Data Communications Company

DCC Price Control Consultation - Reporting Year 21-22

Smart DCC Response

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1. Executive Summary

We are pleased to submit our detailed response to Ofgem's proposals for RY21/22 Price Control. We welcome the challenge and scrutiny of the annual Price Control, but we are disappointed with the consultation proposals, which include an unprecedented set of proposed disallowances, and we do not believe they are reflective of our performance in the year.

Accordingly, we have set out our view of the factors driving DCC's performance and strategy to assist Ofgem in reassessing our performance. Our covering letter provides the strategic context and, in this document, we provide additional explanation and analysis of the areas at risk of disallowance to demonstrate that our expenditure has been economic and efficient and has delivered positive outcomes.

At all times we strive to deliver an economic and efficient service that benefits our customers while meeting our licence requirements and we would welcome further dialogue with Ofgem on any of the areas at risk.

It has been a year of unprecedented challenge, with the aftermath of the pandemic creating resource shortages and disrupting supply chains and the return of significant inflation. Throughout the year, we remained committed to running a secure, reliable service to support our customers, enabled the migration of SMETS1 meters that allow the return of smart functionality to millions of homes and delivered faster, more reliable switching for consumers. We delivered against this commitment, while positioning DCC for the future, as shown by the key achievements below:

- 4.1m SMETS2 meters were installed during the reporting year and our focus on SMETS1 migration led to a further 4.6m meters being successfully enrolled, doubling the number of meters on our system compared to RY20/21, with over 50m devices connected by the end of RY21/22.
- Reduced our total operating cost by £90m, to c. £550m compared to c. £640m in RY20/21.
- Achieved technical go-live of the Centralised Registration Service (Switching) on 21 March 2022, laying the foundations for successful go-live on 18 July 2022.

Given our commitment to delivering benefits while considering the economic effectiveness of our services, we are disappointed with Ofgem's consultation proposals. We summarise the key points below:

- We chose the best procurement approach to deliver the most cost-effective service to our customers: The procurement approach we adopt is always based on our assessment of what delivers the most value for money for customers, as well as what meets our stringent regulatory requirements. In each of the procurements Ofgem has disallowed, we chose a direct award approach because we firmly believed they offered better value for money, quality (or both) than the alternatives we considered. We strongly believe that we need the ability to respond quickly to the challenges we face, in strict compliance with our licence obligations to act economically and efficiently. We have tested the market and can demonstrate that our chosen path is lower cost than a credible alternative, resulting in savings to customers of around £6.8m. We detail these savings in 3.4. below. We ask Ofgem to reconsider the disallowances based on this additional evidence.
- [redacted]

[redacted]

- **Our Business Accuracy Programme (BAP) is a key pillar to maturing DCC:** Since being awarded the Licence in 2013, DCC has changed in nature from a slim contract management-focused organisation to a fully-fledged business operating some of the most complex and secure infrastructure in Great Britain, delivering services in line with Critical National Infrastructure standards. We initiated the BAP following feedback from stakeholders and government that DCC's financial processes and procedures had not kept pace with the growth of the organisation and the changing external environment, and that the organisation needed to mature. We believe that the programme is essential to transforming and maturing our organisation and further, that Ofgem has erroneously included change management costs under the proposed disallowed cost. On the first point, we have included in section 3.1 below a proposed approach to track the efficiency savings and we would welcome further discussion on this with Ofgem. On the second point we have broken out the change management aspect more clearly in section 3.1.1 to facilitate Ofgem's assessment. We strongly believe that this is the right programme for us to undertake to optimise our performance and deliver value for customers, and we ask Ofgem to reconsider the disallowance.

- **Smart metering will continue to play a crucial role in supporting decarbonisation:** DCC has continued to work very closely with government and stakeholders to re-use DCC smart metering infrastructure in innovative ways to support GB's decarbonisation agenda. Ofgem is proposing to disallow all this spend (including through load control). While we fully support Ofgem's view that the core service is our primary objective, the need for spend in this area was in Capita's original bid for DCC and is of increasing urgency given the need to increase the security of GB's energy supply and move to Net Zero. At less than 0.1% of DCC's total expenditure in RY21/22, we believe this activity is entirely proportionate (and could in fact be higher). If DCC is to support the UK Government's decarbonisation policies and realise the full benefits of the system that our customers are funding, it is important that DCC is able to undertake activity in this area and to do so now.

- **Executive Leadership Programme:** During the year, we undertook leadership training. Ofgem's view is that it does not have "sufficient justification that DCC assessed its requirements for senior leadership training" prior to signing the contract. We believe this is not an issue about efficiency and economy and it is not appropriate for Ofgem to disallow. To do so at this level of detail would fetter our discretion to manage the business and develop our staff. We present this argument, with further usage data in section 3.3.

- **Planning (OMS and Customer Portal):** In this response we reaffirm that we made the right decision to stop work on this in January 2021, due to rising costs and project difficulties. There were some ongoing licence costs which were unavoidably incurred. In any business, not all projects run to plan, and we believe we made the right decision for our customers and hence a disallowance represents a penalty for doing the right thing.

In this response, we provide further detailed evidence to aid Ofgem in assessing our case, focussing on clarifying our rationale and enhancing our analysis to demonstrate economy and efficiency. On the basis of the additional information set out in this response, we request that Ofgem reconsiders the proposed disallowances.

We fully recognise that the Price Control process is a necessary and important part of ensuring that DCC's expenditure is economic and efficient. However, we firmly believe that our actions have been in line with our licence conditions and in the best interests of our customers. We also note that the environment we are operating in is unpredictable and subject to changing priorities and requirements, and DCC has had to be able to move with flexibility and autonomy to respond effectively. In this response and accompanying materials, we provide additional evidence that our activities in RY21/22 were economic and efficient, and we ask Ofgem to reconsider the disallowances in the light of this additional evidence.

2. External Costs

2.1. Programme Delivery

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

3. Internal Costs

3.1. Business Accuracy and Change Management

As we set out in our submission and follow up information, the need for the Business Accuracy Programme is clear. Ofgem has made the point in its Price Control publications that DCC's forecasting needs to improve, and wider processes in relation to financial and resource planning were not advanced. Our customers have also urged DCC to improve planning and forecasting.

3.1.1. Business Accuracy versus Change Management expenditure

Ofgem is proposing to disallow £2.56m of internal cost expenditure associated with the Business Accuracy Programme (BAP). The expenditure that Ofgem has categorised as Business Accuracy includes a wide range of business-as-usual Change Management activities [redacted] for DCC under a different contract (DCCT0296 – Change Management), totalling £1.7m.

The bulk of these activities were needed to fill significant gaps in headcount which DCC has worked hard over the last year to fill. We made this clear in the submission and are disappointed that Ofgem has not taken account of the information we provided or sought to clarify it with us if it was unclear. There is a clear separation between the Business Accuracy programme activities to develop our planning, processes, and systems over multiple years to achieve a net efficiency benefit by the end of the licence period and with the costs of training and supporting the Finance team with its Change Management activities.

DCC's submission was clear that the cost of the BAP in RY21/22 was £0.87m. If Ofgem wishes to disallow the costs of the BAP because, in large part, it does not agree with the efficiency savings in the model we provided, it must exclude all Change Management costs under DCCT0296. The model did not include any of the £1.7m Change Management costs.

The main activities delivered for the £1.7m of Change Management costs are set out in full in DCC's Price Control submission and summarised in the table below and following section.

Work	Summary	Key activities	Key benefits
Change Management	Resource back fill, business as usual change management activities	Training and supporting the Finance team Review the existing Business Planning processes, design, and deliver an improved framework Design, Build and Test new systems and reporting architecture Train and onboard staff Reviewing and update Change Delivery Methodology (CDM) and Business Case production.	Ensured the running of a functional full financial planning and analysis team at a time of high leavers and resource gaps; delivering the business-as-usual activities as require by the business
Business Accuracy Programme (BAP)	BAP will deliver robust process, system and data improvements across key business functions including Finance, Commercial, Portfolio and Risk	Develop our planning, processes, and systems over multiple years Phase 0 Vision & Diagnostic Phase 1 – Deliver tactical benefits and design the future for finance	Will achieve a net efficiency benefit by the end of the licence period

Change Management - DCCT0296

From 2016 onwards, DCC has been asked to absorb substantial increases in the scope and complexity of its mandatory business, to include dual-band communications hubs (SMETS2), the adoption and enrolment of (11m+) SMETS1 devices across three cohorts, the successful design, build and test of Faster Energy Switching (Switching Programme), the introduction of 'Enduring Change of Supply', 4G technologies and financing, and we must, going forward, turn our attention to the management of end-of-life and expiry of legacy technologies and contracts. The complexity introduced by such an increase in activity on a national scale, in an ever-evolving technological environment, should not be underestimated, nor should the impact of such expansion be underestimated in terms of the organisation's need to continually evolve and adapt. It is critical that DCC continues to deliver accurate and transparent plans to our stakeholders and easy to use and clear processes for our people. DCC is maturing its capability, fortifying its ways of working by establishing and improving key processes focused on the delivery of better planning, controls, and compliance.

By Summer 2020, it was clear that financial reporting and business planning had not evolved quickly enough to keep pace with the growth of the business. Had DCC not taken action to improve its business planning and to accurately monitor expenditure against those plans, there was a real threat to DCC's financial health, operational performance, and the efficiency of the rollout of government programmes.

