0.041m for RY21/22.**

3.131. We intend to follow the same approach going forward and expect DCC to exclude these costs from SSC for Additional Baseline activities in future years.

3.132. We also note the provision of test labs has now moved from the 'fit-out' phase into live occupation and operation. Whilst we understand that the costs associated with Brabazon House have therefore been renamed to costs that are linked to the operation of the test labs, we are minded to reject the proposed SSC for test labs. The reason here is that DCC has previously decided not to apply for SSC on costs that are associated to the fit out of Brabazon House, which by default included test lab operator costs. Nor has DCC previously provided evidence for why it specifically considers test lab operator costs should be attracting SSC. In terms of context, it is also worth noting that the test lab services were previously provided by the Communication Service Providers (CSP), which do not attract SSC given that the costs associated to them are external costs. **For RY21/22 this amounts to a disallowance of £0.170m. For RY22/23 and RY23/24 the disallowance linked to SSC on test labs amounts to £0.262m.**

3.133. 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 £0.762m in RY21/22 and £12.202m in forecast costs to the end of the Licence term.

Electric Vehicles and Product Management

Context

3.134. The incurred variance linked to the Product Management team in RY21/22 was £0.399m. Forecast variances for the team for RY22/23 and RY23/24 were £0.241m for each year.

3.135. As part of the past two Price Controls, we made partial disallowances against this team, based on the activities that were associated to Electric Vehicles (EVs) and load-control, as well as the exploration of future products. We considered that the focus should remain on the delivery of the core business. The evidence previously received did not indicate 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.

3.136. In RY21/22, DCC also procured a study to investigate the possibility for secure remote connectivity, thereby enabling the wireless communication between charging electric vehicles and DCC's system. The incurred cost of this project (Living Pillars) was £0.184m. In RY21/22, DCC also developed an EV proof of concept (POC) to support BEIS-funded trials on load control and EV charging. The incurred cost of the EV POC was £0.150m. Finally, a residual cost of £0.030m was incurred in RY21/22 that is linked to the strategic advice that DCC procured in RY20/21 to help develop DCC's narrative, stakeholder approach and engagement on EVs. The latter was disallowed as part of last year's Price Control, for the reasons mentioned above.

DCC's justification

3.137. In this year's submission, DCC acknowledged that given Ofgem's past decisions, it is essential that the Product Management team only focuses on those activities that are mandated or central to DCC, Ofgem, BEIS and Customer issues. DCC explained that for that reason this included the development of improvements to existing customers, together with support for development of government priorities related to smart meter implementation and load control (electric vehicle charging). For RY21/22, this included the following activities:

- 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

- supporting BEIS and government policy through the electrification of transport, heat, and energy efficiency in homes through DCC network reuse

- 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

3.138. At this year's Cost Visit, DCC confirmed that the learnings of the EV POC were being used for any future consultations that are issued around EV's and Energy Smart Appliances. DCC confirmed that no further work had been carried out since the completion of this project in September 2021.

3.139. DCC also confirmed at the Cost Visit that no further work had been undertaken on the Living Pillars project since it was completed in July 2021. DCC noted that the learnings from that project had been applied to several BEIS Flexibility Programmes to help determine the feasibility and trial of Smart Meter System based IoT sensor devices.

3.140. As to the future work of the Product Management team, DCC noted that the forecast data for RY22/23 and RY23/24 pre-dated the decision to close the team in May 2022. Going forward, the team's future key activities are expected to be taken on by existing DCC teams.

Our view

3.141. As per our positions in the past two years, we would like to re-iterate that DCC's priority and business strategy must be the delivery of its core business.

3.142. Whilst we recognise that policy requirements, such as in relation to EVs, may potentially become part of DCC's business in the future, we note that the work in this area is currently not a mandated requirement. We therefore consider it not appropriate that DCC continues to incur costs where there are not defined mandated requirements.

3.143. As per last year, we recognise that DCC has engaged with and responded to BEIS requests around load control and EV charging. We are of the view, however, that

DCC's input herein was not expected to be material given that these trials were operating on what the DCC network is already capable of, or what it could potentially do, rather than carrying out any new studies or developing additional products. As per our positions in previous years, we have concerns that DCC is continuing to place undue focus in this area. Notwithstanding that, we remain open to receiving additional evidence from either DCC, government and/or any other stakeholders that were driving the continued work and support around EV charging and load-control trials.

3.144. Our view regarding the EV engagement procurement remains the same as last year. We do not consider it appropriate for DCC to separately procure a communications strategy in this area.

3.145. We are **minded to disallow £0.199m of the costs associated with the product management team in RY21/22**. This corresponds to a 50% proportion of the team's time spent on work relating to EVs and load control and is in line with last year's decision.

3.146. Additionally, we are **proposing to disallow the forecasts associated with this team, amounting to £0.482m over RY22/23 and RY23/24**. 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, and note that the team has closed as of May 2022.

3.147. Finally, we are also minded to **disallow the costs that are associated with the development of the EV POC**, amounting to £0.150m in RY21/22 together with the costs linked to the procurement of the Living Pillars project, amounting to £0.184m in RY21/22. In line with last year, we are also proposing to disallow the residual cost of £0.030m in RY21/22 that is linked to the EV engagement work that was procured previously in RY20/21.

3.148. We continue to adopt 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.

Policy and Markets team

Context

3.149. DCC introduced new roles in the Strategy and Regulation team (formerly Regulatory Strategy and Performance Management), comprising a new Policy and Markets sub-team, and including a role focused on developing policy expertise and leading informed conversations with government. The Policy and Markets sub-team is responsible for developing market strategy, horizon scanning and market intelligence.

3.150. The team was created towards the end of RY21/22, but the roles were not yet filled as of 31 March 2022. The forecast costs associated with the above roles are £0.507m in RY22/23 and £0.480m in RY23/24.

3.151. In last year's RY20/21 Price Control, DCC forecast roles relating to this team which it expected to develop policy expertise within DCC, lead discussions with Ofgem and government regarding the reuse of DCC's network and ensure propositions that DCC puts to government are fit for purpose. We disallowed these forecast roles on the basis that DCC already had existing resource who are able to engage with Ofgem and government where relevant, and did not consider it appropriate for DCC to create additional roles focused on assisting or engaging with government on policy development.

DCC's justification

3.152. In its submission, DCC explained that the Policy and Markets team has been created to enable DCC to provide policy development, market intelligence and stakeholder engagement, led by a new Director of Policy and Markets.

3.153. At the Cost Visit, DCC explained that it regularly receives requests from government on how it can support government objectives and that it would pull resource from other teams to support with such requests. DCC also explained that it has seen an increase in requests for support on new services, including heat networks, hydrogen, and EVs, from other stakeholders.

3.154. Following the Cost Visit, DCC provided further information for the creation of the team and explained that in order to ensure policy alignment and support progress to Net

Zero, it needs to research and understand challenges in the sector so it can understand government, Ofgem and customers' priorities.

3.155. DCC explained that it received a request from government in spring 2021 to consider how it might support delivery of EV charging, heat, energy efficiency, DSO transition, and fuel poverty and vulnerable customers. This request led to further engagement with government and DCC exploring how its capabilities could be used to support government priorities.

Our view

3.156. As with our position last year, we consider DCC already has staff who can engage with Ofgem and government, and do not consider it appropriate for DCC to create additional roles focused on assisting or engaging with government on policy development.

3.157. While we acknowledge that DCC may have been receiving requests for input or support, we have not seen evidence of the scale of the increase of work, nor evidence of requests from government or stakeholders which could justify this level of resource increase. We have seen evidence of a government request which wanted to understand DCC's current capability but explicitly stressed that no additional work was to be carried out. We also do not consider it appropriate for DCC's customers to fund DCC increasing its headcount to support government policy-making.

3.158. As with our position on DCC's work on EVs from this year, and our RY19/20 and RY20/21 decisions, we consider DCC's focus should remain its core business. Where work is not a mandated requirement or part of the Mandatory Business, but comes via stakeholder request, there should be clear routes for funding, approval, and sign-off.

3.159. **We are therefore minded to disallow all costs associated with this team, amounting to £0.507m in RY22/23 of and £0.480m in RY23/24.**

Forecast costs

Context

3.160. 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 may remove them from the forecasts as part of the determination.[72]

3.161. 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 these 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 RY22/23 and RY23/24 where we have concerns over DCC's justifications.

DCC Justification

Corporate Management cost centre - Strategic Customer Engagement Team

3.162. DCC has increased the Strategic Customer Engagement team by 6 roles taking the team to 20 FTE. These roles are primarily to provide additional support with customer engagement, and the integration of Customer Engagement and Customer Portal staff into the Strategy and Regulation team within Corporate Management in RY22/23. In response to a clarification question, DCC explained that it also identified a need to increase resource to respond to the OPR Customer Engagement Incentive.

3.163. DCC forecast £0.209m in RY22/23 and £0.875m in RY23/24 in this team. DCC attributed the forecast variance in the Strategic Customer Engagement team due to no baseline being established for these roles due to these being created as an internal restructure.

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

Corporate Management cost centre - Document writing unit

3.164. DCC has created a sub team within the Regulatory Design and Delivery team, to write business cases in line with H.M. Treasury guidance. DCC provided justification that this team will give DCC the ability to develop business cases in line with the guidance from Licence Condition 16. The team consists of five roles, two of which transferred from elsewhere in DCC. The relevant changes to Licence Condition 16 came into effect in May 2020.

3.165. DCC explained that the scope of the business case requirements had increased from DCC's original assumption which created the need for a dedicated team. DCC had also considered other options such as interim contractor support and consultancy.

Finance & People cost centre – People Team

3.166. In the People Team DCC has forecast a variance of £0.484m in RY22/23 and a further £1.428m in RY23/34. DCC's submission states this variance is primarily caused by roles which provide training, learning and development for staff, and we questioned the number of new roles as it was unclear how many roles DCC had introduced.

3.167. In response to clarification questions, DCC stated that it needed talent acquisition roles, and learning and development roles, as these were identified as areas to improve and recruitment required support. At the Cost Visit DCC explained that only two new roles were forecast within this team. However, there is insufficient evidence for the variance of £0.484m considering only two roles are forecast.

Finance & People cost centre – Commercial Finance Team

3.168. In the commercial finance team DCC has forecast a variance of £0.888m in RY22/23 and £1.001m in RY23/24. DCC's submission states this variance is caused by four new reporting and MI analyst roles. DCC explained these roles are necessary to prepare reports as part of the Business Accuracy Programme.

SMETS1 programme

3.169. Last year DCC provided no payroll forecasts for RY22/23 onwards. This year DCC is expecting to incur costs through to RY23/24, explaining this is due to an updated

programme timeline. DCC provided an explanation in response to a clarification question, explaining that although the programme was due to come to an end, further device issues were identified which resulted in the continuation of this programme.

3.170. DCC further added that the estimated costs for these teams had been based upon the usual processes. The timeline for completion of this programme remains uncertain.

ECoS programme

3.171. This is a new programme, so all costs are variant, however DCC has provided limited details and forecasts have not been explained with sufficient justification.

Network Evolution programme

3.172. DCC have explained in detail the costs incurred in RY21/22 for this programme but have not provided sufficient details to justify their forecasts for RY22/23 and RY23/24. DCC highlighted in response to a clarification question that this programme had no baseline and therefore all costs were variances, and provided a summary of activities DCC expects to carry out.

Operations cost centre - Service Desk

3.173. DCC explained that the forecast variance in RY23/24 of £0.924m for Service Management are material due to a significantly lower baseline. DCC notes that the lower baseline reflects the historical assumptions around the scope of DCC's services, which it claims, has expanded over the years as DCC has been asked to perform more functions on behalf of government.

Forecast Baseline costs

3.174. DCC baseline forecast costs for RY24/25 onwards increase by an average of £67m each year. DCC however did not provide any justification for this increase in forecast costs. As with previous Price Control submissions, and in line with our Price Control Processes and Procedures Guidance, DCC's criteria for inclusion of costs is whether activities and costs are significantly more likely to occur than not. DCC therefore only attempted to justify forecast costs for RY22/23 and RY23/24 as the certainty criteria had not been met for RY24/25 onwards.

Our View

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

3.176. **As such, we are minded to disallow the forecast variance associated with these roles and procurements, amounting to £16.870m for RY22/23 and £14.978m for RY23/24.** Table 3.2 provides a breakdown of these disallowances.

3.177. **We are also minded to disallow all variation in DCC's baseline forecasts from RY24/25 onwards** given the lack of evidence and certainty provided in justifying these costs. This amounts to **£133.819m**, including the associated Shared Services Charge.

3.178. We are supportive of DCC working to improve customer engagement as this has been a concern for many years, and it is possible the current level may be appropriate for DCC to meet the needs of their customers. However, we would not expect DCC to increase this team further without a clear business need. We expect to see improvements in customer engagement next year to justify this increase in the team, and will keep this area under review.

