The voice of the energy industry

Energy UK Response to Ofgem Consultation on DCC Price Control for Regulatory Year 2021/2022

23rd December 2022

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology.

Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, which has over 2,000 members representing over 350 organisations, we are a founding member of TIDE, an industry-wide taskforce to tackle Inclusion and Diversity across energy.

Introduction

This is the Energy UK response to Ofgem's consultation on the DCC's Regulatory Year (RY) 2021/2022 Price Control submission. Our response is not confidential. In our response, we include overarching key points within the Executive Summary, specific high-level points where relevant under the consultation questions and an appendix capturing specific examples of issues that occurred during RY2021/2022 as previously signposted to Ofgem by Energy UK.

Executive Summary

Despite there being multiple areas where Ofgem finds it necessary to disallow many of the costs put forward by the DCC as part of its RY2021/2022 submission, it is welcome news that DCC's costs appear to have fallen by 18% compared to RY2020/2021. Energy UK and its members look forward to further cost reductions for the remainder of the licence-term, especially noting that for the RY22/23, the DCC's costs are already indicated to be back at RY20/21 levels.

However, it is clear from the information presented in the consultation that issues persist the DCC's control of its costs. There are several areas of major concern for Energy UK members:

- The forecast of the total costs over the full licence term is 12% higher than in last year's submission – with multiple examples that demonstrate the DCC's inability to accurately forecast costs overall;
- The DCC continues to resubmit costs that Ofgem has previously disallowed, without sufficient justification and/or evidence, resulting in additional resource effort for both Ofgem and DCC;
- Despite this being the eighth round of DCC Price Control submissions, Ofgem has reported that this year there were more areas requiring more clarity from DCC and justification of its costs than for previous years. This could be perceived as a "trying our luck" attitude which, if true, would be clearly unacceptable bearing in mind the DCC's wider responsibilities in managing billions of pounds in costs that are ultimately passed on to consumers;

- The DCC has disregarded its own internal procurement policies by not completing the necessary assessments to ensure it is procuring the most economic and efficient options (which we note is a potential breach of licence, and assume Ofgem is currently investigating);
- The DCC is still failing in terms of Customer Engagement and Cost Transparency, despite multiple previous improvement recommendations by Ofgem and repeated strong challenge from DCC Users, especially energy suppliers supported by Energy UK;
- The DCC is still predicting increases in 'baseline forecast costs' to the end of the licence term, when DCC Users and other key stakeholders would instead expect to see DCC costs reducing over the same period; and
- The information provided in the consultation is on the whole deeply concerning, and indicates a lack of control, ongoing volatility, continued scope creep, a lack of transparency, a lack of a cost averse mindset and a tendency by DCC to continue to charge DCC Users while operating beyond its licensed remit.

Taking all of these factors into consideration, Energy UK and its members firmly believe that this demonstrates a clear need for a shift away from the current 'ex-post' price control to an 'ex-ante' regime as soon as possible.

Consultation Questions and Energy UK's Response

DCC External Costs:

- *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?*

Energy UK Response:

Energy UK and its members agree with Ofgem's proposals to disallow elements of the DCC's external costs as set out in the consultation. At this stage of the licence term (some 9 years in), we would expect the external costs associated with the DCC's core mandatory business to be reducing to reflect a stable and efficient running of daily operations across the DCC's contracted services portfolio. It is therefore disappointing to learn that the DCC's external costs are some 12% higher than the RY20/21 forecast.

What is even more concerning is that for the External Cost element of the Price Control submission alone, Ofgem found it necessary to ask over 70 questions to obtain further evidence and clarification from the DCC as part of this year's review. It is encouraging that Ofgem has highlighted the importance of the need for the DCC to provide clear evidence and justification for all costs incurred as part of the Price Control review process, and Energy UK encourages Ofgem to take further action if the DCC continues with the same approach next year.

The Programme Delivery aspect of cost disallowance is an area where Energy UK and its members believe Ofgem should take a very firm stance. There is an expectation from all industry participants that one of the key attributes that the DCC must continually demonstrate is its ability to deliver major programmes. It is clear that during RY21/22, the DCC's performance in this area has not met the standards expected, resulting in significant delivery delays, missed milestones, and disruptive programme re-planning, all of which have had a major impact on DCC Users. Ofgem must ensure there are no costs passed through to DCC Users to cover DCC's own failings.