In RY21/22, DCC had a significant number of leavers across the Finance function. Not only did this make improving business planning extremely difficult, but it also made completing the process to historical standards impractical. Because of these factors, DCC took the decision to go to market for a proposal from external experts to perform the following key activities:

- Review the existing Business Planning processes, design, and deliver an improved framework, including:
    - Interviewing colleagues across DCC about the existing issues with the process
    - Multiple workshops with Exco on what approach and reporting processes they wanted to see
    - Overhaul of internal processes and creation of detailed templates for each team to populate
    - Extensive support to colleagues across DCC on the population of the templates
    - Facilitating presentations of the Business Plans to Exco
    - Interlocking the Business Plans across DCC
    - Repeating the process on a quarterly basis and preparing for handover to DCC staff
- Design, Build and Test new systems and reporting architecture
    - In-depth review of existing data capture and reporting tools to manage and illustrate the budgetary position by team/function/programme/cost code
    - Work with DCC colleagues, Exco and the Board to gather improvement requirements
    - Build prototype reporting tools and facilitate workshops to test their efficacy
    - Move from prototype to fully functional reporting system using Power BI
- Train and onboard staff
    - Host detailed knowledge transfer sessions on the new Business Planning approach, including preparation of training materials
    - Train DCC staff in how to use the new reporting tools, including preparation of training materials

DCC initiated the competitive sourcing of Change Management activities through a fully compliant bidding process for contract DCCT0296. A full set of requirements was issued to the market, three tenders were received and evaluated on quality and cost grounds against the criteria in the tender materials. Following conclusion of the moderated evaluation process, [redacted] ranked first and awarded the contract. As Ofgem knows, there were three changes to the scope of the Change Management contract which drew in resources to the Business Planning process, including a significantly more hands-on role [redacted] than envisaged in several areas. The activities also included reviewing and updating documentation in relation to processes that have already been introduced to the business but at this point are being used inconsistently and require reinforcement, including Change Delivery Methodology (CDM) and Business Case production. In each of the contract amendments, we negotiated significant discounts [redacted]. These savings were largely generated from synergies with existing areas of work as well as volume discounts and would not have been available had we retendered the contract.

We believe the Change Management expenditure is demonstrably economic and efficient. As we set out in the Price Control submission to Ofgem, the award of the contract went through a full competitive procurement and evaluation on grounds of quality and cost before contract award. Therefore, there can be no question that DCC has failed procedurally, nor that it chose an inefficient option.

[redacted] team performed the function of a full financial planning and analysis team with a range of programme and project directors and managers, process leads and analysts, change leads and analysts, and engagement leads and support. It is our considered view that it would have been impossible to onboard a large team of multi-skilled business planning and change management experts from DCC's contractor pool to perform the role undertaken [redacted]. However, although we believe in practice this would have been impossible, to support Ofgem in their re-assessment, we are providing a comparison. We have broken down each of the contracts into days and day rates by grade of consultant employed. We have then substituted those day rates[1] for those of a similar type of project management contractor to derive a total cost. Even if we could have achieved the near impossible and recruited an expert team of contractors at short notice with exactly the skills we needed, our analysis shows the costs still would have been **a minimum of £0.9m**.

Given the impossibility of building a significant team from the contractor community, this figure should be discounted, and the only viable comparison would be with an alternative consultancy, which DCC has already done through the tender process. Therefore, there is no proper basis for disallowing any of the £1.7m expenditure on change management.

3.1.2. Economy and Efficiency

Ofgem is arguing that it has not received sufficient information of the economy and efficiency of the Business Accuracy programme. For clarity, DCCT0288 (the discovery phase) went through a full competitive procurement, with five companies providing a bid. That competition tested both cost and quality and [redacted] won the contract following a full evaluation by a panel including two members of ExCo. The process we followed was therefore fully compliant with our Licence obligations and procurement policy. Following award of DCCT0288, it was DCC's view that a further competition for delivering the activities identified in the discovery phase would not have been economic and efficient, and to the contrary would have wasted time and resources.

NCP0123 was a call off contract under the framework agreement we have with [redacted] deliver the recommendations from DCCT0288. Crown Commercial Service use frameworks and call off arrangements under Management Consultancy Framework 3 (MCF3), so we believe that commercial experts across government consider such an approach is economic and offers value for money. Therefore, there is no valid argument to disallow the expenditure on procedural or compliance grounds.

Our business case model shows that we have undertaken a significant amount of analysis to assess the costs and benefits of four options including a "do nothing" case. The costs in the model have been assembled on a bottom-up basis in significant detail including resources at an individual role and team level.

[1] We used the average 50P10 numbers from our benchmarking submission for six different grades of contractor.

We have also included optimism bias scenarios and contingency provision. The conclusion of the analysis is that we estimate our preferred option would generate a net present value saving to customers of £2.3m before the end of the licence period. In the event Ofgem disallows this expenditure, DCC would have no option but to stop the programme, given approval for future expenditure was at high risk of disallowance, and it would be denying customers that saving, and causing costs to be stranded.

The need to transform DCC's systems and processes in the way envisaged by BAP is not in doubt. What does seem to be in doubt is the validity of the efficiencies it will create. As we set out in the Price Control submission, it is impossible to accurately forecast the efficiencies of a programme in pure cost savings. This is true across any company embarking on a transformation of its systems and processes. However, we have relied on a range of studies including work we commissioned from [redacted][1], and a study by [redacted][2] that suggest transformational change, decision automation and improvements to decision intelligence can reduce operational costs by 20%. It is therefore entirely reasonable that the Business Accuracy Programme could achieve the proposed reduction in DCC's total costs of around 2% and indeed, this is almost certainly an underestimate.

We have committed to developing a detailed efficiency tracking approach, allowing us to monitor and report to Ofgem in detail in each price control submission, so it can scrutinise our progress. An alternative option to disallowing all the costs of BAP, sinking costs part way through the programme and depriving customers of the improvements that DCC would make, would be for Ofgem to annually review the savings and determine their validity, and to make a determination on whether or not the costs are unacceptable on that basis and perform a truing-up exercise at the completion of the programme.

3.1.3. Undertaking

The case DCC has made to justify the efficiency savings is robust and defensible. However, in the event that Ofgem continues to have concerns, we would support an undertaking under section 37 of the Licence. Given Ofgem's view is that DCC has not provided sufficient evidence of the credibility of the £11.8m savings by the end of the Licence, and therefore the NPV benefit of £2.3m, we believe the undertaking should focus on this point alone.

We would therefore propose that DCC develops a methodology to track the efficiency savings and agrees this with Ofgem. We would report the savings we have achieved to Ofgem and include a dedicated section and analysis in the Price Control submission each year for the remainder of the Licence period. In the event that DCC does not achieve at least more benefits than the costs of the BAP programme, DCC would return to customers the difference between this amount and the savings it has achieved (capped at the value of the expenditure on BAP). Using this mechanism, customers would be at worst neutral to the costs of BAP. We consider this would provide the right incentives on DCC to deliver, while at the same time protecting customers.

We would welcome the opportunity to discuss the development of the methodology and the reporting arrangements that may be required with Ofgem in the New Year.

3.2. Benchmarking

We broadly welcome Ofgem allowing the vast majority of DCC's internal cost resource spend. However, we would argue that disallowing £0.047m is unnecessary given the general position of efficient staff costs.

[1] Provided to Ofgem alongside this consultation response.

[2] From the report: Top Strategic Technology Trends for 2022: Decision Intelligence. [redacted]".

We note that Ofgem wants DCC to further benchmark our permanent staff bonuses. In RY20/21 we benchmarked our bonuses and other benefits against a range of companies and confirmed that our remuneration offerings were in line with the wider market.

As DCC staff are Capita employees, the remuneration package is the same as the shareholder's; it would be unreasonable to believe that DCC staff bonuses are uneconomic when compared to the wider market when a large organisation like Capita offers the same terms and conditions. The terms and conditions of DCC's pay offer were included in the Licence Application Business Plan that DECC accepted as the most competitive bid for the provision of its programme.

3.3. Executive Leadership Programme

The Executive Leadership Programme is a subscription service which is paid in advance for the following year. As this is a subscription service, it is a fixed price. Because there is no negotiation or discount available, it is difficult to understand how Ofgem could disallow the expenditure on grounds of inefficiency.

Ofgem's view that it does not have "sufficient justification that DCC assessed its requirements for senior leadership training" prior to signing the contract, is not a question about efficiency and economy. The proposed disallowance is equivalent to Ofgem adjudicating on what DCC's leadership team should be trained in. We do not believe that is appropriate and seriously limits DCC's autonomy.

We have provided Ofgem with information on the activities that are in scope, statistics showing it is already well utilised by DCC colleagues, as well as evidence of the payments that have been incurred and subsumption of the old Capita contract into a new one with amended terms.

It is difficult to understand what more DCC could do to satisfy Ofgem aside from not allowing the team access to this training and technical support. We consider this intervention by Ofgem inappropriate and bordering on the regulator running the business.

We are unable to provide Ofgem with the fully executed contract as it contains personal information which cannot be redacted as it was created using an online signature app, but we are providing the full service description documents to accompany this response.

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

We strongly believe the service is a high value training and development resource for our key IT leaders and their staff and has delivered significant benefits. We also suggest that it would be more appropriate for Ofgem to review how DCC has used this service in RY22/23 given the payment was in advance for services in that year.

3.4. Non-Competitive/Single-Source Procurements

We are concerned that Ofgem's approach to the disallowance of costs in relation to non-competitive procurements (NCP) misrepresents DCC's obligations with regard to procurement under its Licence - with which we consider that DCC has complied. We make a number of general points in this regard before turning to the detail of the particular NCP contracts that Ofgem proposes to disallow.

First, at paragraph 3.87 of the Consultation Document, Ofgem states that "*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*". Insofar as the above paragraph is suggesting that under the Licence DCC may award a contract for Relevant Service Capability without competition only in exceptional circumstances, that is incorrect.

Licence Condition 16.6 provides that "*Relevant Service Capability that is not [Fundamental Service Capability or Fundamental Registration Service Capability] may be provided by the Licensee from its own resources, or be procured from an Affiliate or Related Undertaking, or from elsewhere, if the Licensee, having had regard to the Part B Principles (**excluding Principle 2**)*[1]*, is satisfied that the procurement of such capability by that means:*

a. *would be the most economical and efficient option; or*

b. *would be immaterial in terms of its value or use of resources within the overall context of the Mandatory Business of the Licensee."*

This Licence Condition gives DCC flexibility to choose the appropriate procurement route for Relevant Service Capability depending on its assessment of what is most economical and efficient, having had regard to the Part B Principles, excluding, notably, Principle 2, which is the principle that Relevant Service Capability must be procured competitively wherever practicable and proportionate. There is no basis for interpreting this Condition as requiring DCC to demonstrate exceptional circumstances before making a decision to award a contract without a competitive procurement. What is required is that DCC is satisfied that this is the most economical and efficient route having regard to the performance of DCC's functions and the other Part B Principles set out in Licence Conditions 16.8 to 16.12A (excluding 16.9). In all the

[1] Emphasis added

cases of proposed disallowances for NCPs, DCC considers that it has satisfied the requirements of Licence Condition 16.6.