3.179. Initially, it was unclear why the document writing unit required such a large team, nor how DCC currently prepares business cases and so how this team adds value. However, discussions at the Cost Visit explained that DCC likely does need this increased capacity due to volume and nature of business cases, and the insufficient quality of business cases it was developing previously. While we believe it's possible DCC may need this increased capacity, we expect to see clear evidence next year that business cases are of appropriate quality and have been produced in a timely manner, thus justifying the requirement for the team in future years.

3.180. We initially raised concerns with the number of new roles within the people team. However, after explanation from DCC at the Cost Visit we understand that only two new roles fall within this team. This raises questions around the forecast variance as it is not clear how two variant roles correspond to the £0.484m forecast in RY22/23.

3.181. It was unclear to us within the submission how the four roles within the Commercial Finance team can amount to £0.888m, and the requirement for the roles has not been sufficiently justified. In line with our consultation position on the BAP, we are proposing

to disallow the costs associated to these roles, and the entire variance of the Commercial Finance team as the additional variance has not been sufficiently justified.

3.182. In respect of the reasons put forward by DCC about the material forecast variances for its service desk, we are of the view that the increase in functionalities, and in particular the overall volume of devices, is in effect in line with what was historically anticipated.

3.183. Last year we disallowed all forecast variance for Network Evolution, SMETS1 and ECoS, due to large degree of uncertainty in programmes. We are again unsatisfied with the justification provided by DCC for the forecast costs on these programmes, and still consider there to be a large degree of uncertainty. We also do not have assurance that these forecast costs are economic and efficient and therefore propose to disallow all forecasts. We have deducted the cost of procurements where we have proposed a disallowance in the External and Internal Services section of this chapter, to ensure costs are not double-counted.

Table 3.2: Proposed forecast disallowances per cost centre in RY22/23 and RY23/24

Cost Centre	RY22/23 Disallowance (£m)	RY23/24 Disallowance (£m)	Total
Corporate management	0.652	1.174	1.826
Finance & People	1.372	2.429	3.801
SMETS1	4.385	3.302	7.687
ECoS	2.438	1.469	3.907
Network Evolution	7.724	5.680	13.404
Operations	-	0.924	0.924
Total	**16.571**	**14.978**	**31.549**

3.184. 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.

4. Performance Incentives

Section summary

This section covers DCC's submission of its performance under the Operational Performance Regime (OPR), which includes System Performance, Contract Management, and Customer Engagement Incentives. This section also covers any relevant Baseline Margin Project Performance Adjustment Schemes (BMPPAS). There are no decisions to be made on the BMPPAS for RY21/22.

Under the OPR, DCC missed its targets for the SUM1 and SDM2 system performance measures. We are minded to make a reduction to the Baseline Margin (BM) associated with the Baseline Margin Operational Performance Adjustment (BMOPA) terms SUM1 and SDM2 of £0.531m.

For the contract management incentive, an auditor assessed DCC's performance against the National Audit Office (NAO) framework according to the scope set out in the OPR Guidance. After assessing the auditor's final report, we are minded to award a score of 1.33 as suggested by the auditor, corresponding to a BM reduction of £0.338m.

For the customer engagement incentive, we received submissions from both DCC and SEC Panel on DCC's performance during RY21/22. After assessing both submissions we are minded to award a score of 1.42 to DCC, corresponding to a reduction of DCC's BM by £0.535m.

Question 12: What are your views on our proposed position on DCC's System Performance?

Question 13: What are your views on our proposed position on DCC's Contract Management?

Question 14: What are your views on our proposed position on DCC's Customer Engagement?

Background

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

4.2. This is the fourth year in which DCC's performance is being assessed by the Operational Performance Regime (OPR).

4.3. In RY21/22 there were no Projects to be assessed under the BMPPAS regime. R2.0 was finalised in RY20/21 and there were no relevant milestones for the SMETS1 and ECoS programmes.

4.4. Separately to the BM, DCC receives margin on the Switching Programme. This Switching margin is at risk under a separate performance regime. The fourth milestone of the Design, Build and Test Phase of the Switching Programme (the End to End Testing phase, DM4) was assessed this year. This is covered in the Switching section of this document (Section 6).

Operational Performance

Background

4.5. 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 for their views on how the OPR could be modified and improved. All respondents, including DCC, agreed with our concerns and supported a review of the original OPR framework.

4.6. Following consultation, in October 2020 we published our decision[73] to financially incentivise three areas under a revised OPR: system performance, customer engagement and contract management. As part of our decision, we also implemented

[73] DCC Operational Performance Regime Review: October 2020 Decision: www.ofgem.gov.uk/publications/dcc-operational-performance-regime-review-october-2020-decision

a Licence change to enable Ofgem to publish guidance, regarding the process, procedures and criteria of the OPR.[74]

4.7. In March 2021, we published the OPR Guidance to enable implementation, and published a revised OPR Guidance document in March 2022.[75] 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. While we were unable to conduct a trial for contract management, we set out in our RY20/21 Price Control decision[76] that the incentive would come into effect with margin attached in RY21/22 as originally intended. We decided to implement a 12 month grace period ("Transition Year") for system performance measures in RY21/22, for the new regime to come into effect in RY22/23.

4.8. The total BM at risk for RY21/22 is £6.76m. In accordance with the OPR Guidance, 70% of this margin is associated with system performance, 15% is associated with customer engagement, and 15% with contract management.

System Performance

Context

4.9. The original OPR was initially consulted on in March 2016 and the final decision and direction was published in September 2017.[77] In the RY21/22 Transition Year, DCC was assessed on its system performance against a version of the original OPR set out in the original OPR Guidance (March 2021). The revised OPR will come into effect for system performance in RY22/23.

[74] The relevant changes were made to Licence Condition 38.9.
[75] The original and revised OPR Guidance documents can be found at: Decision on OPR Guidance March 2021: www.ofgem.gov.uk/publications/decision-opr-guidance-march-2021
[76] DCC Price Control Decision Regulatory Year 2020/21: www.ofgem.gov.uk/publications/dcc-price-control-decision-regulatory-year-202021
[77] For more detail on the original OPR please refer to the decision document and consultation documents: www.ofgem.gov.uk/publications-and-updates/decision-dcc-s-operational-performance-regime

4.10. The original OPR consists of five performance measures: two Service User Measures (SUM) and three Service Delivery Measures (SDM). These were equally weighted in the original OPR, however for the Transition Year the weighting has been amended, and SDM1 (DCC Wan coverage) has been dropped from the measures as it was fully achieved in RY20/21 (so is now defunct). Table 4.1 lists the four measures and subdivisions for the Transition Year.

Table 4.1: Operational Performance Measures

Measure	Area of reporting	Metric	Weighting
SUM1	DCC service desk	Percentage of incidents resolved within Target Resolution Time	17.5%
SUM2a	Communication hubs	Percentage of Communications Hubs delivered on time	8.75%
SUM2b		Percentage of Communications Hubs accepted by customers	4.375%
SUM2c		Percentage of Communications Hubs not faulty at installation	4.375%
SDM2	Core service requests	Percentage of service responses delivered within Target Response Time	17.5%
SDM3	Service/System availability	Percentage availability of Data Service, User Gateway, Service Management System and Self Service Interface	17.5%

4.11. 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

4.12. The total BM at risk against system performance in RY21/22 is £4.731m. DCC reported that it did not meet the performance targets for the SUM1 measure (DCC service desk), and SDM2 (core service requests).

4.13. DCC's submission stated that performance for SUM1 fell below the target performance level, but above the minimum performance level. DCC explained that this was largely due to encountering issues with onboarding Service Providers and meeting incident timescales. DCC has requested to retain partial margin for this measure.

4.14. For SDM2, DCC's performance fell below the target performance level, but above the minimum performance level. DCC explained that this was due to SMETS1 Alert performance (CPM3)[78] falling below target, and is conducting remedial action. DCC has requested to retain partial margin for this measure.

4.15. DCC applied for three OPR Exceptional Event requests with industry for SUM2a – Communication Hubs (Delivery) - as performance was expected to fall below target, and provided evidence of these requests as part of its Price Control submission. On each occasion the SEC Panel approved the OPR Exceptional Event requested, noting the cause of disruption was outside DCC's control, resulting in DCC achieving the OPR target.

4.16. DCC met all remaining targets. Table 4.2 shows the overall performance DCC reported under OPR system performance for RY21/22.

Table 4.2: DCC's submitted OPR system performance values

OPR measures & performance targets	BM at risk (£m)	BM reduction (£m)	DCC's performance
SUM1 (90.11%)	1.183	0.305	83.84%
SUM2a (99%)	0.591	0.000	100%
SUM2b (99.9%)	0.296	0.000	100%
SUM2c (99.9%)	0.296	0.000	99.96%
SDM2 (99%)	1.183	0.226	97.59%
SDM3 (99.5%)	1.183	0.000	99.94%
Total	**4.731**	**0.531**	**-**

Our view

4.17. We accept the SEC Panel assessment of an OPR Exceptional Event with respect to SUM2a.

4.18. DCC did not meet its target performance levels for SUM1 and SDM2 measures. We consider that DCC should retain partial margin for missing these targets in accordance

[78] CPM = Code Performance Measure, as required by the SEC.

with the defined general formulas for the calculation of the original OPR. **Our minded to position is, therefore, to make a reduction to the BM associated with the BMOPA terms SUM1 and SDM2, of £0.531m.**

4.19. We note and welcome DCC's explanations that it is taking remedial action in relation to the missed targets.

Contract Management

Context

4.20. RY21/22 is the first year where DCC's contract management performance is financially incentivised under the revised OPR. DCC's performance in this area was assessed by an independent auditor using the National Audit Office (NAO) Framework, in line with the scope and requirements set out in the OPR Guidance.[79]

4.21. The scope of the audit covered DCC's contract management of DCC's Communication Service Providers (Arqiva and VMO2), Data Service Provider (CGI), and the three SMETS1 Service Providers which incurred the highest costs over RY21/22. It also assessed DCC's contract management in terms of adherence to the SEC modification change process. The audit also assessed DCC's procurement and re-procurement activity in RY21/22 under DCC's Network Evolution programme, covering the procurement of 4G Comms Hubs and Networks, and re-procurement of the Data Services Provider (DSP) and Smart Metering Key Infrastructure (SMKI).

4.22. The auditor provided its final report to Ofgem following completion of the audit in July 2022.

Auditor report

4.23. The auditor's report ("report") set out the auditor's view of DCC's performance against each supporting question in the NAO framework, which we discuss later in this section. A score of 0, 1 or 2 was awarded for each question, resulting in an overall score of

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

1.33 as indicated in Table 4.3. We also invited DCC and the SEC Panel to provide comment on the report.

Table 4.3: Summary of scores awarded against each supporting question in the NAO Framework domains

Domain	Key question	Supporting questions	Score
1. Commercial strategy	Is there an overarching commercial strategy, with a clear rationale for the approach being taken?	1.1. Is there a clear and consistently held view of what the contract is producing, the type of commercial relationship desired, the basic contract structure and how it will be managed?	**1**
		1.2 Has there been an assessment of strategic drivers, including policy drivers, and the internal and external environment?	**1**
		1.3 Has the commercial strategy been based upon the assessment of strategic drivers and the internal and external environment?	**1**
2. Capability & governance	Does DCC have the capability needed to manage the contract and is it developing capability for the future?	2.1 Does DCC have the necessary capability, skills and systems?	**2**
		2.2 Does DCC understand its future needs and is it working towards meeting them?	**1**
		2.3 Has DCC deployed its capability in a balanced way across the lifecycle and is commercial capability effectively integrated with the business?	**1**
3. Market management & sourcing	Has sourcing supported the commercial strategy and followed recognised good	3.1 Has market management driven long term value for money?	**1**
		3.2 Was there a defensible process that resulted in the selection of a capable supplier?	**1**
		3.3 Was there optimum use of competitive pressure?	**1**

Domain	Key question	Supporting questions	Score
	practice to optimise VFM?[80]		
4. Contract Approach	Does the balance of risk and reward encourage service improvement, minimise perverse incentives and promote good relationships?	4.1. Is there an appropriate allocation of risk between DCC and the supplier?	**1**
		4.2. Are there incentives to encourage the supplier to act in the interest of DCC?	**1**
		4.3. Are suitable mechanisms established to drive the desired relationship?	**1**
5. Contract management	Is the service being managed well, with costs and benefits being realised as expected?	5.1 Do DCC and the supplier have comprehensive knowledge of service performance?	**2**
		5.2. Are the suppliers delivering in accordance with the contracts, and are they actively managed by DCC to meet or exceed requirements (including delivering accurate, timely Impact Assessments)?	**1**
		5.3 Is DCC meeting its obligations?	**1**
6. Contract lifecycle	Will the service continue to demonstrate VfM through its lifecycle?	6.1. Does the contract continue to support DCC's strategic intent?	**2**
		6.2. Are VFM mechanisms used to ensure the contract continues to deliver VFM over its life?	**2**
		6.3. Is change controlled and well managed and does the contract remain current?	**2**
7. Transition & termination	Is DCC ready for the end of the contract?	7.1 Has market management been undertaken to support new contracts?	**1**
		7.2 Has the end of the contract been managed effectively to allow re-bid or handover?	**2**

[80] VFM = Value for Money

Domain	Key question	Supporting questions	Score
		7.3 Are insights from the operation of the contract brought to bear in developing the new contract?	**2**
		Total Weighted Score	**1.33**

4.24. The report noted that, in general, the quality of DCC documentation relating to contract management and procurement is representative of good industry practice, and that the commercial and procurement teams possess sufficient resource and skillset.