With regard to the disallowance of costs for "CSP-C&S Price Support" for Comms Hubs, Energy UK and its members support Ofgem's approach and reasoning. We also agree with Ofgem's proposals to disallow £108.22m of forecast External Costs.

In summary, the value of disallowance for External Costs, while welcome from an overall cost perspective, is deeply concerning. For example, the £13.785m which is being disallowed for 'incorrect reporting' indicates a level of performance that is unacceptable this far into DCC's tenure. Added to the numerous examples where DCC has failed to provide sufficient justification or evidence of costs incurred or forecast, it suggests either a failure to recognise the importance of the Price Control review process, or more worryingly the belief that whatever is submitted does not need to be justified as being incurred (or forecast to be incurred) economically or efficiently.

As we enter the most serious cost of living crisis for decades, DCC Users expect the DCC to spend consumers' money economically and efficiently. Unfortunately, the evidence presented by Ofgem this year gives little reassurance that the DCC has met the expectations of DCC Users or the Regulator.

Internal Costs:

- *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?*

Energy UK Response:

Energy UK and its members agree with all of Ofgem's proposed cost disallowances noted. As with External Costs, it is unacceptable for the DCC to continue to fall short in the provision of justification and evidence to support any costs (incurred or forecast) as part of its Price Control submissions.

The more concerning issues lie in DCC's failure to demonstrate that it is following its internal processes, especially in the area of Non-Competitive Procurements (NCPs) whereby Ofgem notes that "*the DCC was unable to provide the complete suite of paperwork and documentation for one single procurement in the selected sample of NCPs – and for only five procurements was it able to present a completed NCP form*". With clear responsibilities and obligations to demonstrate that all costs incurred (or forecast) are both economic and efficient, there now appears to be a culture of non-compliance forming in too many aspects of DCC's operations.

Energy UK and its members agree that the evidence gathered as part of this year's Price Control submission process (and from commentary from previous years' submissions) warrants the need for clear regulatory action, rather than Ofgem continually reminding the DCC of its requirements and obligations, and the need for improvement.

Performance Incentives:

- *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?*

Energy UK Response:

System Performance:

Energy UK and its members disagree that the DCC should retain any level of margin for the SUM1 performance measure. While Energy UK does not attend the SEC Operations Group meetings where DCC performance is subject to in-depth monitoring, we are able to monitor progress updates on a monthly basis ourselves via the SEC Ops Group report provided as part of the BEIS SMDG meetings.

For most months during RY21/22, the SMDG SEC Ops Group update has reported multiple Target Service Level failures that ultimately have a detrimental impact on DCC Users' systems and operations which, in many cases, result in a poor experience for consumers. It is therefore inappropriate for the DCC to retain any level of margin whilst there have been (and continue to be) multiple examples of failures to deliver Target Service Levels across the year.

Contract Management:

Energy UK and its members agree with Ofgem's proposed disallowance surrounding DCC's Contract Management performance. However, the Independent Audit has provided a suite of recommendations for DCC to take forward and implement, and Ofgem has noted multiple examples where it has made recommendations to the DCC in previous years' Price Control Review process, but DCC has failed to deliver or implement them. Energy UK believes a new approach is required to give the DCC a clear incentive to deliver against all recommendations made.

We note that the Independent Audit report was provided to Ofgem in July 2022, and we assume that the DCC will have received feedback on the Auditor's recommendations prior to the final report being published. By the time Ofgem considers all feedback on its proposals from stakeholders, the DCC will have had more than six months either to implement or make significant progress against defined action plans to deliver all recommendations required. Energy UK and its members agree that this is more than enough time for the DCC to have taken action. If DCC has not, Ofgem should disallow the full £1.014m margin available under the Contract Management measure.

Customer Engagement:

This is an area where Energy UK and its members agree with the SEC Panel's assessment score of DCC's performance during the RY21/22 period, rather than Ofgem's proposed 'halfway measure' and subsequent Baseline Margin reduction of £0.535m. The DCC's performance on Customer Engagement is an area where Energy UK's members believe performance improvements (rather than simply increasing headcount) are essential and – as this is an area where DCC has failed to deliver the necessary improvements since last year's assessment – Ofgem should reconsider its assessment and increase its proposed Baseline Margin reduction of £0.535m accordingly.