Second, in deciding to disallow costs relating to NCPs, Ofgem expresses concern that DCC is not consistently complying with its own procurement policy (paragraph 3.92). In several examples cited, DCC believes it has followed the procurement policy (see below), however it does not automatically follow that if DCC has not followed that policy, that the expenditure is not economic and efficient or that DCC has not complied with its Licence. Pursuant to Licence Condition 16.19 *et seq*, DCC is required to put in place a Procurement Strategy for Relevant Service Capability. That strategy has been in place since September 2014 and is reviewed annually. In addition, DCC has developed and published a Procurement Policy and Procedure document which further explains the policies that support the Procurement Strategy and describes the procedures that DCC intends to follow for the procurement of Relevant Service Capability.

However, the Procurement Policy and Procedure document does not form part of the Procurement Strategy, nor does it affect the substance or interpretation of the Licence obligations with regard to procurement that DCC is subject to. The Procurement Policy and Procedure document has been voluntarily developed and published by DCC in order to explain in more detail how it intends to comply with its Licence obligations. If DCC conducts procurement in accordance with those policies and procedures, it can have a high degree of certainty that it will have complied with its Licence obligations. However, it does not follow that, if DCC has not complied with Procurement Policy and Procedure document to the letter in a particular case, DCC should be considered to be in breach of Licence conditions or that costs so incurred were not economic or efficient, as appears to be suggested at (inter alia) paragraph 3.94 of Ofgem's Consultation Document. What is required is an objective assessment of whether any costs incurred by DCC in procuring Relevant Service Capability were in fact economically and efficiently incurred (per Licence Conditions 16.6 and 37), rather than an assessment of whether a particular procedure was followed.

It further follows that the reference in Procurement Policy and Procedure documents to single-source procurement being undertaken solely in exceptional circumstances (paragraph 2.6) is merely a statement of DCC's internal policy in relation to single-source procurements. It does not change the nature of DCC's Licence obligations nor the flexibility which DCC is afforded under the relevant Licence Conditions as explained above.

In any event, and without prejudice to the above, DCC disagrees with Ofgem's view that it has not followed the Procurement Policy and Procedure in all of the cases of NCPs where Ofgem proposes to disallow costs. This is discussed further below in our detailed commentary on the proposed disallowances.

Third, at paragraph 3.88 of the Consultation Document, Ofgem states that "*As a monopoly, DCC has an obligation to ensure that it does not restrict, prevent, or distort competition. 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.*" A footnote to that paragraph refers to Licence Condition 11.3 – Part A: General requirement in relation to competition.

DCC disagrees that Licence Condition 11.3 is always relevant to the question of whether DCC decides to conduct a competitive procurement for Relevant Service Capability. LC 11.3 requires DCC not to distort competition specifically in relation to (a) activities authorised by an Energy Licence under the Electricity or Gas Acts and (b) the provision of Commercial Activities (as defined in the Licence) that are connected with the Supply of Energy. LC 11.3 is therefore not relevant for any of the NCP costs that Ofgem is proposing to disallow.

It is also wrong to describe DCC as a "monopoly" in relation to every procurement activity it undertakes. When DCC procures Relevant Service Capability it is doing so from suppliers who operate in distinct markets (e.g. IT services, consultancy) and for whom DCC might be a relatively minor customer with little or no "buyer power".

Even if, contrary to the above, DCC's Licence obligation not to distort competition was relevant to Ofgem's consideration of the costs of NCP contracts, paragraph 3.88 is flawed. It does not follow, as suggested in the second sentence of that paragraph, that DCC would be precluded from adopting an NCP approach where a decision to procure a particular service has been postponed. It appears that Ofgem is of the view that DCC has an obligation to conduct competitive procurements in virtually all cases. That is not a correct interpretation of DCC's obligations as outlined above.

In summary, insofar as Ofgem takes the view that it is entitled to disallow costs merely as a result of an alleged failure by DCC to follow its Procurement Policy and Procedure document in relation to the procurement of Relevant Service Capability and/or because DCC may have awarded a contract on an NCP basis in circumstances that Ofgem did not consider to be "exceptional", that is incorrect as a matter of law. DCC nevertheless accepts that the costs it incurs must be economic and efficient.

Our decisions to directly award a number of contracts in RY21/22 have resulted in savings of **more than £6.8m** compared to plausible counterfactuals. These savings are because DCC has negotiated discounts, undertaken due diligence to compare quotes with another provider, or in the case of OPR leveraged unique knowledge and skills to avoid passing on costs to customers. We strongly believe we have clear evidence that we have acted economically and efficiently in all of the contracts Ofgem is proposing to disallow.

With those points in mind, we turn now to consider in detail the specific NCP costs that Ofgem proposes to disallow. The following table summarises the NCP costs in question and the significant savings DCC has delivered for customers from our procurement approach.

Activity	Expenditure	Avoided Costs[1]	Comments
[redacted]	£0.245m	£0.045m	Required [redacted] to waive Assurance Partner costs. This excludes the significant benefit [redacted] Savings figure excludes 13% day-rate savings
OPR Review	£0.319m	£6.200m	At least £6.2m could have been wasted on an abortive reporting system. Savings figure excludes 13% day-rate savings
Implementation of Rolling Quarters [redacted]	£0.178m	-	Backfill of staff to deliver BAU activities on a time and materials basis
[redacted]	£0.340m	-	Contract designed to ensure optimum financing strategy for Net Evo 4G Comms Hubs. This could save an extremely large sum of money for customers
[redacted] DBCH Strategic Positioning Paper	£0.163m	-	Requested by BEIS
NEP – [redacted]	£0.399m	£0.200m	Comparison against DCC average framework rate for same grade consultants gives a £0.2m saving
Resource (Contractor) – Net Evo (IS)	£0.441m	£0.170m	Saving relative to CCS MSF3 rates
BAU – ITES – Laptops	£0.311m	£0.115m	Saving relative to [redacted] quotation for 800 devices
Office 365	£0.699m	£0.113m	Saving relative to quotation provided by [redacted]
Total	**£3.095m**	**£6.843m**	

3.4.1. [redacted]

As explained in the submission, this category is formed of [redacted] and the Scaling and Optimisation project.

[redacted]

As explained in DCC's Price Control submission, [redacted] suggested there was an urgent and imminent threat to the Smart Metering rollout Programme in the CSP.N Region which needed to be analysed and evaluated. [redacted]

To do this, DCC needed expertise in Long Range Radio, the [redacted] and the wider DCC and Smart Metering technical ecosystem in order to move quickly in the timescales required, to ensure an accurate assessment of the issue, and to identify immediate mitigations [redacted] in the CSP.N Region in the immediate-short term. Additionally, and equally

[1] These savings are directly attributable to DCC's procurement decision to direct award.

important was trusted relationships with the key stakeholders that were unconvinced by the Problem Statement at the time, including BEIS, [redacted], and the DCC Board. [redacted] met all the criteria [redacted] and as such were considered uniquely placed to move at the pace required.

Circumstances such as these are expressly recognised in DCC's Procurement Policy and Procedure document as being an "exceptional circumstance" justifying a single-source procurement. Appendix C states that one of the circumstances constituting an exception is "*Where DCC have established that the capacity and/or capability to provide the goods or services as required currently only exists with one provider and there is no possibility of it [sic] that changing within the required timescale*". This precisely describes the situation that arose [redacted]. Having determined that it was appropriate to make a direct award without competition [redacted], DCC then took steps to ensure that the costs of the contract were economic and efficient. DCC negotiated a 13% discount on the original day rate proposed [redacted]. It was also negotiated that this rate must be honoured [redacted] for any subsequent activity (if required) in the future relating to this specific piece of work. [redacted] also secured significant support at zero cost from [redacted] the engagement.

The output of the work undertaken [redacted] also demonstrates how DCC's decision to appoint [redacted] without competition was economic and efficient. The findings and the report produced by [redacted] successfully convinced the DCC Board, BEIS, [redacted], and DCC's customers that there was a significant issue that needed full exploration and support. [redacted] identified the opportunity for two additional channels to be allocated to each Tower (from two to four) in the short term [redacted] The cost to industry and the Smart Metering Programme of such an event would have been materially significant.

It is therefore clear that the decision to make a direct award [redacted] in these circumstances on the agreed and negotiated commercial terms was economic and efficient and has helped DCC and its customers to proactively mitigate a significant network performance risk.

Scaling and Optimisation (SECMP0124)

The rationale for awarding the contract [redacted] is similar to that set out above. There was an imminent threat [redacted] in the CSP.N Region. There was the potential for flawed investment decisions to be made without understanding the limitations of the long-range radio technology deployed in the CSP.N Region, and a risk of regressed deployments (and significant financial and reputational damage as a result).

DCC's need for expertise was similar to that outlined, but with the addition of the need for an even deeper understanding of the [redacted] and the challenges than before. All parties (DCC Board, Customers, BEIS, and [redacted]) trusted the assigned [redacted] resource based on the work that had been done previously and the positive impact [redacted] had made. There were no resources available internally with the skills, knowledge, relationships, and capacity, and no other consultancy could have come in without taking a significant amount of time to educate themselves - time that was not available. Again, as above, these were exceptional circumstances as defined in DCC's Procurement Policy and Procedures document.

The activity prevented reduced confidence in the [redacted] and enabled the rollout to continue. In terms of cost savings, in addition to the same 13% discount as [redacted], 30% of [redacted] were at risk against the CSFs - which had significant dependencies on other parties that [redacted] had to manage. All CSFs were achieved [redacted]

[redacted]

In summary, the decision to make a direct award to [redacted] in these circumstances on the agreed and negotiated commercial terms was economic and efficient.

3.4.2. OPR Review

The costs incurred in the OPR Review area were formed of two distinct phases as below:

OPR SECMP0090

Ofgem had set a clear objective for new OPR measures to be implemented in RY22/23. Knowing that systems development and releases would be required, the timescales were extremely challenging and DCC needed to mobilise immediately. Ofgem made it clear that DCC failing to deliver workable proposals that could be implemented by 1 April 2022 was a regulatory requirement. This was not planned activity and as such DCC did not have time to run a competitive tender.

No other third party could offer the recent experience and the level of expertise of the DCC ecosystem offered by [redacted]. Additionally, understanding of the SEC Governance Process, relationships with key internal and external stakeholders, and with the DCC service providers was critical if things were to progress at pace. Solutions offered by service providers needed to be scrutinised quickly to ensure best value was being offered, and [redacted] had the expertise to do this. It was also vital that customers and stakeholders believed in the solutions being offered, and the trusted relationships with the [redacted] practitioners were critical to rapid decision-making.