4.25. However, the report also notes that procedures set out in documentation are not consistently implemented in practice. In particular, the report finds that contract management processes and risk management is not embedded across DCC and its service providers.

4.26. The report also finds that there is often a lack of oversight or strategic steer coming from senior leadership, which results in an inconsistent approach to contract management and procurement.

4.27. Further, the report sets out that DCC consistently underperforms on timeliness for SEC modifications ("SEC mods").

4.28. The auditor also provided a set of recommendations which we have briefly set out below. These recommendations include improvements DCC could implement together with areas which should be considered for the second year audit covering contract management and procurement activity over RY22/23.

Summary of Key Recommendations

4.29. The auditor has provided several key recommendations going forward:

4.29.1. There should be a deep-dive review into implementing appropriate remedial actions in response to the deficiencies found in the first year audit, including (but not limited to):

- DCC's procurement process, including the approach to planning and market engagement
- The need for a stronger strategic steer of procurement and contract management activities by the DCC executive leadership team
- DCC's approach to risk management, and the absence of a clear overarching risk management and contract management framework which is fully embedded

4.29.2. There should be a competency and maturity assessment of the procurement and programme functions to ensure DCC's capability, capacity and strategy are aligned to delivering its Licence obligations. The auditor in particular highlighted this as a key consideration as an area of focus for the RY22/23 audit.

4.29.3. There should be an end-to-end review of terms of engagement/reference and ways of working between parties, particularly regarding:

- Approval/review of formal business cases and commercial strategies
- SEC mods, including adherence to and appropriateness of the impact assessment timescales
- Adoption of second tier providers (eg CSPs, FSPs, SMETS1 service providers) into the modification process

4.29.4. The methodology and approach to scoring future audits should be reviewed, as the current method (providing a score in aggregate across procurement, reprocurement, contract management and SEC modification change) has the potential for the scoring to be less representative of the actual performance by DCC, and cannot provide a detailed view of competency in an individual area.

Findings and recommendations - Procurement and reprocurement

4.30. The auditor identified that DCC has an inconsistent approach to stakeholder engagement, and noted that engagement to date with BEIS on business cases has been insufficient. The auditor recommends that terms of engagement should be reviewed and established to ensure stakeholder and service provider collaboration. The auditor also noted that the business case for the 4G CH&N programme was still outstanding at the time of audit, and raised it as a note of caution to ensure that lessons learned are taken forward into the DSP programme.

4.31. The auditor identified that when putting a tender to the market, DCC's market engagement is often not sufficient and fails to ensure value for money through creating sufficient competitive tension, which can result in poor outcomes – for example, receiving limited suitable bids. The auditor recommends that DCC improves its market approach, clearly articulating requirements to engage with potential suppliers better, and attract a range of different suppliers. The auditor suggested that for RY22/23 focus in this area should be increased, as this will become of increasing importance and is an area of significant concern. In particular, DCC aligning its procurement approach with customer needs should be considered.

4.32. Finally, the auditor notes that DCC does not consistently apply lessons learned analysis (or conduct them) for previous programmes before going to market for a new procurement, and recommended that lessons learned analysis should be embedded as standard practice across all programmes. The auditor also found the DSP reprocurement, at the time of the audit being conducted, was following good practice in terms of conducting lessons learned and taking them forward.

Findings and recommendations – Contract Management

4.33. The auditor highlights that DCC's overarching approach to defining and managing risk at an organisational level is undefined, and found there was no consistently applied approach to risk management and classification. Further, a number of the second tier providers indicated to the auditor that they felt disengaged in the approach to risk management through the contract management process. The auditor recommends an agreed and organisationally embedded risk management strategy, set at board level, with a clear organisational framework ensuring the processes are adhered to. The auditor would expect these to be incorporated into contract management activities

which represent the minimum acceptable requirements for how DCC manages its suppliers.

4.34. The report also finds that DCC has an inconsistent approach to supplier engagement, and recommends clear roles and responsibilities to be defined across the organisation, in alignment with stakeholder expectations.

Findings and recommendations – SEC modifications

4.35. The audit report sets out that DCC consistently does not meet required timescales for SEC mods. The auditor identified that there does not appear to be any proactive management of DCC in terms of the timeliness of Preliminary/Full impact assessments, and the level of collaboration amongst participants in the process does not appear sufficient, resulting in unexpected outcomes or KPIs not being met. The auditor recommended that the SEC mod process, and roles and responsibilities between DCC and SECAS, should be reviewed, ensuring compliance is monitored and DCC can be reasonably held to account. We would expect DCC to engage with relevant Service Providers as necessary so they are able to understand requirements.

Our view

4.36. After assessing the report and additional information provided by DCC and SEC Panel, we are not proposing any changes to the auditor's score and are **minded to award a score of 1.33 to DCC. This corresponds to a reduction of £0.338m of DCC's margin, out of £1.014m available.**

4.37. We consider the auditor's report sets out a comprehensive overview of DCC activity in RY21/22 within the scope of the audit. We expect DCC to take steps to address the issues and recommendations put forward by the auditor, engaging with industry, BEIS, SEC Panel, and other relevant stakeholders as necessary. As stated in our 2021 decision on the original OPR Guidance, while we recognise DCC may incur further costs to deliver improvements as a result of the audit's findings, we would assess any costs DCC incurs as part of our Price Control process to determine whether those costs were incurred economically and efficiently.

4.38. We note that the auditor currently finds the DSP reprocurement to be indicative of good industry practice. In the SEC Panel's feedback on the report, the Panel raised

concerns that the auditor did not discuss the late extension of the DSP contract and it was not included in the assessment.

4.39. We understand stakeholders' concerns with the late timing of the DSP extension, which occurred in March 2021. As the OPR contract management incentive came into effect from April 2021, the late extension was out of scope of this year's audit, though we note issues in DCC's market approach were identified this year in other areas. However, we expect the DSP reprocurement to be under significant scrutiny in the RY22/23 audit.

4.40. We also note the auditor's concerns with the scoring framework and that the overall score, as proposed this year, may not be a true reflection of DCC's performance. We intend to consult on the OPR Guidance to explore potential changes to the audit for next year.[81] This may include, for example, amending the scoring framework (to align with the customer engagement incentive's scoring of 0, 1, 2, or 3, allowing for more granular scoring), amending the respective weighting of different areas, including additional areas in the scope, or increasing focus on individual activities.[82]

Customer Engagement

Context

4.41. For the first time, DCC's customer engagement is financially incentivised under the new OPR. DCC's performance in this area assessed based on qualitative submissions received from both DCC and SEC panel. The assessment covers 3 sections: timing and frequency of engagement; quality of information provided by DCC; and accountability of customer views.

4.42. The three sections under customer engagement each have three assessment questions with relative weightings. The individual weighting for each assessment question is calculated as one third of its section weighting, with the overall score calculated using

[81] Licence Condition 38.9 sets out that any changes to the OPR Guidance require, at minimum, consultation with DCC. Our OPR Guidance states that, in general, we will publicly consult on modification to the guidance that could have a material impact on DCC's retained revenue, or that would lead to a material change to the focus of the OPR.
[82] The current scope of the audit is set out in paragraph 4.21

a weighted average of the scores specified for each question. For full details on the scoring methodology please refer to our guidance.[83]

4.43. To inform the scoring, we received submissions from both DCC and SEC Panel on DCC's performance during RY21/22 against the criteria set out in the OPR Guidance. We considered both the submissions and evidence provided to assess DCC's customer engagement performance in RY21/22.

DCC and SEC submission

Timing and frequency of engagement

4.44. DCC understands that it is critical to receive customer views to inform decision making processes. It has established a series of mechanisms to provide customers with sufficient opportunity to feed in views at appropriate frequencies.

4.45. DCC notes that it actively engaged with customers during RY21/22, ensuring it sought customer feedback at appropriate times during each stage of the programme delivery. DCC developed a new Change Delivery Methodology (CDM) which defined the processes to be produced during the lifecycle of its programmes. In RY21/22 DCC state they shared and jointly agreed engagement plans with its customers for 8 major programmes which included details surrounding the engagement activities that would take place. DCC declared that each engagement plan was reviewed with customers at all delivery lifecycle stages alongside the issues they intended to engage customers on.

4.46. DCC cited specific examples such as the SMETS1 Migration, which it believed was a prime example of how it enabled customers to feed in views. DCC also made reference to programmes such as the Great British Companion Specification (GBCS) change programme and the Joint Industry Plan (JIP) change request for Fylingdales where customers had 4 and 5 weeks respectively to provide feedback.

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

4.47. DCC made reference to its RY21/22 Business and Development Plan (B&DP). DCC stated to have captured insights at a customer workshop where it discussed their views, inputs, areas of concern and how they should prioritise.

4.48. DCC state they provided sufficient notice of their regulated consultations with customers having a minimum of 20 days to contribute their views, with a reduced response time only in exceptional circumstances. DCC state 95% of their communications were delivered within Service Level Agreement (SLA).

4.49. Overall DCC believes it has made concerted efforts to enable customers to feed in their views at appropriate points and frequency in RY21/22. Based on this, DCC proposed an average score of 2 for this assessment section.

4.50. According to the submission by SEC Panel, they received a varied level of customer engagement from DCC. On some occasions, papers were provided on time and with a clear purpose whilst on other occasions, papers were received late with some slides provided "on the day". Late submissions from DCC results in it being difficult for the Panel and Sub Committees to provide meaningful, useful and timely responses.

4.51. SEC Panel noted issues with the Network Evolution and SMETS1 Enrolment & Adoption engagement being poorly timed, unclear, or too late to make a difference to the overall decision. The Operations Group (OPSG) also experienced issues with DCC providing little time to discuss issues brought before it. This was especially challenging as DCC sought the decisions of this particular group to feed into the final outcomes.

4.52. SEC made reference to a Major Incident where DCC did not provide sufficiently frequent or timely information to Parties to enable them to make decisions in the most effective way. SEC feel categorisation and communication of Incident Management has been a recurring problem across Regulatory Years. DCC has been late to raise and escalate Major Incidents, following reports from multiple parties.

4.53. Additionally, SEC Panel are concerned that notifications of when a consultation is being published is not always clear for stakeholders.

4.54. SEC Panel believes DCC need to progress with their level of customer engagement as engagement is not always consistent. SEC Panel recommended an average score of 1 for this section.

Quality of information provided by DCC

4.55. DCC is aware of the need to deliver high quality information to its customers. SECAS rated DCC with an average quality score of 94% for RY21/22 across all Sub Committees indicating that the majority of DCC's papers were readable and comprehensible. DCC believe they have met the required standard and have consistently produced information that is of sufficient quality for broader engagement.

4.56. DCC provided an example of a SEC mod, where DCC provided SEC Panel and subcommittees with quality information which summarised the potential impact of a decision, and also provided examples of where DCC has undertaken reactive broader engagement in response to requests from industry. DCC regularly sought both quantitative and qualitative feedback to monitor the quality of information they have provided so they could improve accordingly.

4.57. DCC state they communicated with relevant audiences through their Nominated Contact List which is used for general communications, incidents, and SMETS engagements. DCC conduct a monthly audit to ensure the accuracy of this information by requesting that parties complete a Nominated Contact form to detail any additions, modifications, or deletions to the list.

4.58. DCC acknowledged areas where the quality of information could have been better. For example, during the DSP Tech Refresh, DCC's performance failed to meet its high standards. DCC state they are committed to undertaking a lesson learned exercise to improve and will be implementing a new strategy to ensure significant improvements are made in both downtime planning and the way it engages with stakeholders.

4.59. Overall DCC believes their information is of a quality standard and proposed an average score of 2 for this assessment section.

4.60. SEC highlighted the quality of information provided by DCC to Panel, Sub Committees and SEC Parties varies. SEC acknowledge DCC have made several attempts to discuss activities across Network Evolution projects with the Panel and Sub Committees, but have not provided the Panel and Sub Committees with clear plans and at times provide ambiguous statements for delivering objectives.