Baseline Margin and External Contract Gain-Share:

- *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?*

Energy UK Response:

Energy UK and its members agree with Ofgem's assessment to both the Baseline Margin and External Contract Gain-Share (ECGS) applications.

With regard to the ECGS element, there are two particular areas that give rise to concerns with Energy UK and its members:

- Despite the refinancing arrangements for CHs delivering clear financial savings, the DCC is unable to explain why expected CH rental costs vary so much on a quarterly basis between RY21/22 and RY23/24; and
- DCC's proposed 'cost savings' associated with its Brabazon House test facilities are clearly inflated if the DCC is basing its calculations on test-lab use from previous years (whereby test lab use associated with DCC's core mandatory business activities have reduced significantly over the last year or two).

Regarding the DCC's test lab facilities, there is now a fully established commercial and competitive market for testing services using smart metering-related technology, with multiple organisations providing testing services under commercial terms with many industry participants. Energy UK urges Ofgem to work alongside the DCC to understand whether there are now opportunities for the DCC to begin offering testing services on a commercial basis (for example, as an elective service, or as an explicit charge levied to relevant DCC Users individually). This would allow DCC to recoup some of the test lab set-up costs (and pay this back to DCC Users who have met the set-up costs) and to meet its ongoing operational costs (therefore reducing DCC's future costs).

Switching 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?*

Energy UK Response:

Energy UK and its members agree with Ofgem's proposed position on the DCC's Switching Programme costs and its assessment of (and proposal that DCC should retain the margin associated with) Delivery Milestone 4.

Over-Recovery of Revenue:

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

Energy UK Response:

Energy UK and its members share Ofgem's disappointment that the DCC breached the over-recovery threshold this year, and support Ofgem's view that there is no justification for the DCC continuing to breach the threshold in future in order to maintain a 'healthy cash-flow position'.

Energy UK and its members agree that Ofgem should apply the penalty interest rate in accordance with the DCC Licence for the breach by 113% for RY21/22, and for the DCC's failure to provide sufficient justification for the breach.

Appendix

The following items are specific key examples of issues, in no particular order, captured during the RY2021/2022 as previously promised to Ofgem by Energy UK:

- The ECoS programme delays demonstrated issues DCC experienced in its contractual and commercial negotiations with perspective bidders / service providers. Specific concerns:
  - ROM costs of the replan that were not shared in a timely manner with industry;
  - Late and inadequate communications by DCC on the major delay to the programme (some delay was mentioned but not the extent); and
  - That there was no indication as to how critically DCC has challenged the Service Providers' delivery plans and timescales.
- The CH&N (4G) programme delays demonstrated issues DCC experienced in contractual and commercial negotiations with prospective bidders. Additionally, industry is still no closer to understanding the full costs impacts and the basis for these cost assumptions despite asking DCC for its CBA on multiple occasions.
- DCC delivery issues continue to impact DCC Users with no sign of significant improvement, ultimately leading to increased costs on energy suppliers. Key examples of these include:
  - CH related issues on the WNC variant resulting in connectivity issues;
  - A rise in the number of unplanned outages; and
  - Further demonstration of sub-optimal contract management as seen on the CRP535 issue discussed at length via the BEIS IMF. For this item, there was real frustration from industry that DCC proposed its initial impact assessment at around £3m, only challenging its Service Providers on this cost after significant pushback from industry at the BEIS IMF. Notwithstanding that DCC Users / energy suppliers should not be bearing the costs of fixes resulting from DCC failures, to be presented with a revised impact assessment cost of around £1m did nothing to strengthen energy suppliers' already limited confidence that DCC is applying sufficient downward cost pressures through their Service Provider contracts.
- DCC appears to continue to recruit heavily in senior management roles especially across its customer engagement and regulatory functions without DCC Users fully understanding the need for these roles and what benefit they provide to DCC Users. Some roles appear to be business development areas, in readiness for the licence review process – these should be funded by Capita, not paid for by DCC Users (and, ultimately, energy consumers).