As in the previous cases, these were "exceptional circumstances" within the meaning of Appendix C of DCC's Procurement Policies and Procedures document.

DCC insisted [redacted] honoured the 13% discount being applied to other activity for the Managing Partner leading the activity. For the other [redacted] resources, DCC negotiated a 10% reduction in the rates proposed. In addition, 15% of the fee was placed at risk based on CSFs being met, one of which was to agree a Get to Green Plan with Ofgem. One of the other CSFs was not met (despite best efforts by [redacted]) and DCC negotiated that the percentage of the fee associated with this measure would not be paid.

As above, the valuable outputs of [redacted] work demonstrate that the costs were economic and efficiently incurred. Due to the highly specialised expertise of the [redacted] team, they were able to recognise the impact of the systems constraints. Once this had been identified, the [redacted] team were able to clearly articulate the issue to customers (OPR Working Group and latterly SEC Operations Group) and, due to the trusted relationships between the [redacted] team and customers, it was decided not to progress any further with Impact Assessments, saving >£200k, and potentially a saving of around £6m in a measurement and reporting solution which would not have delivered the results expected by customers. The savings brought about by the [redacted] insight far exceeded the cost of engaging them to complete the work.

In summary, the decision to make a direct award to [redacted] in these circumstances on the agreed and negotiated commercial terms was economic and efficient.

Scaling OPR (SECMP0120)

The implementation of OPR Measures that all parties can support is highly complex, especially when there is no time available for systems development or contractual changes. Ofgem had set a very clear deadline that DCC had to work to. The new OPR was agreed with days to spare, demonstrating that there had been no time to complete a competitive procurement and or to train non-experts in the issues needing resolution.

The appointment of [redacted] was based on a very similar rationale to the appointment for OPR SECMP0090. [redacted] has in-depth knowledge of the SEC Governance Processes and in-depth knowledge of DCC's Systems. Most importantly during this phase, trusted relationships with DCC Stakeholders and customers were critical if timescales were to be met.

DCC insisted on the same 13% discount for the Managing Director being applied as per the previous agreement. In addition, 14% of the fee was put at risk based on successful delivery of a new OPR in time for RY22/23.

[redacted] ensured that new measures were implemented in time for RY22/23. If [redacted] had not been successful, and the previous regime had needed to be rolled over for another year, based on current in-year performance, DCC would be in a position to retain significantly more margin in RY22/23 based on current predictions. Whilst customers were unable to fully support the new measures as there is a view that all contracted measures need a review (an activity that DCC has recently started) their endorsement of the regime for RY22/23 given the impossible timelines and difficult history relating to SECMP0122A is testament to the influence [redacted] was able to have on the process. DCC do not believe any other third party could have achieved the same result.

In summary, the decision to make a direct award to [redacted] in these circumstances on the agreed and negotiated commercial terms was economic and efficient.

3.4.3. Implementation of Rolling Quarters [redacted]

During RY20/21, and in light of concerns over movements in DCC's expenditure relative to allowed revenue during the year, DCC determined it needed to urgently move to a quarterly business planning cycle. Ordinarily this work would have been performed by DCC staff working in the Financial Planning and Analysis team. However, both team members in that team had recently left DCC and the work needed to be taken forward in their absence.

DCC was satisfied that it was economic and efficient to enter into a time and materials contract with [redacted] based on the day rates we secured while we were recruiting replacement resources into the Finance team. Our view at the time was that because of the competitive day rates offered, the familiarity with our systems and processes, and the uncertainty regarding the duration of the need for the resources while recruitment persisted, it was economic and efficient to procure support from [redacted].

3.4.4. [redacted]

DCC's Price Control submission sets out that DCC employed the services of [redacted] to advise us on the options for financing 4G Dual Band Comms Hubs and DBT costs as part of the BEIS approved Network Evolution Comms Hub and Network programme.

Comms Hubs are currently financed with banks as per the original DECC contracts with the CSPs. DCC has secured significant reductions in the rate of interest on which these Comms Hubs are financed and has returned over £135m in savings to customers between RY2015/16 and RY2021/22.

Given the progress of the Network Evolution Comms Hub and Network programme, we engaged [redacted] to assist with the initial market engagement, structuring optionality, and to outline the market findings for the potential debt financing. The scope included the following:

[redacted]

- [redacted]
- [redacted]

- [redacted]
- [redacted]
- [redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

DCC does not have the in-house skills and resources to design a robust and economic debt financing strategy. Failing to produce expert advice on a complex and extremely large financing activity would not only have been uneconomic and inefficient but would have been negligent. Having determined it was a necessary activity, we leveraged the interdependency with [redacted] knowledge of other Relevant Service Capability activity to drive a competitive price.

3.4.5. [redacted] DBCH Strategic Positioning Paper

We explained the drivers for this work in the Price Control submission and gave first hand evidence that this work was one of BEIS's Critical Success Factors for DCC. We are therefore perplexed that Ofgem has proposed to disallow this expenditure on the basis of its view that we did not adequately follow our own internal procurement policy.

The advice we sought from [redacted] came under a call-off contract pursuant to the framework agreement we have with the company. The framework was competitively procured, so it is not correct to suggest DCC has failed to comply with our Procurement Policy and Process document. We have also given Ofgem evidence that utilising the call off arrangements was authorised by DCC's ExCo.

3.4.6. NEP – [redacted]

We signed a framework agreement with [redacted] in January 2020, allowing us to call off support at rates that are significantly discounted from [redacted] standard rates. All of the expenditure in RY21/22 was called off using this contract. Having a framework agreement and call off approach is not unusual and is the approach Crown Commercial Service use under MCF3. Given Ofgem is incentivising DCC under OPR to comply more closely with best practice in government procurements, and MCF3 is the most recent framework arrangement used by CCS, it would be deeply unreasonable for Ofgem to disallow the costs of call offs under competitively procured framework agreements.

As a general point, setting up frameworks to govern the terms of call-off contracts to be awarded for specific requirements that occur over time is well-known and widely used in both the public and private sectors as a mechanism to achieve efficiencies through aggregation of demand and simplification of the procurement process for future call-offs. It is therefore highly concerning that Ofgem should be questioning the economy and efficiency of costs that have been incurred through call-off contracts.

Notwithstanding the above, should further evidence be needed of the economy and efficiency of the costs payable under call-off contracts awarded to [redacted] in RY21/22, we have set out below a comparison of the day rates payable to [redacted] under the framework agreement and the average day rates of all the companies on DCC's Business and Management Consultancy Services framework (which itself was competitively procured):

[redacted] day rates under the framework agreement, which were applied in all call-off contracts performed or awarded in RY21/22, are:

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

We have compared these rates to the average day rates of all of the companies on DCC's Business and Management Consultancy Services framework. The figures below are the average day rates of the eleven companies on DCC's framework:

- [redacted]
- [redacted]
- [redacted]

Based on the above differences in day rates, we estimate that using [redacted] has saved customers over £200k. Had we chosen to adopt a competitive procurement upon expiry of the first contract with [redacted], we would have caused delays to the programme, incurred extra DCC resource costs in the procurement team, and subsequently incurred significant extra costs through higher day rates.

In summary, therefore, in relation to call off contracts awarded to [redacted] under the framework agreement, DCC considers that (a) it has complied with the Procurement Policy and Procedure and (b) the costs incurred were economic and efficient.

3.4.7. Resource (Contractor) – NetEvo (IS)

Ofgem has challenged the decision to use Capita Procurement Solutions (CPS) staff to support the Net Evo Comms Hub and Network programme. The variant costs of £0.441m arise from the use of five CPS procurement consultants brought into DCC under the Intercompany Framework Agreement.

Insofar as Ofgem's criticism is that DCC has not followed its Procurement Policy and Procedure document in this regard, that criticism is misplaced. DCC's Procurement Policy does not cover procurements made under Master Service Agreements (MSA) and the Intercompany Framework Agreement (IFA) with Capita. In the case of the CPS staff engaged to support the Net Evo Comms Hub and Network programme all approval processes in the IFA were properly followed and we have provided evidence that this is the case to Ofgem.

DCC was also satisfied that the award to Capita was economic and efficient in accordance with LC 16.6. The documentation we have provided to Ofgem shows a discount off Capita's standard rate card of 20% to 30% for each of the resources we used. The table below shows the discounts DCC negotiated with Capita for these procurement specialists relative to both the standard CPS day rates but also to the Government's Management Consultancy Framework 3 (MCF3), overseen by Crown Commercial Service.

As Capita has been successful in being appointed to MCF3 on the basis of the day rates providing efficiency and economy, we strongly challenge Ofgem's disallowance. We do not believe it is justifiable to disallow the costs when they are on average 25.5% lower than the MCF3 framework rate. The £0.441m incurred costs using the discounted rates is £0.17m lower than the costs that would have been incurred if the MCF3 day rates were used.

[redacted]

3.4.8. BAU – ITES – Laptops

We are surprised that Ofgem is proposing to disallow the £0.311m variance associated with replacing DCC laptops. This is a core business spend and necessary for the efficient running of DCC. Capita's licence bid was based on the following core principles:

> *"All staff will be provided with the equipment appropriate to their role, task and location, whether this is a laptop, PC, mobile phone/smartphone, company vehicle or more specialised equipment. The DCC SMT will agree a standard IT equipment policy.*
>
> *Capita's Managed Desktop Service will provide equipment to the Licensee that is built, managed and refreshed to consistent, reliable and secure standards and will be charged on a transactional basis, leveraging group-wide negotiated rates and discounts. Standard build equipment will be issued to ensure that support costs remain low."*

The combined peak number of laptops and desktops Capita's financial model assumed was 123 in total in reporting year 2020. This was based on the narrow scope of DCC's activities at the time of licence award, excluding amongst others, Switching, SMETS1, MHHS, ECoS and Network Evolution. But as was clearly stated in the licence bid, the commitment was for all staff to be provided with equipment appropriate to their role, based on a standard IT equipment policy agreed by SMT.

DCC keeps an up-to-date log of all of its laptops, detailing the machine name and type, its shipping date, its warranty end date, its lease date end and whether the machine is experiencing any performance issues. This allows us to identify which machines need replacing when. Our IT equipment policy is to replace a machine if it is more than four years old and out of its lease period, or if it is out of warranty and experiencing performance problems. We are providing this spreadsheet to accompany our response.