4.61. SEC Panel noted concerns with the Nominated Contacts List methodology, where information does not appear to be targeted to the right individuals. SEC Panel feels DCC updates are not always clear if the information provided is a general 'for awareness' message or if more specific action is required for a decision.

4.62. SEC feels DCC does not appear to engage with all constituents, for example Meter Asset Providers do not feel they receive relevant information. SEC Panel, Subcommittee and Parties feel DCC's customer engagement is not as good as it should be.

4.63. As a result of the above, SEC Panel awarded DCC an average score of 1 for this assessment section.

Taking account of customer views

4.64. DCC created DCC Boxed which is a product that was internally developed to enable end-to-end testing across the entire DCC ecosystem. Over the course of customer engagement, DCC stated to have sought views from stakeholders across a range of topics, starting from customer demand to consulting on technical detail. DCC stated to have utilised a range of engagement channels to provide and receive feedback from customers with relevant skills and expertise, such as Testing Advisory Group (TAG), Technical Architecture and Business Architecture Sub-Committee (TABASC) and Quarterly Finance Forum (QFF).

4.65. DCC state to have recorded all actions and views shared by customers and collated them in its central action log to ensure no action was missed. Since March 2022 DCC claimed to have set up a monthly review process for these actions to review key risks and worked with the action owners to ensure actions were closed properly and on time.

4.66. DCC published 24 consultation decisions which covered regulated and non-regulated areas of its work. DCC say they listened to the feedback customers provided and reflected it in its decisions. DCC introduced 'feedback loop and summary reports' as a widespread process improvement on how it communicates outcomes to its customers.

4.67. DCC state to have listened to customer frustrations on CSP-N performance and knew performance on this needed to improve. DCC also acknowledged issues in identifying

the prepayment metric under the OPR approach, and so held a stakeholder engagement meeting to discuss the technical details of this metric to find a solution.

4.68. Overall, DCC feel they have met the required standard and proposed an average score of 2 for this assessed section.

4.69. SEC Panel state it's not always clear that Parties' responses to requests made by DCC will make a difference and be considered. SEC recognise 'commercial confidentiality' is a blocker to Parties providing meaningful input. SEC believe sharing of the full picture to understand DCC's position is necessary.

4.70. SEC Panel generally feel feedback is ignored or not addressed by DCC. SEC Parties believe decisions are made prior to meetings and consultations, with the engagement with wider industry viewed as a 'tick box' exercise for DCC. SEC Panel feel when DCC disagrees with feedback provided, it typically remains silent and proceeds 'without explanation or justification'.

4.71. SEC recommended an average score of 1 for this assessment section.

Our view

4.72. We recognise DCC has put customer engagement plans in place, however there are inconsistencies with the level of engagement provided to customers and across the different channels used by DCC. It appears customers have opportunities to feed in comments particularly with consultations, and DCC seems to have multiple stages of decisions in its engagement plans. On the other hand, in some cases it appears DCC doesn't engage frequently enough with little time for stakeholders to make informed decisions.

4.73. It seems that while some existing processes such as DCC's consultation process work well, improvement is required in other channels. For example, information relating to the Network Evolution Programme and move to 4G Communication Hubs, has been described as both 'high level' and 'poor', and there are highlighted issues with the level of cost information provided. We are concerned that customers feel DCC is not clear on costs or benefits and as a result are unable to make informed decisions based on the level of information provided.

4.74. It appears that DCC has made some decisions which don't always align with the feedback DCC has received. Customers feel feedback is ignored and not acknowledged appropriately. There is limited evidence from RY21/22 that DCC closes the feedback loop with its customers.

4.75. Overall, we believe DCC has made efforts to seek views from stakeholders to inform decisions but needs to have greater consistency with its level of customer engagement. Based on the submissions received, **our minded-to position is to award an overall score of 1.42, corresponding to a BM reduction of £0.535m.** A breakdown of the scores is provided in Table 4.4 below.

Table 4.4: Customer engagement assessment criteria

Assessment questions	Ofgem Score	SEC Score	DCC Score
Timing and frequency of engagement			
1. Has DCC engaged proactively with customers, enabling them to feed in views at appropriate points in decision-making cycles?	2	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. 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	2
Average score	1.67	1	2
Quality of information provided by DCC			

Assessment questions	Ofgem Score	SEC Score	DCC Score
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	1	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
6. Has DCC provided the appropriate information to the relevant audiences when engaging with customers?	1	1	2
Average Score	1.33	1	2
Taking account of customer views			
7. Has DCC ensured its customers understand on which issues their views will inform decision-making?	2	1	2
8. Has DCC taken customer views into account in its decision-making?	1	1	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	1.33	1	2
Final weighted score	**1.42**	**1**	**2**

4.76. We also note that DCC is making improvements to customer engagement and has shown improvement over RY20/21. We would expect the improvements DCC has made and begun to implement would result in more consistent engagement next year.

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 £13.27m for RY21/22 to RY23/24. We are minded to reject the adjustment application for some of the activities, reducing the Baseline Margin adjustment by £0.32m. In addition to this, 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 £6.30m. Thus we propose to amend DCC's Baseline Margin application and allow £6.97m.

DCC submitted an application for an adjustment to its External Contract Gain Share (ECGS) of £35.10m across RY21/22 to RY25/26. This adjustment relates to the continuation of re-financing arrangements, the financing of Communication Hubs (CHs) and the operation of DCC's in-house test lab service. This year's ECGS application also includes forecasted savings that stem from the operation of DCC's in-house test lab service. We propose to accept DCC's ECGS Adjustment application of £11.89m relating to the continuation of re-financing arrangements, CHs financing and DCC's in-house test lab service. We are minded to reject £23.18m of the adjustment relating to forecasted DCC's in-house test lab service savings, and £0.03m relating to the temporary increase in CHs costs.

Questions

Question 15: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

Question 16: 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.[84]

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 RY21/22 Price Control submission, DCC has applied for a £13.27m[85] Relevant Adjustment to its Baseline Margin for work performed in RY21/22, RY22/23 and RY23/24.

5.5 DCC has identified eight drivers this year. All of them were included in previous years' BMA applications, and are associated with increased cost certainty or changes to

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

[85] The Relevant Adjustment and dependent figures might be revised following further engagement with DCC to quality assure the Baseline Margin model for any potential mathematical errors.

complexity, scope, timescales and/or volumes of the activities. No new grounds were raised this year.

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

Change Driver	Grounds and Activities: Resource and Non-Resource	RY driver first raised
SMETS1 (Increased certainty)	**SMETS1 programme** – various resource and non-resource activities	RY16/17
Network Evolution Programme – NEP – (Increased certainty)	**NEP programme** – various resource and non-resource activities	RY19/20
Enduring Change of Supplier - ECOS – (Increased certainty)	**ECOS –** various resource and non-resource activities	RY18/19
Facilitating Additional Relevant Services (Increased certainty)	Various resource and non-resource activities related to Brabazon House, DCC Test Labs	RY18/19
Market-wide Half-Hourly Settlement (MHHS) (Increased certainty)	**MHHS -** various resource activities	RY20/21
People Transformation (Increased certainty)	Various resource and non-resource activities	RY17/18
Technology Driven Change	**Security Driven Change** - Various resource and non-resource activities	RY17/18
	Technology transformation – resource activities	RY17/18
Operational Change	**Service Standard expectations –** resource and non-resource activities	RY18/19
	Moving beyond ITIL – resource activities	RY18/19
	Scope of Support – resource activities	RY18/19
	Operational resilience – Early Life Support – resource activities	RY18/19

5.6 The SMETS1 driver 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 over the next three years of £2.355m 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), and Test Automation. DCC is applying for an adjustment over the next three years of £4.437m due to increased certainty for this driver.

5.8 DCC first applied for adjustment of Baseline Margin for the Enduring Change of Supplier (ECOS) programme in RY18/19. In RY21/22 work in this area included: completing the procurement phases – Design, Build Test (DBT) and Hosting and Service Management; and providing a final draft of SEC Variation Testing Approach Document to BEIS, in relation to the Joint Industry Plan LC13. DCC is applying for an adjustment over the next three years of £1.322m due to increased certainty for this driver.

5.9 DCC first raised the Facilitating Additional Relevant Services driver in RY18/19 which was justified in relation the Brabazon House costs (which hosts both DCC's test lab and the Technical Operations Centre – TOC-). This year, together with the Brabazon House activities, DCC is applying for an adjustment based on "other activities facilitating additional relevant services" not related to the Brabazon House activities. DCC justified the inclusion of these new activities based on:

- Significant increase in the demands on project, programme and portfolio management activities arising from DCC providing a range of new capability and Programme services
- Material changes to the nature of the testing activities that DCC is now required to perform
- Additional obligations on DCC arising from BEIS taking powers under LC13 to require DCC to develop HMT Green Book compliant business cases

DCC is applying for a total adjustment over the next three years of £3.752m due to increased certainty for this driver.

5.10 DCC first applied for adjustment of Baseline Margin for the Market-Wide Half-Hourly Settlement (MHHS) programme in RY20/21. The application was based on the grounds that DCC is expected to play a central role in the MHHS solution, as its network would need to be able to accommodate the increased volume and regular retrieval of the data. In RY21/22 activities in relation to this programme ramped up as it moved into the implementation phase of deploying the technical changes that are required to DCC's network. DCC is applying for a total adjustment of £0.042m (mostly in RY23/24) due to increased certainty for this driver.

5.11 The People Transformation driver was first raised by DCC in RY17/18. Since then, the transformation of this function has been based on: the requirement to proportionally increase the level of resourcing in light of DCC's overall headcount increase; and to define and maintain DCC's culture and ways of working. This year there are costs associated with additional pay and reward work, as well as welfare and additional staff training. DCC is applying for a total adjustment over the next three years of £0.597m due to increased certainty over the costs for this driver.

5.12 This year's application for adjustment of Baseline Margin under the Supporting a Changing Business driver is based on Resource Planning and Management grounds. The basis for this application remain similar to previous years: increased volume and complexity of stakeholder engagement as well as the complexity of managing a multi-programme business. According to DCC this has fundamentally changed the nature of DCC and the requirements for its systems, processes and methodologies. In particular, DCC said that it is critical that DCC continues to deliver accurate and transparent plans to its stakeholders and easy to use and clear processes to its own staff. DCC is applying for a total adjustment over the next three years of £0.899m for this driver.

5.13 DCC is applying for adjustment of Baseline Margin under the Technology Driven Change driver based on two different and previously approved grounds: Security Driven Change and Technology Transformation. The Security Driven Change relates to activities enabling the transformation of DCC's security model. The main activities in the Security function over the RY21/22 are split into specific Security-related activities (eg security assessments, security compliance enhancement etc.) and Enterprise IT.

DCC is applying for a total adjustment over the next three years of £1.758m for the Security Driven Change ground.

5.14 The Technology Transformation ground relates to resource costs for device-specific technology experts who have deep knowledge of the specifications and performance of meters and installations that DCC's systems have needed to accommodate or are expected to accommodate in future. DCC is applying for a total adjustment for RY22/23 and RY23/24 of £0.155m for this ground.

5.15 DCC is applying for adjustment of Baseline Margin under the Operational Change driver based on several previously approved grounds:

- Ops Service Standard Expectations
- Ops - Moving beyond ITIL
- Ops - Scope of Support
- Operational Resilience - Early Life Support

5.16 These grounds relate to investments in DCC's operational capacity. DCC stated that over the last few years the operations function has grown 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. In addition to this underlying drivers, this year DCC has reported activities in relation to: the submission of its Communications Hubs to the SMDA Scheme (Smart Meter Device Assurance); and the need to use SMETS1 and SMETS2 emulators to model device-specific behaviour without impacting the live system. The basis for application in terms of volume and complexity remain similar to last year. DCC is applying for total adjustment over the next three years of £1.623m due to new activities associated with this driver.

Our View

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

5.18 We are minded to reject the resource and non-resource activity related to the grounds: Moving beyond ITIL, Scope of Support and Operational Resilience - Early Life Support - as DCC has not provided any specific justification for the proposed adjustment to BM for these grounds. **This is a proposed reduction of £0.155m**.

5.19 We are minded to reject the following non-resource activity under the Facilitating Additional Relevant Services driver: HMT Business Case Development. It is our view that DCC has missed the "Application Window"[86] for this activity. This is because the relevant changes to the Licence Conditions (LC) which prompted DCC to incur this cost came into effect in May 2020, after a period of public consultation. Therefore, our view is that the first Application Window to raise any expected costs in relation to this changes to the LC was within the month of July 2020. In addition to this, we are not convinced this activity meets the Licence criteria of a material change in volume, complexity and/or timescales. This is because DCC should have been applying a robust and documented methodology to ensure its procurement process delivers value for money in any event. The requirement that this process is aligned with HMT Business Case Development guidance should not represent a material change in the volume or complexity of this activity. **This is a proposed reduction of £0.04m**.