Disallowing the costs of replacing ageing business-critical equipment sends a concerning message when DCC is at the cutting edge of smart technology and cyber security. It is also contrary to the provisions in Capita's licence bid.

We have provided clear evidence that we engaged with an alternative provider who could offer devices at scale and to DCC's required specification. The documentation we have given Ofgem demonstrates that the devices we purchased were on average £100 cheaper than the alternative provider because of the bulk buying power of [redacted] a Capita subsidiary. Below is a summary table of the unit price, cost and savings between the [redacted] quotation and sourcing via Capita, which shows a total saving of £115k for the replacement of DCC laptops.

[redacted]

As we set out elsewhere, the obligation on Smart DCC to direct award a contract is based on us being satisfied the procurement would be economic and efficient. We have provided first hand evidence that the option we pursued was cheaper than the comparator, and that we had been able to move away from a four-year lease lock-in.

3.4.9. Office 365

We disagree with Ofgem's proposal to disallow the expenditure on Office 365 licences. The decision to move to E5 licences was made in 2019 as part of the Board approved Enterprise IT migration project.

DCC has always included Office 365 costs in its Price Control submissions and Ofgem has not previously disallowed any spend. In RY19-20 we forecast that Office 365 costs would be £0.824m in RY21-22. Ofgem did not disallow this forecast. However, in last year's Price Control submission DCC had assigned Office 365 costs as "allocated" or "uncommitted". We are investigating why this was not assigned a "committed" status like all prior years. Because of the way in which our data works, the internal forecast set Office 365 costs to zero and overrode the previously existing baseline. Had this not happened, rather than the costs of Office 365 showing as a variance of £0.699m it would appear as an underspend against the baseline of £0.125m.

Prior to Enterprise IT, DCC used a combination of Office 365 E3 and E5 licences sourced by Capita. Over the last two years we have rationalised our licences and moved away from a combination of E3 and E5 licences to just E5 licences. We are getting a better service, which reduces security risks and increases functionality, at a cost that is significantly lower than a comparable offering from a rival, due to Capita's purchasing power.

As we explained to Ofgem before its consultation, as part of our due diligence to ensure we were getting a good deal, we engaged and compared the costs of contracting through [redacted] (an alternative retailer) with the Capita offering and found it would have been significantly more expensive. We have already provided this evidence to Ofgem but repeat it in the table below. In addition, unlike the E3 licences, we are not pre-committed to a minimum number of licences and can reduce or increase the number of E5 licences we have efficiently. We believe that on performance, cost and risk grounds the revised licence approach is superior to the pre-existing arrangement.

The table below sets out the cost comparison between [redacted], demonstrating an overall saving of almost £113k.

[redacted]

3.5. EVs and Product Management

Ofgem's consultation document recognises that DCC has engaged with and responded to requests from BEIS relating to load control and EV charging, but it is challenging the economy and efficiency of expenditure incurred in meeting those requests on the basis that DCC's priority and business strategy should be the delivery of its Mandatory Business.

As we set out in the submission, we committed to customers that we would keep our expenditure on EVs and related activity to less than £1m, and if we planned to exceed it, we would return to them with a formal business case. For the avoidance of doubt, we have not exceeded £1m, and our focus is solely on helping BEIS and other stakeholders to understand the capability of the system. We set out in the submission that the two main activities under the EV category of Living Pillars and EV Proof of Concept were technological proofs of concept to demonstrate the potential connectivity into DCC's system, including the processing of non-GBCS compliant messages. The combined total expenditure of these two important technological proofs of concept of £0.33m is immaterial (0.06%) within the context of DCC's total expenditure in the year of £550m.

Ofgem proposes to disallow all expenditure on innovation citing the primacy of DCC's Mandatory Business. We strongly argue that Ofgem is not interpreting DCC's Licence conditions correctly in categorising this expenditure as not forming part of the Mandatory Business. Licence Condition 5.3 clearly states that DCC's General Objectives in the period between the Licence Commencement Date and Completion of Implementation are comprised **of both** the Interim General Objective and the Enduring General Objectives, and not the interim objective only. The Second Enduring General Objective includes in LC5.10(b) requires DCC to carry on its Mandatory Business in the manner that is most likely to facilitate:

> *(b) such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation*

As explained in more detail below, all our work on innovative projects this year has focussed on how DCC's smart metering infrastructure might be used to support Government policies in relation to EV smart charging and Smart Meter Enabled Thermal Efficiencies Ratings. In our view this is precisely the kind of activity that LC5.10(b) envisages that DCC should undertake in the operation of its Mandatory Business. Furthermore, because significantly less than 0.1% of DCC's total expenditure in RY21/22 relates to "innovation", we do not consider there is any validity in the argument that DCC is prioritising such activity over other parts of its Mandatory Business.

During RY21/22, DCC worked with BEIS and the Office for Zero Emission Vehicles (OZEV) (at BEIS's request) on the development of their policy objectives to:

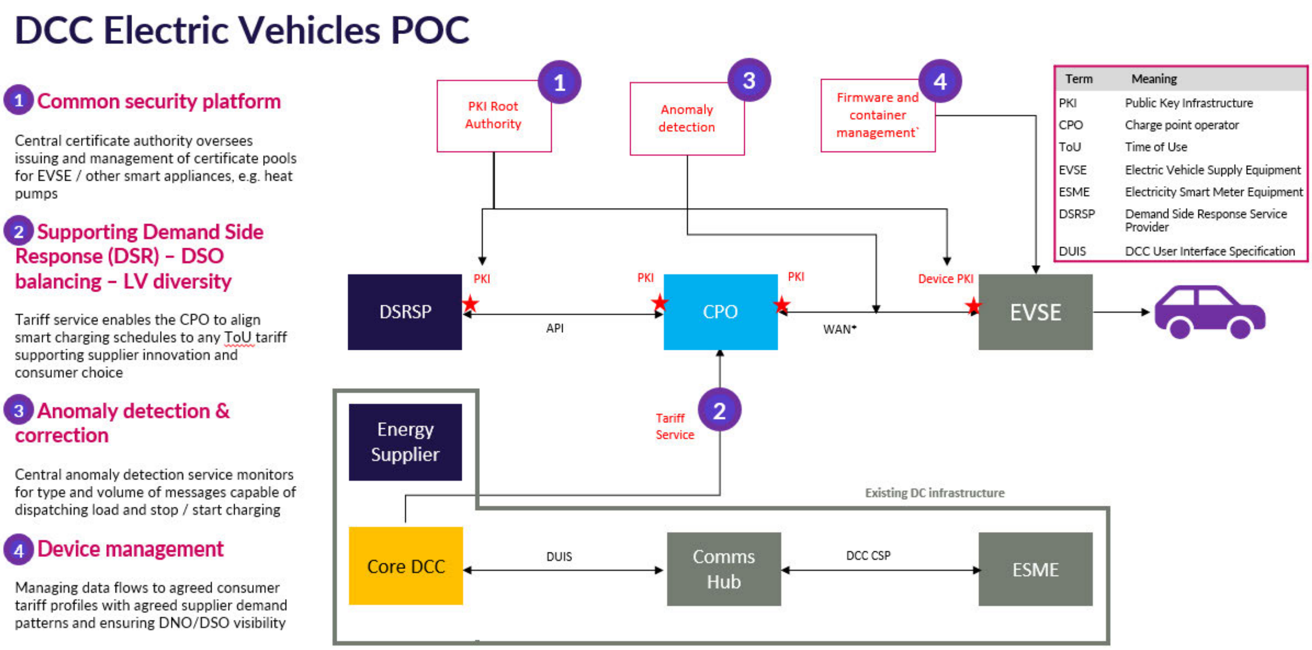
- Set out the different models for utilisation of DCC smart metering infrastructure in EV smart charging
- Facilitate discussion on how these different models compare against policy objectives and perceived industry challenges & concerns

The table below shows sets out BEIS's EV problem statements, and what DCC's role could be in helping resolve them. We have included the BEIS slide pack alongside this submission.

Issue	Response
Latency/Lack of real time control and metering	Sub-second response can (and usually is) built into loads rather than operated manually. Grid services can be delivered without remote sub second control. *Domestic demand side response (DRS) events need to take account of the BSI standards emerging in PAS 1878, the solution will need to translate a DRS calls into open standards messages that can be consumed by the EV charge point.*
Consumption data aggregated to household level	Proposal is to mandate smart metering for load control, not for metering. Second meter can be installed (doesn't need to be smart meter) and are usually part of charge point anyway. *OCPP would provide device level metering for a charging session*
Smart Metering will hinder innovation and limit consumer choice	Smart Metering offers platform for innovation whilst maintaining interoperability – we have seen lots of innovation around smart metering *The EV charging solution would enable innovation as it will provide communications and a set of standards to innovate by, if consumers are able to switch whilst retaining the hardware, this should spur competition for domestic EV charging services*
Single service provider will limit competition	Delivering interoperability promotes competition between service providers. *As above, the solution will drive competition for driveway charging service provision*
DCC single point of failure to attack	The system wide approach to security under smart metering means there would have to be failures simultaneously at multiple levels for there to be a catastrophic attack. *The EV charging service would have a separate supply chain to the SMKI DSP so this is mitigated*
Isolation of GB market	GB Smart Metering has seen large scale international investment, as it has provided certainty. Additionally, there will be many common components to all devices and systems, it is normal for local adaptation to occur. *OCPP would provide internationally recognised standards to a mandated GB solution, so the market would not be isolated.*
DCC slow to implement change	We have proven we can deliver new functionality by implementing new proportional load control within 12 months. *Agree, the EV platform has the potential to be more agile to change by falling in line with open standards (OCPP/OCPI/OpenADR) whilst providing PKI security wrapper.*
High Costs of DCC access	Any system which delivers similar levels of interoperability and cyber protection will have similar requirements. *We believe that more modern platforms, such as AWS IOT core have the potential to reduce costs*

In undertaking this work, we engaged extensively with senior BEIS colleagues to examine the considerations and constraints associated with the widespread domestic charging of EVs. We also discussed the associated load control opportunities arising from connected distributed EV and domestic battery storage potential to the low voltage network and using the smart meter interface to control charging and discharge. This work examined the requirements for both network and consumer protection and resulted in a number of outputs, including several DCC EV white papers, Proof of Concepts (POCs) and propositions to specifically review the interoperability benefits of the use of common systems for the management of PKI certificates for device connection, centralised anomaly detection and security resilience. This work was delivered to BEIS during April to September 2021 and was not only commended for its excellent contribution to the development of policy but formed part of the foundations of the subsequent (2022) BEIS industry consultation into the development of a Smart and Secure Electricity System.