5.20 Finally, we are minded to reject a number of non-resource activities under the following grounds: Security driven change, Facilitating Additional Relevant Services, Resource Planning and Management. The reason for this is that we feel we have not received enough evidence to properly assess whether these activities meet the LC criteria for a Baseline Margin adjustment:

- For some of these activities, it is not clear how they specifically meet the material increase in volume and/or complexity criteria. In some cases DCC provided some vague justification or very detailed description of the activity but without directly addressing how they meet the LC criteria.

[86] The Application Window for a Relevant Adjustment is defined under LC36, Appendix 2, paragraph A6 as follows: "Notice given under paragraph A2 of a proposed Relevant Adjustment: (a) may be served at any time during the month of July ("the Application Window") in any Regulatory Year […]; (b) must be served within the first Application Window after the date on which the grounds for proposing the Relevant Adjustment first arose.

- We also requested DCC evidence on how all of these activities met the "Application Window" which was not provided.

This is a proposed reduction of £0.166m.

5.21 We were disappointed that in some instances DCC applied for a Relevant Adjustment to the margin for activities under grounds and/or drivers that were not relevant to those activities. In those cases, we sought to assess the application for adjustment based on its own merits rather than relying on the justification for the Driver or Ground (ie, as if DCC had raised a new ground for that particular activity), which usually required requesting further information from DCC. However, this increases the complexity of assessing DCC's application for a BM adjustment. We would encourage DCC to ensure it is applying for margin under the right grounds and drivers in future applications.

5.22 As in previous years, we remain open to receiving additional evidence from DCC to justify its application for Relevant Adjustments and would take into account such evidence to revisit the proposed reductions where appropriate.

5.23 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.

5.24 **For RY21/22 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

5.25 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 £5.978m.

5.26 Similar to last year, a significant proportion of BM reduction due to cost disallowances is due to forecast cost disallowance for RY22/23 and RY23/24. 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.

5.27 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 RY23/24, RY24/25 and RY25/26.

5.28 Taking all of these disallowances into account, **we propose reducing the adjustment by £6.30m, therefore amending DCC's application to an adjustment of £6.97m between RY23/24 and RY25/26**, as shown in Table 5.2.

Table 5.2: Proposed Baseline Margin compared to Baseline Margin as of the RY20/21 Price Control decision

Baseline Margin (£m)	RY23/24	RY24/25	RY25/26	Total
Baseline Margin as of RY20/21 decision	7.492	5.648	0.917	**14.057**
Adjusted by RY21/22 application (Difference from RY20/21)	11.160 (3.668)	8.988 (3.341)	7.177 (6.259)	**27.325 (13.268)**
Adjusted by RY21/22 consultation proposal (Difference from RY20/21)	8.620 (2.540)	7.995 (0.993)	3.741 (3.436)	**20.356 (6.969)**

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

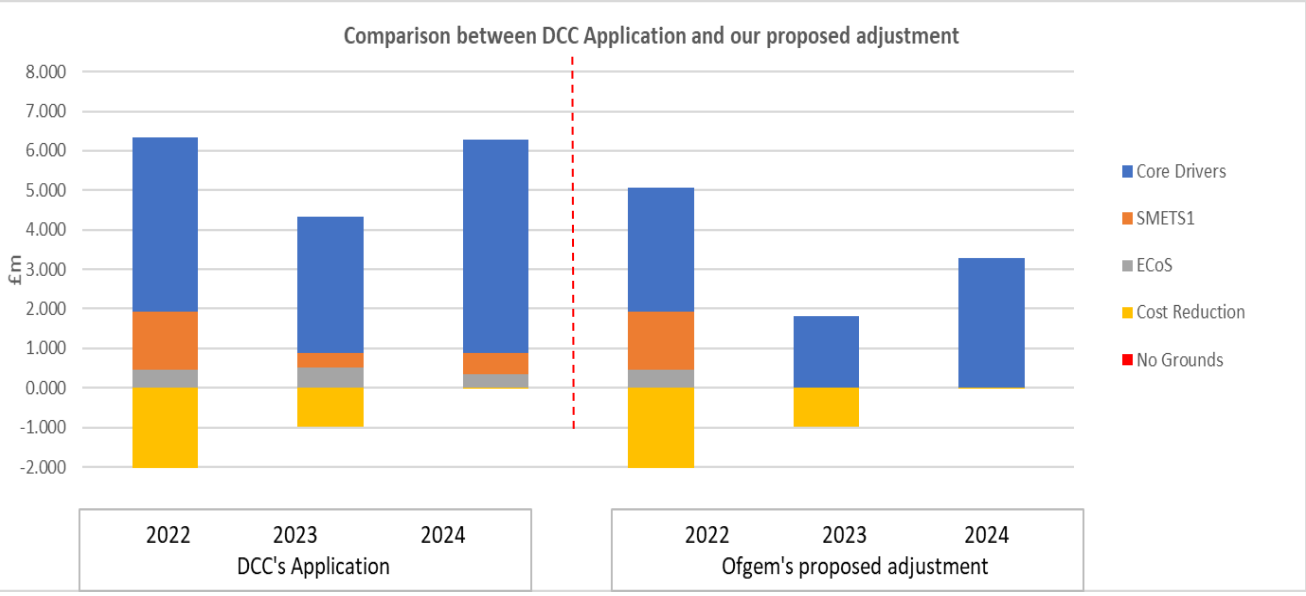


Figure 5.1: Data Table

Driver	Application			Proposal		
	RY21/22	RY22/23	RY23/24	RY21/22	RY22/23	RY23/24
Core Drivers	4.414	3.451	5.399	3.286	1.980	3.446
SMETS1	1.480	0.358	0.517	1.480	0.000	0.000
ECoS	0.451	0.519	0.353	0.451	0.000	0.000
Cost Reduction	-2.676	-0.987	-0.010	-2.676	-0.987	-0.010
No Grounds	0.000	0.000	0.000	0.000	0.000	0.000
Total	**3.668**	**3.341**	**6.259**	**2.540**	**0.993**	**3.436**

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 in People Transformation	0.20	0.17	0.23	0.15	0.08	0.13
Increased Certainty in Security Requirements (Security driven change)	0.44	0.32	1.00	0.23	0.23	0.90
Increased Certainty Levels on the Development and Delivery Network Evolution Programme	2.19	0.93	1.32	2.03	0.00	0.00

Driver	Application			Proposal		
	RY21/22	RY22/23	RY23/24	RY21/22	RY22/23	RY23/24
Increased Certainty on Facilitating Additional Relevant Services	0.82	1.62	1.31	0.63	1.27	1.03
Increased Certainty on MHHS	0.00	0.00	0.04	0.00	0.00	0.04
Increased Certainty on the development and delivery of the ECOS Programme	0.45	0.52	0.35	0.45	0.00	0.00
Increased Certainty on the development and delivery of the SMETS1 Service	1.48	0.36	0.52	1.48	0.00	0.00
Increased Certainty Service Standard expectations (Operational Change driver)	0.21	0.16	1.08	0.21	0.16	1.08
Moving beyond ITIL (Operational Change driver)	0.00	0.00	0.04	0.00	0.00	0.00
Operational Resilience - Early Life Support (Operational Change driver)	0.00	0.00	0.04	0.00	0.00	0.00
Scope of Support (Operational Change driver)	0.00	0.00	0.07	0.00	0.00	0.00
Service standard expectations (Operational Change driver)	0.00	0.00	0.01	0.00	0.00	0.01
Supporting a Changing Business	0.55	0.15	0.20	0.04	0.15	0.20
Technology Driven Change	0.00	0.10	0.06	0.00	0.10	0.06
Cost reduction	-2.68	-0.99	-0.01	-2.68	-0.99	-0.01
No Grounds	0.00	0.00	0.00	0.00	0.00	0.00
Total	**3.67**	**3.34**	**6.26**	**2.54**	**0.99**	**3.44**

External Contract Gain Share

Background

5.29 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[87]. 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

5.30 DCC has applied for a £35.10m Relevant Adjustment to its ECGS term for RY21/22 to RY25/26 on the basis of £93.90m savings to industry as a whole and £58.77m being returned to customers, reflecting a reduction in External Costs.

5.31 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 £6.0m across both Communication Service Providers (CSPs) from RY21/22 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. In relation to the continuation of these re-financing arrangements, in RY21/22 DCC applied for a Relevant Adjustment of £2.14m[88] based on £6.0m total savings to industry and £3.64m being returned to customers.

5.32 In RY19/20 DCC successfully managed to secure alternative, value for money, funding arrangements for the financing of Tranche 2 Comms Hubs, which has continued to generate savings in reach RY since. The significant reduction in interest rates for both CSPs have resulted in £10.11m savings in RY21/22. This financing relates to Tranche 2 CHs which represent approximately 85% of all Communication Hubs (CHs). In relation to CHs financing, in RY21/22 DCC applied for a Relevant Adjustment of £3.79m (37.5% DCC's gain share) on the basis of £10.11m of total savings to industry and £6.32m being returned to customers (62.5% customer gain share).

5.33 DCC has also applied for a Relevant Adjustment for the savings made from in-house test lab service DCC is providing at the Brabazon House. The provision of testing

[87] 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.
[88] DCC's gain share ranges from 25% to 37.5% depending on the CSPs. Customer share ranges from 50% to 62.5%.

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 £16.0m have been achieved in RY21/22, and DCC expects a further £61.8m savings by the end of RY27/28.

5.34 In RY21/22 DCC has applied for a Relevant Adjustment of £29.17m (37.5% DCC's gain share) for achieved and future savings relating to test labs, on the basis of £77.78m of total savings and £48.61m being returned to customers (62.5% customer gain share). Of this Relevant Adjustment, £5.99m are related to the achieved savings by RY21/22, and £23.18m are related to the expected savings by the end of RY27/28. It is worth noting that this is a departure from last year's submission where DCC only applied for a Relevant Adjustment in relation to the achieved savings. DCC explained that it changed its approach following the issue of our revised guidance regarding the grounds for proposing a Relevant Adjustment.

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

Customer Benefits

5.36 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.

5.37 Between RY15/16 (DCC's first ECGS Adjustment application) and RY21/22 (including this year's application), DCC has secured cost reductions of £249.40m, relating to savings in in the FSP contracts, CHs financing and DCC's test labs; and brought benefits of £142.2m (c.57% of total cost reductions) to DCC's customers (based on DCC's ECGS applications).

Our View

5.38 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.

5.39 We are minded to accept most of the Relevant Adjustment related to the financing of Tranche 2 CHs. We consider that, for the most part, DCC's application is duly made and that DCC has provided sufficient evidence that it was instrumental in the arrangement. DCC's application justified that the overall saving from the refinancing and financing arrangements would not have been achieved without DCC's involvement.

5.40 However, we note that there has been a temporary increase in CHs unit prices above and beyond of what was stipulated in the standard contractual terms, which has had the effect of slightly inflating the savings used to calculate this Relevant Adjustment to the ECGS term (for a more detailed discussion around the temporary increase in CHs unit price please see paragraphs 2.52-2.60 in Chapter 2 of this Consultation document). The purpose of ECGS is to reflect cost reductions that DCC helped to achieve. It is our view that awarding ECGS stemming from a temporary increase in costs outside the standard contractual terms would go against the intended purpose. Therefore, we propose to reject the amount of Relevant Adjustment due to the temporary increase in CHs unit price. We have calculated this amount to be £0.025m. This means that we are proposing to accept a Relevant Adjustment related to the financing of Tranche 2 CHs of £3.766m.

5.41 We are minded to accept the Relevant Adjustment related to the realised savings made from DCC's in-house test lab service. We consider this Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence. This is a Relevant Adjustment of £5.99m. However, we are proposing to reject the Relevant Adjustment related to the forecasted savings expected to be made from DCC's in-house test lab service. This is a rejection of Relevant Adjustment to the ECGS term of £23.18m. DCC would be able to reapply for a Relevant Adjustment to the ECGS terms for these savings in future years, once they are realised or certain. We discuss the reasons for our position in the paragraphs below.

5.42 Although we welcome DCC's role in consolidating testing facilities we do not believe all the criteria for Relevant Adjustments for future savings, which are set out in LC39 and further clarified in the Guidance, have been met.[89] In particular, we note that the future savings have been submitted to us as estimates or forecasts and DCC did not submit evidence of its certainty. Therefore we do not consider the estimated savings to be certain. In our view the Guidance is clear on this: "If DCC proposes an adjustment which spans several years of its Licence, and it is accepted by Ofgem, but the values for future years are not certain at the time of the original application DCC should apply for the specific values in the first application window after such values becomes certain (for example, when net savings are realised or certain to be achieved)."

5.43 In addition to the above, DCC's position goes against last year's precedent: in last year's submission, DCC only applied for a Relevant Adjustment to the ECGS term for the realised savings from Test Labs. We disagree with DCC's justification for this change of approach. As noted in the paragraph above, our guidance is clear that specific values should be applied when they become certain and not before.

5.44 Apart from the Relevant Adjustments related to the forecasted Test Lab service savings, and the temporary increase in Tranche 2 CHs unit price, 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.

5.45 We therefore propose to reduce the Relevant Adjustment to the ECGS term by £23.21m, therefore amending DCC's application to an adjustment of £11.89m between RY21/22 and RY25/26.

[89] See paragraph 5.10 of "Guidance - DCC Price Control: Processes and Procedures" (July 2022): www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

6. Switching Programme

Section summary

This section provides our assessment of DCC's costs associated with the Switching Programme in RY21/22 and the forecasts to the end of the licence period. We find that the costs incurred in RY21/22 are economic and efficient. We propose to disallow DCC's forecast costs of £8.636m for RY23/24 onwards as DCC has not provided sufficient justification for these costs.

This section also gives our view on the fourth incentivised delivery milestone of the Design, Build and Test phase of the Switching Programme: Delivery Milestone 4 (DM4). This year, DM4 was successfully achieved. We therefore propose that DCC should retain all margin associated with this milestone.

Questions

Question 17: What are your views on our proposed position on DCC's costs associated with the Switching Programme?

Question 18: What are your views on our assessment of Delivery Milestone 4 of the Switching Programme?

Switching costs

Context

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

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

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

DCC's justification

6.4. DCC submitted incurred and forecasted costs for the Switching Programme until the end of the Licence period. DCC incurred total costs of £25.429m in RY21/22, which is broken down into £5.366m of Internal Costs and £20.063m of External Costs.

6.5. DCC forecast a total cost of £20.103m from RY21/22 until the end of the Licence period, which is broken down into £6.29m of Internal Costs and £13.813m of External Costs. DCC only provided some justification for forecast costs in RY22/23 and RY23/24 which totals to £14.363m.

6.6. However, there is not sufficient information on how these costs are aligned with the costs in delivering the new switching arrangements now that the Switching Programme went live in July 2022.

Our view

6.7. Due to insufficient justification our minded-to position is to disallow all forecast costs for RY23/24 to the end of the Licence period, amounting to £8.636m. We will therefore also disallow the corresponding margin (which is calculated as a percentage of Internal Costs), an additional £1.174m

Switching Performance

Context

6.8. 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.[90] Note this is a separate regime from the Operational Performance Regime and Baseline Margin Project Performance Scheme (discussed in chapter 4).

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

6.9. The first of the delivery milestones under the DBT Phase occurred in RY19/20. As Delivery Milestone 1 was delayed, DCC lost all associated margin. The second and third of the delivery milestones occurred last year in RY20/21. Both milestones were successfully completed. Delivery Milestone 4 (DM4) required DCC to complete the Programme-led End to End Testing which was achieved in February 2022.

DCC Submission

6.10. DCC provided evidence of DM4 completion via a report confirming the three criterions for this delivery milestone were achieved and approved by the licenced assurer. The report gave details of the acceptance criteria and the method for testing whether each requirement had been successfully met.

6.11. All margin on Internal Costs relating to the successful delivery of the DBT phase is at risk against the DBT milestones, with 10% of the total margin at risk against DM4. 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.

6.12. DCC submitted evidence that it should retain all margin associated with DM4 as they had achieved their milestone for RY21/22.

Our view

6.13. We are satisfied with the evidence DCC have provided on the completion of their delivery milestone.

6.14. In light of the above, **we propose that DCC should retain all margin associated with DM4 which equates to 10% of the total margin**.

7. Over-Recovery of Revenue

Section summary

DCC over-recovered revenue from customers by 113% in RY21/22, which is above the 110% threshold. DCC has provided some reasons for the over-recovery of revenue. However, we were not convinced by DCC's justification and are therefore proposing to apply the penalty interest rate against the amount that has been over-recovered. We are open to receive additional evidence and explanation from DCC on what has caused the over-recovery and why it could not have reasonably predicted the increase in costs.

Questions

Question 19: What are your views on our proposal on DCC's over-recovery of revenue?

Over-Recovery of Revenue

Context

7.1. 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.[91]

7.2. A penalty interest rate regime was introduced in RY16/17 to incentivise DCC to improve the accuracy of its charges to users and deter it from over-recovering.[92] The threshold for over-recovery of service charges is equal to 110% of Allowed Revenue, and 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.

[91] See LC36.4
[92] Ofgem (2016), Decision to modify licence to introduce a DCC penalty interest rate. www.ofgem.gov.uk/publications/decision-modify-licence-introduce-dcc-penalty-interest-rate

7.3. For RY21/22, the ratio of Regulated Revenue (£563.9m) to Allowed Revenue (£499.7m) is 113% – above the 110% threshold.

DCC's justification

7.4. DCC argued that almost 77 per cent of the total over-recovery was due to the accumulated correction factor, with the remaining 23 per cent being related to in-year underspend.

7.5. DCC explained that it has allowed the cumulative correction factor to grow in order to meet their cash flow policy, which allows DCC to deal with any potential spending peaks during the year. This cash flow policy means DCC will always breach the threshold going forwards, and DCC suggests a change in the penalty interest regime to allow DCC to keep a healthy cash position.

7.6. In relation to the in-year underspend, DCC argued that this was due to a combination of both, a slight underspend and greater revenue that expected. The underspend was due to different factors such as: fixed CH charges and Explicit Charges were lower than expected, unused prudent estimate, pass-through costs lower than forecast, baseline margin lower than forecast, and timing of receipt of invoices and relevant payment terms. The additional revenue was due to additional meter numbers. DCC explained that in Q1 2022 it identified that it was expecting to spend less that what it was initially forecasted, and that the majority of this underspend was returned to customers through reduced charges. However, there was still a slight underspend in the balance for RY21/22.

Our view

7.7. We are disappointed DCC breached the threshold, and find it concerning it intends to keep doing so in the future in accordance with their current cash flow policy. Given the justifications provided to date, we are not convinced DCC needs to breach the threshold in order to keep a healthy cash flow position.

7.8. In relation to the in-year underspend, we recognise that there may be acceptable circumstances where unanticipated costs and or revenue can lead to an over-recovery of charges. When this is the case, we do expect DCC to provide sufficient detail on what has caused this and why it could not have reasonably avoided such cost increase. DCC provided some justification for this underspend, however we do not consider it to

be sufficient. For example, it did not provide any detail around the "unused prudent estimate", or the "timing issues". We also consider that DCC could take further steps to improve the accuracy of its estimates.

7.9. As per our views elsewhere, and in previous years, we expect DCC to improve the predictability and accuracy around the forecast costs.

7.10. Given the above arguments, we are, therefore, proposing to apply the penalty interest rate, in accordance with the Licence[93], against the amount that has been over-recovered.

7.11. We welcome, however, additional evidence and explanation from DCC on what has caused the over-recovery and why it could not have reasonably predicted the increase in costs.

[93] Part G, LC36.20 (a)

Appendices

Index

Appendix 1 – External Costs Assessment

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, the change and project requests (CRs/PRs) with value over £1m which DCC progressed within the SMETS2 and SMETS1 programmes, and the introduction of new service providers in the ECoS programme.

A1.2. Table A1.1 below provides an overview of DCC's main contracts relevant to our assessment of DCC's External Costs.[94] DCC's main role is to effectively manage these contracts to derive value for money and quality service for its customers.

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

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

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

Capacity	Role	Provider	RY of contract
ECoS service providers			
Technical Application Service		CSW	21/22
Hosting Services and Service Management		Accenture	21/22

Key material variances

SMETS2

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

A1.4. In RY21/22 DCC incurred £298.78m in total FSP costs. DCC justified 12 new material CRs/PRs with a total value of £49.33m.[95] The principal drivers behind were as follows:

- Delivery of the November 2021 SEC release
- Firmware updates to mandated HAN[96] devices
- SI[97] Release Management
- DSP Extension Tech Refresh

[95] £20.91m of these new costs were incurred in RY21/22 with the remainder to be incurred in future RYs.
[96] Home Area Network
[97] System Integrator

Testing Services

A1.5. DCC justified 3 CRs/PRs extending DSP testing services driven by the extension of this service provider's contract to October 2024: CR4195, CR4191 and PR7069. Their scope is set out in table A1.2 below.

A1.6. DSP's User Integration Testing (UIT-B) environment came into service in May 2018, for a period of 36 months. CR4195 extends the DSP's UIT-B test environment support and operation until the end-point of the extended DSP contract in October 2024. DCC negotiated savings in service labour costs as well as through challenging 3rd party supplier prices and licensing requirements.

A1.7. CR4191 extended the DSP's UIT Testing Services to support Test Participants, CSPs and SPs from April 2021 to October 2021.

A1.8. PR7069 extended Production Support Testing (PST) services from 1 April 2021 to 31 March 2022. PST is needed to fix defects and production incidents via maintenance releases. Compared to PR1267, which provided this service from the period October 2020 to 31 March 2021, DCC secured a 43.6% reduction in charges through assessment of actual effort spent on PST in the previous period, estimated lower volumes of testing through the new 12-month period, as well as more stringent control over activities using project trackers.

A1.9. DCC also justified 2 CRs covering testing services for CSPs: CR4157 and CR4074.

A1.10. CR4157 extends SIT-A and UIT-B test environments for CSP C&S beyond July 2021 when the contractual scope of CR208 (Commissioning and Provisioning of SIT-A and UIT-B environments) expires.

A1.11. CR4074 delivers baseline UIT testing services requirements for CSP-C&S. Following a series of reviews with the CSP on UIT testing support services, DCC decided that only core activities should be contracted on an enduring basis while other support services, including firmware maintenance releases and triage & defect management would be contracted as and when they are required through new CRs/PRs. DCC explained that this was in line with its strategy to minimise dependence on External Service Providers (with more testing performed in DCC's labs) and to separate out the standing elements of the service from the project related ones, so that cost allocations between the two are more accurate.

Table A1.2: Overview of newly justified CRs/PRs within Testing Services

Material CR/PR	Description	Service Providers Affected
CR4195	Extension of DSP UIT-B environment until the end of October 2021	**DSP**
CR4157	Extension of the CSP Central and South SIT-A and UIT-B test environments beyond 31 July 2021	**CSP (C&S)**
CR4074	Delivery of CSP Central and South support of User Entry Process Testing and Enduring UIT Testing (end to end testing)	**CSP (C&S)**
CR4191	Covers the requirements to deliver UIT Testing Services for the period from 1 April 2021 to 31 October 2021	**DSP**
PR7069	Provide cover for the continuation of the Production Support Testing Services, previously provided under PR1267 for the period from October 2020 until end of March 2021	**DSP**

November 2021 SEC Release

A1.12. Delivery of November 2021 SEC Release was the main driver behind new SMETS2 costs, accounting for c.51%. DCC justified two CRs affecting all FSPs: CR4141 and CR1408.

A1.13. CR4141 provided a release wrapper for a number of functional CRs set out in table A1.3. After negotiations with the FSPs, which included multiple interactions of impact assessments detailing scope, resource and charges, DCC arrived at a total combined price of £6.87m with achieved savings of c.10%.

Table A1.3: Overview of CRs incorporated in CR4141

CR	Description
CR1408	SECMP0007 – Part 1 – Firmware updates to mandated HAN devices
CR4069	SECMP0077 – DCC Service Flagging
CR1341	SECMP0090 – Incorporation of Non GBCS Non-Mandated Alerts into the SEC

CR	Description
CR1397	SECMP0105 – Sending SR11.2 to Devices in Suspended State

A1.14. CR1408 responded to SEC Modification Proposal SECM007 (Firmware updates to mandated HAN devices) enabling suppliers to send firmware updates to prepayment meter interface devices (PPMIDs) and HAN-connected auxiliary load control switches (HCALSs) via the DCC network. Under the agreed solution DCC will process the request containing the firmware image and forward it to the CSPs along with corresponding comms hub identifiers. The CSPs will then deliver the firmware image to the corresponding comms hubs and the comms hubs will in turn deliver it to the target device within the HAN. This requires two different firmware image delivery mechanisms to be used by comms hubs: ZigBee over-the-air delivery for PPMID and the existing GBCS route for HCALCSs. The CR recommended introduction of a new Service Request 11.4 'Update PPMID Firmware' to distribute the firmware images specifically for the PPMIDs. For HCALCS, the existing SR and the process for electricity and gas smart meters will be used (SRV 11.1 and 11.3).

A1.15. CR1408 is being delivered in 2 parts: The initial firmware distribution progress tracking formed part of November 21 Release. Firmware distribution to PPMIDs and HCALCSs will be delivered in 2022 when comms hubs updates become available.