A schematic of the EV POC presented to BEIS is below.



As part of this assignment and in order to properly engage with the Government's concerns regarding the use of the smart metering infrastructure for EV charging, DCC developed a technical POC to support a number of use case propositions including examining the feasibility of the connection of remote sensors and control equipment through the smart metering network in order to fully understand and develop the options available under current and future regulatory models.

The work undertaken on 'the Living Pillars' project was part of a DCC POC to support the BEIS project on Smart Meter Enabled Thermal Efficiency Ratings (SMETER).[1]

This project set out to examine the detailed considerations for the use of DCC's smart metering infrastructure for remote monitoring and measurement of domestic energy consumption and its application to determine the thermal efficiency of a smart meter equipped property as a more accurate means of evaluating the retrofit requirements for UK housing stock. In its simplest form, this required the connection of both temperature and humidity sensors to the smart meter comms hub in the home. The living pillars were a development of this concept, connecting these sensors to other monitoring and humidity modification equipment in real world climatic conditions. This negated the need for the provision and use

[1] See: [Smart meter enabled thermal efficiency ratings (SMETER) technologies project: technical evaluation - GOV.UK (www.gov.uk)](https://www.gov.uk)

of bespoke test bed facilities in a lab. The resulting analysis and learnings were provided to BEIS for incorporation within the Government's decarbonisation strategy.

In summary, the work we undertook in RY21/22 on the above projects was both part of the Mandatory Business and low in value. We therefore request that Ofgem reverses its proposed disallowances of the £0.15m costs incurred on the EV POC work as well as the £0.18m disallowances associated with the 'Living Pillars' POC.

As we explained last year, the Product Management team's focus continued to be on Elective Services, DCC Boxed and government priorities. These are all mandated activities, and the costs of the team should not be disallowed on the sole ground that Ofgem considers it is permitted business.

3.6. Policy and Markets team

We are concerned that Ofgem is proposing to disallow the forecast costs of the Policy and Markets team. Our interpretation of Ofgem's position is that rather than arguing that DCC's has chosen an uneconomic route to bring such resources into DCC, it simply disagrees that DCC should have these skills in the organisation. That is a concerning position for the regulator to adopt.

Capita's original licence bid made provision for resources related to strategy and innovation as per the extract below of the financial model submitted to DECC in the original licence bid process.

[redacted]

It was always anticipated, and explicitly accepted by DECC that permanent resources within DCC should be devoted to strategy and innovation. The scope of this activity was described in the tender bid as including:

> *"horizon scanning drivers for service development including:*
>
> - *emerging technology roadmaps (including Service Management Technology Roadmap)*
> - *policy, legislative and regulatory environment*
> - *consumer behaviours and trends*
> - *Service User requirements captured by the Industry team"*

Capita's licence bid also included the following statements:

> *"Our Strategy and Innovation Manager will monitor forthcoming changes in industry regulations and technical advancements to ensure the DCC supports Service Users in meeting their requirements (e.g. Ofgem Smarter Markets). We will also ensure that change is designed and implemented in a controlled manner to ensure service stability and availability."*

We would also remind Ofgem that DECC's licence bid template contained the following questions:

{2.3}	**Innovation and service development**
Licence reference:	The key condition in the Licence is: - 17 Requirements for the provision of services. Other conditions that have some particular relevance include: - 23 Change control for Smart Energy Code.
SEC reference:	The key reference is Section D, although H7 and H8 are relevant in part.
SSR reference:	SM.3.1, SM.3.2, SM.3.3
Evaluation criteria:	{OPM-ISD} Innovation and service development
Word limit:	No more than 3,500 words
Please set out how you will innovate and develop new service proposals for future Service Users in conjunction with your service providers including, but not necessarily limited to: • Optimising the performance and cost of existing services • Responding to demands for the development of new services from Service Users • Proposing new services where opportunities are identified • Managing the entry into service of new services of different sizes and complexities without impacting existing services • Obtaining the necessary capability and capacity (the response should clarify the capability and capacity included in the underlying solution, and that which would be considered additional) • Principal risks and their mitigation.	

It is clear from DECC's original tender material and DCC's successful bid that innovation, service development, new products and horizon scanning were all within scope of the successful company's offerings. It is therefore disappointing that over time the scope of DCC's activities have been narrowed through disallowances and challenges that both work against government's Net Zero ambitions and the terms of the original licence bid.

The DCC Licence sets out an enduring obligation (LC5.10.b) to carry out the mandatory business in the manner most likely to facilitate '*such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation*' . This requirement is further reinforced under the General Objectives of the Smart Energy Code (specifically the Fifth General SEC objective – Part D 22.15)

Licence condition 14 requires DCC to prepare and maintain a development plan which must be produced annually (before 31 July), setting out the Licensee's business development objectives for the five-year period consisting of the Planning Year and each of the four succeeding Regulatory Years. Furthermore, it specifies that DCC must annually review the main changes in the energy market and determine those most relevant to the current and future undertaking of its authorised business. Having done so, there is a further obligation to engage with both SEC and REC parties to determine and understand, market trends, policy developments and those opportunities likely to be available to the Licensee for developing the infrastructure, systems, and processes in place for the provision of Services under or pursuant to the Smart Energy Code or Retail Energy Code and align them with the general obligations of the DCC licence.

These requirements are resourced and discharged through the Policy and Markets team. The team also leads on the identification, bidding and management of all relevant statutory innovation projects. The work requires the team to undertake regular horizon scans throughout the year and to digest the relevant market intelligence in order to develop the appropriate DCC policy responses in accordance with the requirements of the SEC and REC. Since the UK Government amended its commitment to the Climate Change Act and set out its strategy to deliver Net Zero carbon emissions by 2050, there has been a significant increase in both the number and frequency of Government policy initiatives affecting the energy sector more generally and the evolving role of smart metering, opportunities for re-use and the potential for more developed use cases for smart metering data. The figure below sets out the key headline changes since 2019.

[redacted]

The increase in the pace of development within the energy sector, has created a significant increase in the number of and variety of enquiries from both existing and new/potential market participants. This has been particularly true around demand side response (DSR) and the future role of the Distribution System Operator (DSO) as this spans the boundary between the electricity networks and the consumer's home and frames many of the potential opportunities for re-use of the capabilities smart meter system and the data that it carries. These enquiries have become increasingly complex in nature, focussing on potential new use cases as well the adaption of existing technology to accommodate new applications such as demand flexibility services and domestic hydrogen metering. This has required DCC to strengthen its capabilities to interpret, understand and meaningfully support these developments.

We therefore urge Ofgem to reverse its proposed disallowances on the policy and horizon-scanning activities of the Policy and Markets team.

3.7. Planning (OMS and Customer Portal)

OMS is DCC's strategic tool set for the forecasting, ordering, returning, and tracking of assets. When operating at scale, it is estimated that there will be in the region of £1.5bn of assets in use. Presently, OMS is split into three instances, with one in the North and two covering South and Central. Operating these three instances generates several risks, which can be grouped into the following areas:

- Increased operational support costs with slow development and enhancement.
- Poor user experience through functional differences and multiple logins.
- Inefficient and manual processes for DCC and Service Providers that are unsustainable in the long term given the anticipated increase in the volume of assets managed by the OMS.

The project was paused in January 2021 due to rising costs and project difficulties, with the planned new portal and service not having been successfully used. We believe it was the right decision to stop the work and avoid any abortive spend. The expenditure in the year related to ongoing legacy costs of licences, not people costs. As we believe we did the right thing we do not consider it appropriate for Ofgem to penalise us by imposing a disallowance.

We are applying all applicable lessons learnt from the OMS project to the development of the 4G OMS and Logistics service, reusing all applicable artefacts and information.

The Customer Portal disallowance, while relatively immaterial, is disappointing given the efforts put in to deliver for customers. We have taken onboard customers' feedback on the portal and will learn lessons from it.

3.8. Shared Service Charge

We understand that the majority of the reduction in Shared Service Charge arises from the disallowances. However, we continue to disagree with Ofgem's position that there is a difference in eligibility for overhead between baseline and additional baseline. We consider the LABP clearly provides for overhead on baseline and additional baseline activities on the same basis.

4. Penalty Interest

4.1. Overview

The Penalty Interest regime exists to incentivise DCC to accurately charge our customers and to deter us from over-recovering.

DCC has continually sought to improve its forecasting capabilities to ensure the charges that we set at the start of each regulatory year reflect – as much as is possible – our annual expenditure.

In prior Price Control consultations, Ofgem has asked DCC to improve the predictability and accuracy of its forecasts. Over the last year, the Business Accuracy programme has been a key driver towards helping to improve these forecasts and by its full implementation, we expect to have reduced the variances between our forecasting and actuals even further.

Ofgem has asked us to explain why we could not have reasonably predicted the increase in costs over RY21/22, but this underspend is representative of a decrease in costs and can be explained by several factors as set out in our Financial Reporting Commentary. This includes functional and programme underspend and is explained in further detail within section 4.2.3 below.

DCC took active steps to return cash to customers when it became clear that our spend in RY21/22 would be lower than expected. DCC assessed the amount to return to customers in late 2021. The factors noted below were events not known at the time of the reforecast and were often not within DCCs control. In addition, these all occurred late in the year (periods 11 and 12). DCC notes that the governance process regarding the reopening of the Charging Statement and return of cash to customer in year is lengthy – requiring a three-month notice period – and as such, these late reductions in cost could not be returned in year.

DCC has set an approved target of maintaining a healthy cash range of £25-53m each month. This is in-order to manage fluctuations in costs, not reflected in the flat phasing of revenue across the year. The only possible source of funds for this cash reserve is cash collected from customers. However, if DCC does maintain its healthy cash range of between £25-£53m, this places a disproportionate and severe challenge on DCC to manage its current year spend if it is to stay within the 110% threshold. It is essential that DCC maintains its future healthy cash range when considering timely return of cash to customers and this estimate is needed earlier than expected given the three-month notice period. DCC therefore requests Ofgem reviews the process to allow DCC to return cash to customers with less notice after an underspend is identified. This will enable changes in circumstances late in the regulatory year to be acted upon.