A1.16. DCC justified total costs of implementation of £27.5m. £1.40m was incurred in RY21/22 and DCC forecasted £17.42m in committed spend in future RYs. However, DCC also confirmed that it expects the total costs to increase above £28m in RY22/23 with the inclusion of a deferred GBCS 4.1 update in the CSP-C&S solution.

A1.17. DCC's negotiations with FSPs focused on securing value for money by challenging FSP's proposals for a new charging model for the new service and suggested alterations to contractual service measures. During negotiations CSP-C&S expressed a view that the increased volumes of devices and messages on the network would lead to high enduring costs. It recommended to lower contractual service level agreements and proposed a data usage model as the basis for charging for the additional traffic on its network. DCC explained that it had rejected these proposals and resolved the issue by agreeing to in-life charges of £5.7m between CSP-N and CSP-C&S covering additional messaging and network resources, costs to measure and report a new service credit measure for the new type of devices on the network, and negotiated early life conditions. DCC confirmed that this would limit additional

enduring costs to transaction (message) charges, which will be paid as incurred in line with the existing charging mechanism for firmware downloads to meters.

SI Release Management

A1.18. DCC justified a new DSP PR covering the continuation of the SI Release Management Services from November 2021 for a period of 12 months. This service was previously provided under PR7077. DCC achieved savings through agreed discounts on labour costs due to Covid travel restrictions. DCC further explained that it controlled spend by opting for financing on a 'time and materials' basis, a mechanism used where scope is uncertain.

DSP Extension

A1.19. Driven by the extension of the DSP contract, DCC explained the need to upgrade various technologies used by the DSP for security reasons. Due to the large amount of DSP hardware in need of replacement in 2021 and 2022, DSP recommended a consolidation to a small number of replacement pieces of equipment which generated a saving compared to purchasing like-for-like replacement equipment. DCC raised one change request to cover the purchase and deployment of the new equipment.

A1.20. DCC agreed to pay for the software and hardware upgrades which were known to reach end of manufacturer support during the DSP extension term, in exchange of the DSP keeping its Fixed Operational Charge at the same level as of October 2021. The key actions DCC took to ensure value for money included:

- Requesting detailed breakdown of the equipment in the scope of the refresh
- Introduction of a procurement tracker to track actual procurements and payments
- Challenging labour costs

SMETS1

A1.21. The purpose of the SMETS1 programme is to integrate first generation smart meters into the DCC service to ensure their interoperability. Under an agreed plan, the enrolment and adoption of the SMETS1 meters happens in three releases – Initial (IOC), Middle (MOC) and Final (FOC) Operating Capability – with each release delivering a capability for a different type of meter installed by energy suppliers. The SMETS1 service went live in July 2019 for

IOC meters. DCC then consulted on revisions to the Joint Industry Plan (JIP) to deliver solutions for the MOC and FOC cohorts. The capability to migrate and operate some MOC devices went live in August 2020. In RY20/21 DCC made some progress towards delivering the solution for FOC, however the programme suffered delays due to testing issues and a replan had to be agreed at the end of 2020. DCC reported that throughout RY21/22 it engaged with TBDG and IMF[98] to establish a revised and phased commissioning approach and the first phase of the FOC capability was commissioned in February 2022.

A1.22. The key objectives of the SMETS1 programme in RY21/22 were to:

- Deliver a second release for the FOC cohort, consisting of capability changes and defect fixes; the key milestones were Uplift 2.1 (R2.1) in July 2021 and Uplift 2.2 (R2.2) in October 2021

- Completion of Device Model Combination Testing (DMCT) to enable DMCs to be added to the Eligible Product Combination List (EPCL), which is the mechanism that authorises DCC to migrate devices onto its network

A1.23. DCC confirmed that there are three operational workstreams outside of migration that remain to be delivered in RY22/23:

- FOC stabilisation with ongoing maintenance releases

- Maximising migrations with regulatory and maintenance release changes to unblock further SMETS1 meters

- Device Swap Out (the ability to swap a SMETS1 meter for another SMETS1 meter in certain circumstances)

A1.24. DCC justified 4 material CRs/PRs across three areas: FOC, DCO/CP and DMCT.

[98] Industry Managers Forum

FOC

A1.25. CR4089 and CR4193 delivered Uplift 2.1 and Uplift 2.2, respectively. These releases included necessary additional capability for FOC as well as fixes for identified defects. The technical content of these releases is set out in table A1.4 below. DCC provided justification for the costs incurred by DSP but clarified that FOC and DCO service providers were also affected by these changes, although their individual incurred costs per CR were below £1m.

A1.26. DCC provided details of its negotiations with DSP which focused on clarification of scope and resource allocation to ensure value for money. DCC also sought to leverage test automation to drive efficiencies. However, DCC confirmed that both releases were delayed due to technical issues.

Table A1.4: Overview of newly justified CRs/PRs within FOC

Material CR/PR	Description	Service Providers Affected
CR4089	Uplift 2.1 provides for the delivery of additional changes for FOC deployed in July 2021, including: • Opt-in Opt-out Tactical Fix • Prepayment Meter Interface Device (PPMID) Firmware Swap Out • PPMID Firmware Update • Split Supplier with certificates • Duplicate UTRN Change	**DSP**
CR4193	Uplift 2.2 provides for the delivery of additional changes for FOC deployed in October 2021, including: • Top Up Change • MI Extract Decryption • S1SP Alert Handling • S1_CSP API for Comms Hub Diagnostic • Scalar Fix	**DSP**

DCO/CP

A1.27. DCC justified one change request with S1_DCOb which extends the DCO Support Service to end-October 2024 and the CP Support Service to end-July 2022, with the option to extend it on a month-by-month basis thereafter. Both of these are essential components to the delivery of SMETS1 solution and the enduring service.

A1.28. As part of the service extension DCC also negotiated a continuation of support for the Interoperability Checker Service until end-July 2022, with the option to extend it on a month-by-month basis thereafter.

A1.29. DCC sought to secure value for money by renegotiating the terms of the expiring agreement and challenging the scope and pricing of change proposed by the service provider. When compared to the terms of the original contract, DCC reports achieved savings of c.16%.

DMCT

A1.30. DCC carries out DMCT for each SMETS1 cohort to ensure that combinations of different smart meters, comms hubs and PPMIDs are compatible with each other. DCC justified one project request raised with DSP covering DMCT activities for MOC Secure and FOC meters and additional testing for certain IOC devices.

A1.31. In RY20/21 DCC described an optimised approach towards DMCT agreed with DSP, under which DCC can request which devices should be tested together in defined 'tranches', resulting in a 'menu-based pricing'. DCC worked with DSP to further improve this approach to secure value for money.

ECoS

A1.32. The ECoS Programme takes over from the Transitional Change of Supplier (TCoS) procedure for identifying and changing security certificates on smart meters when a customer changes supplier. DCC began procurement of two contracts for the programme in April 2020. They separated the work into two bundles (Lots) for which parties could bid: Lot 1 comprising the DBT phase of the programme, plus ongoing support; and Lots 2&3 together comprising Hosting & Services Management.

A1.33. DCC undertook a three-stage procurement process for the two ECoS contracts. Bidders DCC first sent a Request for Proposal (RFP) to a list of parties inviting them to bid for the

Lots. Shortlisted bidders were then invited to present their proposals to DCC in further detail. From these, final two bidders were selected. Further negotiations with both finalists led to a final offer for the relevant contract, which were assessed against 'Commercial' and 'Quality' criteria. The bidder scoring higher across these two areas was awarded the contract.

A1.34. Both contracts underwent similar bidding procedures, though an extra assessment stage took place for the award of Lot 1 to allow DCC to ask further questions to bidders around the programme, security and transition concerns.

A1.35. DCC initially provided overall timelines for the contract procurement procedures as well as high-level details of the assessments each bid underwent. We asked clarification questions requesting exact dates of key bid deadlines, further detail around the 'Commercial' and 'Quality' assessment criteria and the questions asked of the Lot 1 bidders in the additional assessment stage. DCC also provided additional assurances around the enduring costs of the programme describing a de-risking approach to minimise the need for future changes.

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.[99] Table A2.1 gives an overview of the types of costs associated with each cost centre.

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

Cost Centre	Functions Include
Corporate Management	• Strategy and Regulation • Corporate Affairs • Stakeholder engagement • Business Improvement and Internal Audit • Accommodation and Test Labs • Price Control support for DCC
Commercial	• Commercial Operations • Procurement • Vendor Management • Contract management • Relationship management of contracts in DCC's strategic supply chain • Meet Price Control needs.
Finance and People	• Financial Reporting, including responding for producing statutory accounts, Price Control data, managing annual audit • Commercial Finance activities, including responsibility for producing and managing financial plans and forecasts of the business • Regulatory Finance and Pricing activities, including preparing and publishing annual charging statements and indicative budget documents.

[99]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
	• Finance Transformation and Business Operations, including responsibility for ensuring DCC reporting system is maintained and modified, and introducing systems to automate finance processes. • People team, including ensuring DCC attracts and acquires the talent and expertise required • Legal, including supporting DCC with in-house Legal resource and managing relationships with external law firms
Operations	• Delivers reliable and repeatable service, at scale • Reports operational performance to DCC's Customers and Regulatory Parties • Supports DCC's focus on customers, including customer relationship management and service desk • Supports the prioritisation of activity and development effort for DCC through customer insight, process measurement and Industry engagement • Improves the solutions proposed by DCC through early and effective engagement in the design process • Protects the margin and reputation of DCC through a focus on service.
Design and Assurance	• Designs the Enterprise Architecture for the DSP reprocurement and Network Evolution comms Hubs • Works with DCC customers to improve existing ways of working and maximise benefits to be delivered by NEP • Reviews existing practices, technology and tooling and defines new ways of working to incorporate technology that maximises testing efficiency and quality of deliverables • Responsible for the design of technical solutions that address new SEC Modifications and Customer-led changes. • Responsible for ensuring DCC executes key services and operates to the standards required by DCC's licence and customers. • Delivers quality and consistency in Design and Testing Services
Security	• Assures the security of all DCC systems

Cost Centre	Functions Include
	• Ensures the platform and new programmes being added to it are secure and meet with Licence and code requirements • Addresses the changing threats to the systems through a risk-based approach in line with industry and regulatory guidance • Provides security assurance to the regulators and DCC customers. • Information governance and data protection
Service Delivery	• Accountable for programme delivery, and professional practices of Business Analysis, Test Assurance and Programme and Project Management that support delivery of the change portfolio for DCC • Delivers DCC's inventory of Programmes • Improves Service Delivery Practice Capability and resourcing approach • Increases the maturity and effectiveness of the business analysis capability to support the evolution of the DCC total system • Increases the maturity and effectiveness of the Test Assurance practice • Drives PM performance management via engaging and supportive approach, with clarity of R&R across Programme and Practice.

A2.2. Figure A2.1 shows the variance over the Licence period in Internal Costs by cost centre compared to the RY20/21 forecast, including the Additional Baseline cost. This shows that the increase in costs over the Licence period compared to last year's forecast are concentrated in Additional Baseline, Programme and Operations cost centres.

Figure A2.1: Cost variance by cost centre - compared to RY20/21 in current year prices

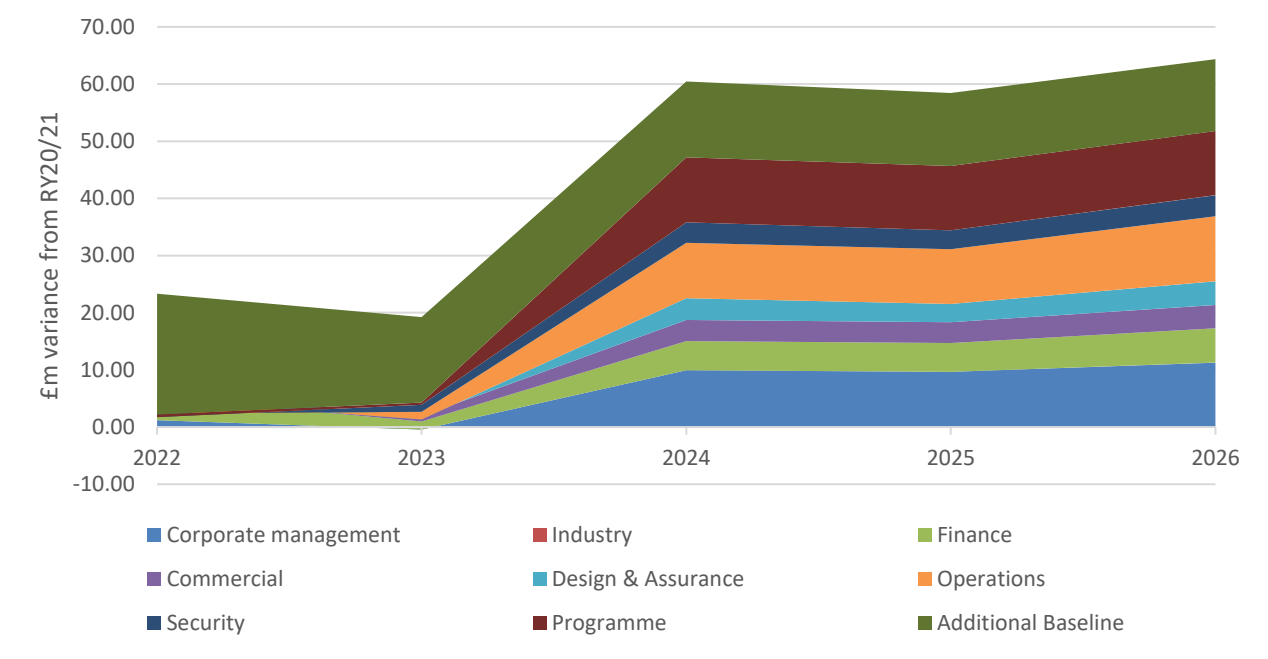


Figure A2.1: data table

Cost Centre	RY21/22 (£m)	RY22/23 (£m)	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Corporate management	1.22	-0.44	9.95	9.65	11.26
Industry	0.00	0.00	0.00	0.00	0.00
Finance	4.03	1.41	5.07	5.03	6.02
Commercial	0.50	0.98	3.72	3.67	4.07
Design & Assurance	-1.05	-0.62	3.81	3.17	4.14
Operations	-2.35	1.34	9.68	9.58	11.38
Security	-0.62	1.24	3.56	3.33	3.68
Programme	0.46	0.38	11.38	11.25	11.24
Additional Baseline	21.13	14.95	13.25	12.75	12.57

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

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

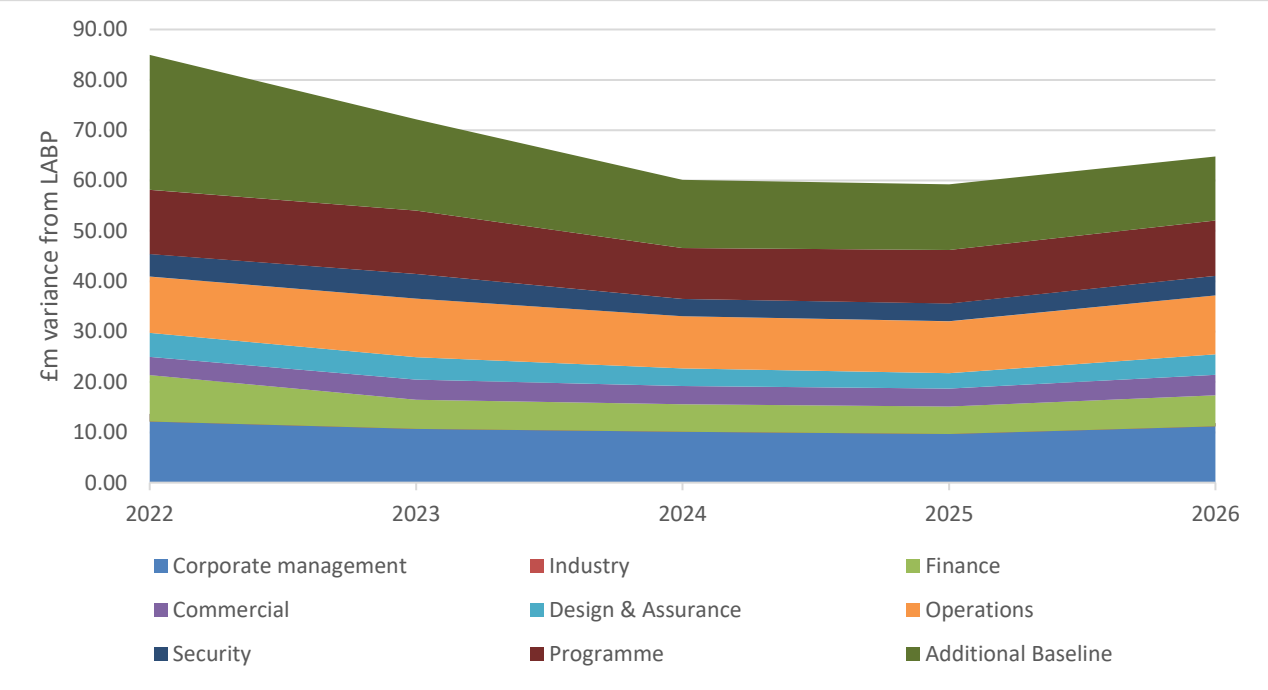


Figure A2.2: data table

Cost Centre	RY21/22 (£m)	RY22/23 (£m)	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Corporate management	13.65	12.18	11.59	11.17	11.80
Industry	-1.53	-1.52	-1.52	-1.52	-0.63
Finance	9.24	5.82	5.50	5.46	6.19
Commercial	3.62	4.00	3.62	3.57	4.04
Design & Assurance	4.77	4.43	3.48	3.07	4.09
Operations	11.17	11.64	10.35	10.31	11.71
Security	4.50	4.90	3.46	3.51	3.87
Programme	12.73	12.57	10.11	10.64	10.99

Cost Centre	RY21/22 (£m)	RY22/23 (£m)	RY23/24 (£m)	RY24/25 (£m)	RY25/26 (£m)
Additional Baseline	26.80	18.16	13.53	13.02	12.76

A2.4. Payroll costs are a major driver of Internal Costs across the different cost centres. Table A2.2 summarises DCC's headcount from RY20/21 to RY21/22 as measured in full time equivalents (FTEs) by cost centre. In RY21/22, there is an 11% decrease in FTE compared to the RY20/21 forecast.

Table A2.2: FTEs by cost centre

Cost Centre	RY21/22	RY20/21 forecast for RY21/22
Corporate management	72.40	75.87
Industry	0.00	0.00
Finance	52.92	66.94
Commercial	35.40	48.48
Design & Assurance	40.84	28.10
Operations	107.31	185.03
Security	36.93	43.71
Programme	106.77	104.42
Additional Baseline	146.32	126.59
New Scope	0.00	0.00
CRS	44.07	39.72
Total	**642.95**	**718.85**

Appendix 3

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

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
LABP (21/22 prices)	221.219	218.165	224.327	231.618	97.963
Previous year (21/22 prices)	421.294	427.690	385.485	421.851	213.912
Submitted AR RY21/22	**499.664**	**470.597**	**513.281**	**556.476**	**372.072**
Cost Disallowances					
External costs					
Programme costs - incurred	[redacted]*.***[100]	0.000	0.000	0.000	0.000
DSP – forecast	0.000	-16.217	-4.590	-2.131	-1.512
CSP-N - forecast	0.000	-1.890	-1.890	-1.832	-0.199
CSP-C - forecast (comms hubs)	0.000	-0.257	-0.758	-0.734	-0.720
CSP-S - forecast (comms hubs)	0.000	-0.199	-0.593	-0.575	-0.564
S1SP_1 - forecast	0.000	-1.029	-1.058	-1.135	-1.343
S1SP_3b - forecast	0.000	-12.643	-12.902	-12.919	-13.124
S1_DCOa - forecast	0.000	-6.640	-5.121	-5.021	-5.021
Total External Costs disallowances	*.***	***-38.875***	***-26.913***	***-24.347***	***-22.483***
Internal Costs					
Baseline forecast Internal Costs	0.000	0.000	0.000	-58.425	-64.362
CRS forecast Internal Costs	0.000	0.000	-2.895	-2.895	-2.846
Benchmarking	-0.047	0.000	0.000	0.000	0.000
Business Accuracy Programme (BAP)	-2.560	0.000	0.000	0.000	0.000

[100] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed disallowance has been redacted. For more information please see paragraph 2.44 in chapter 2.

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Commercial Finance - forecast	0.000	-0.888	-1.001	0.000	0.000
Customer Engagement - forecast	0.000	-0.209	-0.875	0.000	0.000
Document Writing Unit - forecast	0.000	-0.443	-0.299	0.000	0.000
ECoS - forecast	0.000	-2.438	-1.469	0.000	0.000
ES & IS - Executive Leadership Programme	-0.262	0.000	0.000	0.000	0.000
ES & IS - Planning	-0.620	-0.195	-0.200	0.000	0.000
ES & IS - Procurement	-3.095	-0.674	-0.590	0.000	0.000
EVs and Product Management	-0.562	-0.241	-0.241	0.000	0.000
Network Evolution - forecast	0.000	-7.725	-5.680	0.000	0.000
People team - forecast	0.000	-0.484	-1.428	0.000	0.000
Policy and Market - forecasts team	0.000	-0.507	-0.480	0.000	0.000
Service Desk - forecast	0.000	0.000	-0.924	0.000	0.000
SMETS1 - forecast	0.000	-4.385	-3.302	0.000	0.000
Shared Service Charge	-0.762	-0.469	-0.701	-5.247	-5.785
Total Internal Costs disallowances	***-7.909***	***-18.658***	***-20.085***	***-66.567***	***-72.993***
Total cost (internal and external) disallowances	**-7.909[101]**	**-57.533**	**-46.997**	**-90.914**	**-95.476**
Performance Adjustment Reductions					
OPR	-1.404	0.000	0.000	0.000	0.000
CRS performance	0.000	0.000	-0.394	-0.394	-0.387
Consultation AR excluding BM and ECGS adjustments	**490.351[102]**	**413.064**	**465.890**	**465.168**	**276.210**
Baseline Margin and ECGS adjustments					

[101] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed External Costs disallowance in RY21/22 has been redacted. Therefore, this total does not include the proposed External cost disallowance. For more information please see paragraph 2.44 in chapter 2.

[102] As above, this figure does not include proposed External Cost disallowance.

Regulatory Year	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
BM adjustment (21/22 prices)	0.000	0.000	2.540	0.993	3.436
ECGS adjustment	0.000	0.000	10.691	0.413	0.785
Consultation AR with BM and ECGS adjustments	**490.351**[103]	**413.064**	**479.121**	**466.575**	**280.431**

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

Regulatory Year	Total across Licence term (£m, RY21/22 prices)
LABP (21/22 prices)	**1,904.07**
Previous year (21/22 prices)	**3,867.48**
Submitted AR R21/22	**4,408.67**
Cost Disallowances	
External costs	
Programme costs – incurred	*.***[104]
DSP - forecast	-24.450
CSP-N – forecast	-5.811
CSP-C - forecast (comms hubs)	-2.469
CSP-S - forecast (comms hubs)	-1.932
S1SP_1 - forecast	-4.565

[103] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed External Costs disallowance in RY21/22 has been redacted, therefore, the proposed Allowed Revenue figure for RY21/22 does not include the proposed External cost disallowance. For more information please see paragraph 2.44 in chapter 2.

[104] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed disallowance has been redacted. For more information please see paragraph 2.44 in chapter 2.

S1SP_3b - forecast	-51.588
S1_DCOa - forecast	-21.803
Total External Costs disallowances	***-112.617***[105]
Internal Costs	
Baseline forecast Internal Costs	-122.787
CRS forecast Internal Costs	-8.636
Benchmarking	-0.047
Business Accuracy Programme (BAP)	-2.560
Commercial Finance - forecast	-1.889
Customer Engagement - forecast	-1.084
Document Writing Unit - forecast	-0.742
ECoS - forecast	-3.907
ES & IS - Executive Leadership Programme	-0.262
ES & IS - Planning	-1.015
ES & IS - Procurement	-4.359
EVs and Product Management	-1.044
Network Evolution - forecast	-13.405
People team - forecast	-1.912
Policy and Market - forecasts team	-0.987
Service Desk - forecast	-0.924
SMETS1 - forecast	-7.687

[105] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed External Costs disallowance in RY21/22 has been redacted. Therefore, this total, as well as the proposed Allowed Revenue figures, does not include the proposed External cost disallowance in RY21/22. For more information please see paragraph 2.44 in chapter 2.

Shared Service Charge	-12.965
Total Internal Costs disallowances	***-186.212***
Total cost (internal and external) disallowances	**-298.830**
Performance Adjustment Reductions	
OPR	**-1.404**
CRS performance	**-1.174**
Consultation AR excluding BM and ECGS adjustments	**4,107.26**
BM adjustment (21/22 prices)	**6.969**
ECGS adjustment	**11.889**
Consultation AR with BM and ECGS adjustments	**4,126.12**[106]

[106] Please note that due to commercial sensitivity and confidentiality reasons, the amount of our proposed External Costs disallowance in RY21/22 has been redacted. Therefore, the proposed Allowed Revenue figure across the whole licence term does not include the proposed External cost disallowance in RY21/22. For more information please see paragraph 2.44 in chapter 2.

Appendix 4 – Privacy notice on consultations

Personal data

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

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

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

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

3. Our legal basis for processing your personal data
As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. ie 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 0303 123 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".