During RY21/22, DCC took prompt action to return cash to customers and remain with the 110% tolerance permitted by the Penalty Interest regime guidelines. DCC does not believe it is fair or correct that Penalty Interest charges are levied on apparent breaches of the regime which are driven by cost reductions outside of DCC's control and/or occur too late in the Regulatory year for DCC to process the return of cash to customers due to Ofgem's timeline for reopening the charging statement. DCC would not have breached the Penalty Interest threshold if:

- Migration of SMETS1 meters by the wider Energy Industry had been in line with external forecasts;
- Cost reductions delivered through the finalisation of SEC Mod releases with customers and resolution of related contractual issues on the In-Life change programme (all of which were outside of DCC's full control) could have been passed back to customer within the Ofgem's Charging Statement timelines; and
- Additional cost savings in February and March 2022 from higher employee churn, Enterprise IT savings and reductions in Functional programme costs could have also been passed back to customers within Ofgem's timelines.

Where events outside of DCC's control were identified on other Programmes such as ECoS and Network Evolution but occurred within the timeframe whereby the charging statement could be reopened, DCC returned cash to customers on a prompt basis within the £80m refund.

Given the factors detailed below, DCC therefore proposes that our underspend for RY21/22 should be reported as £4.8m.

4.2. Summary of adjustments to reported underspend

4.2.1. Timing of spend and cash balances

It is very important for DCC customers that they can reliably predict their costs and as such we primarily charge on a fixed cost per meter basis. This means DCC cashflows are reasonably stable month-on-month. To remain liquid, we must charge enough to be able to meet our cost obligations without increasing charges mid-year. This is in line with our Licence Obligations. Where feasible, DCC has always sought to return any underspend to customers within year by reopening our Charging Statement and amending final invoices for the year. This was done in RY21/22, 20/21, 18/19 and 17/18, as well as in RY22/23.

Throughout the year our cash outflows can range significantly. For external spend, this was between £18.7m and £46.8m, with timing of payments to FSPs being the main contributor.

Our cash forecasting process is based on several assumptions including timing of current contracts and planned outflows, estimations of rough order of magnitude of contract change, and internal budgeting.

We have dramatically improved the forecasting relating to internal budgeting through our new quarterly lock process as well as our Business Accuracy programme, but the timings around contract change are more difficult to forecast and are the primary driver of volatility and underspend.

Given the three-month notice period required to return cash to customers, DCC had to decide on cash return to customers in late 2021.

4.2.2. Actions taken to limit over-recovery

Through our regular processes, DCC assesses the accuracy of our forecast regularly throughout the year. Based on a regulated revenue of £656.0m (which allows £65.6m underspend before breaching the PI threshold) our quarterly forecast identified a possible underspend in November 2021. The forecast at the time indicated that a return of £80m cash to customers in the form of reduced charges would allow us to maintain a healthy cash balance, not over-charging our customers and remain within the penalty interest threshold.

To return cash to customers, DCC must reopen the Charging Statement. The process for this involves a recalculation of charges, internal sign-off, a notice to Ofgem, and publication of a draft Charging Statement issued three months ahead of when we expect the new lower charges to start. While we can request a reduced notice period (as we did in this case), the process is nevertheless lengthy and, on average, DCC requires a minimum of four months to go through this process. This means that any underspend must be identified by November to return cash to customers in-year.

From November 2021, our forecast for RY21/22 remained stable and we were predicting to finish the year with an appropriate cash balance. However, as part of our regular review processes, in late February early March we identified some additional underspend. The drivers behind this are set out below. As a result of the late timing of the change in forecast, we were unable to return cash to customers within-year which resulted in an over-recovery of revenue by the year end. Once identified, this underspend was, however, returned to customers early as part of the RY22/23 Charging Statement, rather than waiting for the Correction Factor return in RY23/24. These factors – and the timings the changes impacted the forecast - are not within DCC's control and as such we think should be excluded from any revenue comparisons.

DCC requests Ofgem undertakes an urgent review of the process to reopen the Charging Statement and return underspend to customers. The requirement to give three months' notice does not allow sufficient time for DCC to undertake in-year reforecasting to account for any events (most of which are outside DCC's control) that occur in the second half of the year, is therefore not in the best interest of consumers.

In addition, we believe the current penalty interest system could create a perverse incentive whereby DCC is discouraged from making efficiency savings in the second half of the year, as this would risk creating the appearance of an underspend and breaching penalty interest thresholds. This would be inefficient for DCC and costly to consumers. Allowing DCC to return cash to customers sooner would remove this unintended negative consequence of the current regime.

4.2.3. Drivers of underspend

The table below details the impact on the penalty Interest calculation driven by events in period 11 and 12, plus timing of Correction Factor

Adjustment	£m impact (1dp)	Description of impact	Percentage of underspend	Penalty interest percentage
Unadjusted difference between RR and AR	**63.3**	**This is the submitted difference between our RR and AR as per the submitted Main RIGS v4.**		**112.7%**
Functional underspend	7.7	Savings on EIT, Finance, and Security budgeted costs and movement of work into RY22/23	12.2%	
Programme underspend	13.1	Programme underspend greater than expected as projects and milestone spend deferred from RY21/22 to RY22/23	19.1%	
Total	**20.8**	**All factors**	**32.9%**	
Timing of Correction Factor	37.7	This artificially inflates the RR so should be removed from the difference	59.6%	
Total	**58.5**	**All factors + CF**	**92.4%**	
Revised difference between RR and AR	**4.8**	**Updated for explanatory factors and C F as noted above**		**101.0%**

4.2.3.1. Functional underspend

Internal change programmes - specifically related to Enterprise IT and Business Accuracy - were delayed in the latter part of the year because of a lack of resource and capacity within teams and a decision to reduce the scope of the Business Accuracy programme following receipt of feedback from customers.

Enterprise IT finished the year with £2.3m of savings and delayed activity across R&M support, staff vacancies and CMS and LMS systems work moving into RY22/23. The Finance function was £2.1m below budget as a result of the decision to reduce the scope of work on the Business Accuracy programme and a delay to the planned office refurbishment.

The Security function delayed procurement and had lower resources on the TSP programme which resulted in £3.3m lower spend in RY21/22.

4.2.3.2. Programme underspend

We reforecast programme spend and returned £80m to customers mid-year which included an estimate for lower spend on In-Life Change and SMETS1.

On the In-Life Change programme, the expectation in late 2021 was that the programme would be delayed but would start in RY21/22. On the basis of this, DCC's reforecast estimated the In-Life Change programme would come in £5.8m under forecast. However, as a result of contract signature delays the full programme moved to RY22/23 rather than expected partial programme costs. This resulted in the programme underspending by £12.6m versus budget (£6.8m lower than had been expected in late 2021).

In late 2021, the updated forecast for the SMETS1 programme had identified issues with slower than expected migrations. The impact was forecast to be a £2.9m underspend which was factored into the £80m return of cash to customers. In period 11 and 12 the migrations were lower than expected and significant milestone payments due to be paid in RY21/22 moved into RY22/23. This meant that spend was a further £6.3m lower than had been expected in late 2021.

4.2.4. Timing of Correction Factor

The Allowed Revenue formula includes the cumulative Correction Factor, which in RY21/22 was £48.6m. This comprises the total over-recovery of funds compared to costs incurred in the previous regulatory years, adjusted for indexation.

The Regulated Revenue for RY21/22 based on the charges set in the Charging Statement, includes an amount given back to Service Users of £10.9m for main correction factor (in addition to the £80m we returned to customers mid-year). The remaining £37.7m is given back through the RY22/23 charges and so will be part of the Regulated Revenue for that year.

Our view is that any consideration of penalty interest needs to exclude the cumulative Correction Factor as this is the only means available to DCC to ensure we have a healthy cash balance. Had we paid back our cumulative Correction Factor in full in RY21/22 (i.e. the year before it was due to be returned to customers), our April cash balance (minus credit cover) would have been £28.1m. This is only just within the lower limit of a healthy cash balance (which ensures we can pay all our suppliers on time) at £25m-£53m and we had removed our contingency from the RY21/22 budget in the £80m return of cash.

This timing delay impacts the difference between Allowed Revenue and Regulated Revenue, with Allowed Revenue accounting for a £48.6m Correction Factor but the Regulated Revenue in the same year only accounting for £10.9m. If the Regulated Revenue for RY21/22 had accounted for the additional £37.7m on the same basis it would have been £538.2m.

The timing issue of when the Correction Factor enters the Regulated Revenue formula accounts for 60 per cent of DCCs underspend in RY21/22. Accounting for this would result in a difference of only 102.2% which is significantly below the Penalty Interest threshold.

5. Incentive Schemes

5.1. OPR

5.1.1. System Performance

We accept Ofgem's assessment of our operational performance in RY21/22. Aspects of RY21/22 performance were more challenging than we hoped, particularly with the inclusion of a small set of SMETS1 metrics. We have been working on establishing the causes for this and we continue to work towards solutions to improve our performance.

OPR reporting for RY22/23 sees a new set of measures. We are working through the reporting of this currently. We are keen to work with Ofgem to obtain the final reporting templates to ensure performance is reported and tracked as intended.

In parallel, we are making good progress on the development of an enduring OPR. In September 2022 we submitted our first OPR progress report to Ofgem which set out our plans, as agreed with industry, for developing an enduring set of OPR measures. The new Performance Measures Review Group (PMRG) is now established and is actively working on a full review of the measures for an enduring OPR that is fit for purpose. We will next report to Ofgem on progress in this area in March 2023.

5.1.2. Customer Engagement

Whilst the scoring and measurement approach is highly subjective, we accept Ofgem's assessment of our performance in RY21/22 on customer engagement.

We are in full support of the prioritisation of customer engagement through the OPR. The trial year was a useful learning experience, and we worked hard to act on the findings and to improve our submission to Ofgem.

We continue to seek improvements in customer engagement. This year we are implementing the following:

- The roll out of the Programme Assurance Framework across DCC, enabling a consistent approach to customer engagement; the design and implementation of a Customer Engagement Performance Framework, allowing an in-year indication of performance, helping to help drive continuous improvement.
- A move to an account strategy approach to develop closer relationships and build advocacy outside of formal SEC governance structures.
- The sharing of business cases with customers and the move to business case ownership within Customer Engagement.

As we look forward to next year, we are analysing the feedback from customers, SEC Panel and Ofgem and will work on improving our performance.

5.1.3. Contract Management

Whilst we were disappointed that there was not an opportunity for a trial year and we moved immediately to an incentivised regime, we accept Ofgem's assessment of our performance in RY21/22 on contract management.

Based on learnings from the DCC and Ofgem audit, we have implemented the following improvements to address the key findings of both audits this year:

- Strengthened the leadership of the commercial function which will enable us to begin the first stage of our commercial transformation.

- Implemented a revised lessons learned process and accompanying central depository to ensure best practice is taken forward and that ideas are shared for continuous improvement.
- Developed a contract handover toolkit to ensure the key details of agreements are shared with the contract management team in order to facilitate a smooth transition from contract to in-life.
- Developed commercial strategies for DSP and the WAN suppliers for SMETS1 and SMETS2.

In addition to those listed above, we have kicked off the implementation of our commercial transformation programme, which includes:

- Establishing and mapping core commercial processes in preparation for the implementation of a new source to requisition platform. This single end-to-end commercial system will replace three standalone tools and provide easier auditability, improve our ability to forecast and understand future cost and better facilitate alternative procurement routes to market.
- Revising our procurement strategy, which will outline preferred sourcing options, routes to market and meet future business needs.
- Launching a new SRM[1] framework with the aim to complete the first phase by Q2 2023.
- Designing and implementing a new commercial organisation structure to ensure the right capabilities are available to support the existing and future business throughout the entire contract lifecycle.

We look forward to sharing more on this as part of the RY22/23 submission.

5.2. Switching

We are pleased to have completed the DBT phase of the Centralised Registration Service, and to have demonstrated to Ofgem the milestone was achieved for DM4.

[1] SRM – supplier relationship management

6. Baseline Margin Adjustment and External Contract Gainshare

6.1. Baseline Margin Adjustment

While we largely support Ofgem's proposals for the RY21/22 BMA adjustment, we also note that a significant proportion of the proposed reductions are the direct result of disallowances of forecast costs for RY21/22 and RY22/23.

However, Ofgem has proposed a number of disallowances of incurred costs in RY21/22 and beyond based on rejecting the grounds.

6.1.1. Operational Change

Ofgem has rejected three grounds related to the Operational Change driver:

- Ops – Moving Beyond ITIL,
- Ops – Scope of Support and
- Operational Resilience – Early Life Support

Ofgem states that it has disallowed the resource and non-resource costs of these drivers, as well as arguing DCC has not provided any specific justification for the proposed grounds. We do not understand Ofgem's position on this as there were no non-resource costs in our application for these three grounds (there was in another ground under this driver), and we provided a detailed description of the reasons for these activities in the submission. We have also not been able to replicate Ofgem's proposed disallowances based on the above grounds being disallowed and would appreciate the chance to view Ofgem's underlying calculations.

All of the roles that Ofgem has disallowed under the above three grounds have been employed by DCC for several years. There has been no underlying change to the need to retain these colleagues and we believe a disallowance of the margin for these roles after several years of accepting it, with no other factors having changed is not rational.

6.1.2. Facilitating Additional Relevant Services driver: HMT Business Case Development

On HMT Business Case Development, we note Ofgem's view that DCC should have been applying a robust methodology to ensure its procurement policy delivers value for money in prior years. We do not accept this argument as a.) the reason BEIS introduced the provisions was because it wanted to hold DCC to a much higher standard than previously and b.) the licence changes were specifically related to the increase in new programme activity that DCC was expected to deliver. We did not have dedicated resources in post to formulate HMT-compliant business cases in any prior year.

We also note Ofgem's argument that DCC has missed the application window because the grounds arose in May 2020 when the licence was changed. This is inconsistent with Ofgem's stated position on ECGS which uses the same wording in the licence as the BMA provisions. Ofgem's RY20-21 Price Control decision document states that for ECGS purposes, the grounds for proposing an adjustment first arise when either of the following occur:

- When amendments to the FSP contract are agreed and the contract is signed with an aim to realise savings; or
- When costs are incurred to deliver the same service previously delivered by the FSPs with an aim to realise savings. It is reasonable to assume that if costs have been incurred elsewhere to deliver the same service the FSP contract will be amended to realise the savings and the delay is just procedural.

If this was applied to the BMA, the grounds would first arise when we had signed a contract with the contractor. This happened during RY21-22, and hence the Application Window has not been missed.

6.1.3. Security Driven Change, Facilitating Additional Relevant Services, Resource Planning and Management

Ofgem argues that in some cases DCC's submission is not clear on how the activities meet the volume and/or complexity criteria, and that in some cases we provided either vague justification or very detailed description of the activity without explaining how it meets the criteria for an adjustment.

We explained to Ofgem in the submission, the clarification questions and cost visit that our policy on allocating certain expenditure types to drivers matches previous applications that Ofgem has approved. For example, our IT-related costs have always been assigned to the Security Driven Change driver. There is very little guidance on how to make the BMA application, and in the absence of detail, we applied rules that Ofgem has previously accepted. We consider this to be reasonable.

On Facilitating Additional Relevant Services, as per our submission, we would remind Ofgem that Brabazon accommodation costs were approved in RY20/21 under this driver. We have simply adopted the same approach this year. As we set out in our submission the Test Labs provide additional testing services that the CSPs had previously provided. Consequently, this is the correct ground to make our application. We do not believe that for ongoing cost items such as Brabazon accommodation that it is appropriate to make a full and comprehensive submission justifying every item of spend in detail as if it had been raised for the first time. This would be inconsistent with prior statements by Ofgem in its Price Control publications.

In the submission we set out how, as a multi-programme organisation with more concurrent programmes than at any stage during its existence, DCC has needed to adapt and evolve its business processes, planning, monitoring, and reporting. If DCC was established to run five programmes concurrently when the licence was awarded, the activities we have incurred expenditure on would have been in Capita's licence bid as the costs of running DCC, and therefore would have earned margin.

We are concerned that there is an inconsistent understanding of how the BMA mechanism works and what it is designed to do, and we would appreciate further engagement with Ofgem during the remainder of the reporting year.

6.2. External Contract Gainshare

We welcome Ofgem's proposal to accept DCC's ECGS adjustment of £11.89m relating to the continuation of re-financing arrangements and CH financing, as well as DCC's Test Labs. DCC has realised these savings as a direct result of the efforts of our commercial team to secure financing at more competitive rates, as well as through the positive relationship DCC has built with investors by continuing to meet our payment obligations.

DCC's Test Labs have made it possible to provide a fully integrated end-to-end test facility that better meets our customers' needs as per the requirements in the SEC, at a cost cheaper than the testing services that were initially provided by the CSP. We recognise Ofgem's draft decision to reject DCCs gainshare application for forecast Test Lab savings but reiterate our view that we have saved industry and customers a further £77.8m until the end of the licence period. We welcome Ofgem's statement that DCC may reapply for gainshare on these savings in future years once they are realised or certain.

7. Quantifying "unacceptable" costs

In conclusion, DCC is concerned by Ofgem's proposed disallowances this year. They are out of step with prior years, with no advanced warning that would be the case. It is concerning that despite the general increase in scrutiny from Ofgem, many of the disallowances appear not to have been properly examined during the Clarification Question and Cost Visit process. Only one question was asked relating to [redacted], and very few on non-competitive tenders. There was no indication during the process that Ofgem was minded-to disallow nearly three times more costs than any prior year. We expect regulatory consistency and for Ofgem, in performing its public duty, to apply the principles of better regulation.

Ofgem should exercise extra caution in disallowances due to the ex-post nature of the regime. DCC cannot mitigate disallowances; they have a very real impact on the business, and on our core duty of providing an economic and efficient service.

We recognise that DCC has to justify its expenditure as being economic and efficient. However, it is imperative that DCC is able to manage its affairs without being performance-managed by the regulator on the minutiae of our activities. A particularly concerning example of this was how Ofgem seized on disallowing the ETB entry in the RIGS without understanding what it represented or how it was calculated.

We are also concerned with the reasoning behind some of Ofgem's disallowances. In many cases Ofgem's only argument for the disallowances is not because it believes DCC could have delivered the activities more efficiently and economically, but rather because Ofgem questions whether DCC should be spending money on them at all. This goes beyond the envisaged scrutiny of the Price Control process. If Ofgem believes that DCC has not incurred costs efficiently and economically, it should focus on disallowing the incremental costs relative to the efficient counterfactual. In many of the examples Ofgem has targeted for disallowances, such as Laptops, Office 365 licences, Net Evo Resource Contractor (IS) we have provided at least one counterfactual that shows our decision was the most economic and efficient. On Business Accuracy, we have demonstrated to Ofgem that we have chosen the most economic and efficient of the four options we assessed. The remaining non-competitive procurements such as [redacted] and the OPR review can clearly be justified on unique skills grounds as well as the savings that have been created through improving performance or avoiding abortive costs.

We have, via our initial engagement, extensive clarificatory responses, and now this response, demonstrated how we have acted in compliance with the Licence and Ofgem's own Price Control Processes and Procedures document. Furthermore, the bulk of Ofgem's disallowances are because it argues DCC has been unable to provide documentary proof that RY21/22 costs were economic and efficient at the time the decisions to incur the costs were taken. Whilst contemporaneous documentary evidence of DCC's consideration of whether a particular cost or procurement strategy is economic and efficient is highly desirable and helpful for Ofgem's price control assessment, it is not the case that the absence of such evidence necessarily leads to a conclusion that costs were inefficiently or uneconomically incurred. The price control regime is ex post, and it is clearly possible and necessary for DCC and/or Ofgem to analyse incurred costs after the event to determine whether they were in fact economically and efficiently incurred. That test in our submission is an objective one relating to the actual costs incurred, not a test of DCC's contemporaneous record-keeping. Where necessary, we have sought to provide the necessary ex post justification for costs incurred in this submission and in previous submissions to Ofgem in connection with the present price control process. We continue to believe we have acted both economically and efficiently at all times.

Finally, if Ofgem wishes to disallow the costs of DCC's activities for value for money reasons, it should focus on disallowing the difference between the incurred costs and the efficient counterfactual, rather than disallowing all costs. Throughout this document, and in prior submissions, we have compared our incurred costs with viable alternatives where they exist and can clearly show that we have acted economically and efficiently. We therefore request that Ofgem reconsiders its disallowances and brings them back into alignment with prior years.

We look forward to further engaging with Ofgem in the New Year to achieve clarity on how Ofgem will reassess DCC's efficiency.