



# DCC review: Phase 1 consultation

DCC response

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# 1. Executive Summary

Today, Great Britain (GB) is the world's most complex deployment of smart meters, and the DCC is a business required to engage, design and secure, assure and operate the data network underpinning this deployment as 'Deemed Critical National Infrastructure', a significant evolution from the original design as a light touch contract management entity. By the time of the licence re-award, the smart metering system will support secure data communication across ~100 million devices in ~30 million homes, as well as delivering the central systems needed to support faster, more reliable switching.

The coming years are likely to witness significant change in the energy sector as the stable and centralised model of previous years shifts to a more decentralised and fragmented landscape, dynamically managing supply and demand through smarter use of data and digital technologies. This transformation is essential if we are to address the complexities inherent within the energy trilemma - security, sustainability, and affordability. As the digital backbone of a smarter energy system, the DCC will be at the core of this transformation, acting as a platform for policy implementation to accelerate decarbonisation and drive societal benefits: improving consumer choice and control over energy consumption, facilitating new market entrants providing innovative consumer services and helping to optimise energy networks to keep costs down and performance high.

The future DCC will need to support these broad energy policy objectives while continuing to deliver the GB-wide smart meter network effectively and efficiently. It will play a critical role in enabling innovation for current customers, new market entrants and not-for-profit research. To do this the future DCC needs to be an agile, mature organisation which can optimise high quality with value for money, running reliably and securely in line with the expectations around critical national infrastructure.

We have operated the DCC since being awarded the licence in 2013 and hence bring a unique and practical perspective to this consultation, as well as extensive experience interacting with a range of stakeholders from across the increasingly fragmented energy system. We have taken an analytical approach to our response, considering multiple variants of the proposed Options.<sup>1</sup> In doing so, we objectively assessed the opportunities and risks for each Option against Ofgem's evaluation principles, outlining the implications of different choices on industry, end-consumers, and the practicality of running the DCC.

There are clearly advantages and disadvantages to both Options and the DCC is committed to ensuring a smooth transition to whichever model is selected. On balance, we propose the adoption of Option A for the future DCC and support the following characteristics in particular:

1. A continuation of our current mandatory services, with mechanisms allowing the **DCC's roles as a licence holder to evolve and extend** as and when needed, to maximise the value of the secure nationwide infrastructure, informed by broader societal impact.
2. **Private ownership** providing structural independence from Government and industry, to maximise cost efficiency incentives and enhance the value of DCC assets for consumers, industry, and society.
3. An **independent board** including representatives from Suppliers, Retail networks, and consumer groups to bring a wide range of expertise and skills, to keep consumers front and centre.
4. **A mix of funding models**, continuing the current approach for mandated services, and introducing the ability to raise external sources of funding, within appropriate guardrails for dedicated services, to reduce the burden on existing customers and the risk to consumers.
5. **Ex-ante price controls** for core activities with predictable operating cost budgets in multi-year cycles that contain incentive mechanisms to reduce costs and deliver an agreed quality of service. This should be combined with flexibility for distinct cost categories relating to early stage mandated programme activity.

<sup>1</sup> We include a list of the variants we considered in Appendix A.

6. An **extension to the current licence**, a minimum of one year with longer depending on the scale of changes, and with the entirety of this granted from the outset, as opposed to a series of shorter extensions.

We are committed to working with Ofgem to ensure a smooth transition to the most appropriate regulatory framework and, if appropriate to a new governing body, that will ensure the DCC can utilise its full potential, leverage the value of its assets, and deliver societal and system benefit through cost efficiency and high-performance quality.

## 2. DCC response

The following section sets out the DCC response under each of the consultation questions.

### a. Alternative regulatory models (questions 1-5)

**Question 1: Which of the two broad models do you think we should adopt as the basis for our design of the future regulatory framework for DCC and why? What are the features of your preferred option that lead you to this choice?**

Ofgem's Option A envisions retaining the privately-owned DCC model, with revisions to some of the key parameters of the existing framework including price control arrangements, governance and incentive regimes. Option B explores more extensive changes and the transition to a 'not-for-profit' industry or publicly owned model with budget setting-based price reviews.

Both Options have merits, delivering against Ofgem's criteria in different ways. Below, we assess their key advantages and disadvantages (along with availability of mitigatory actions).

Please note, for both Options we strongly argue for the creation of an independent Board with minority industry and consumer representation, and in line with reflect best practice (the UK Corporate Governance Code requires at least 50% independent representation). We believe an independent Board is more empowered to think about the longer-term health and delivery of the DCC alongside the immediate needs of its customers.<sup>2</sup> This ensures a much-needed focus on innovation, strategic renewal, and investment to deliver value for consumers and the energy system over the long term. An independent Board can do this by fostering independent decision-making and mitigating conflicts of interest that may arise under a shareholder-controlled or industry-controlled model. Furthermore, our experience suggests independent directors bring wider expertise and skills from across relevant industries, helping to foster rational, robust, and innovative decision-making. By including minority consumer and industry representation we can further improve how the DCC considers its impact on end-consumers while also increasing accountability to our direct customers. It will also help the energy industry and consumer groups to better understand the DCC and its operating and policy environment.

#### Option A:

Key advantages:

- Private ownership creates strong structural independence from industry and Government. This reduces potential conflicts of interest which may occur in industry-owned models. It provides greater scope for the DCC to act in the best interests of customers and consumers, enabling a more innovative and future focused approach.
- A profit-making owner will be incentivised to deliver cost efficiencies. An appropriate sharing factor will ensure both the owner and customers benefit from ongoing savings.
- Ex-ante price control for core activities will drive greater spending discipline by fixing DCC costs. It also provides stakeholders with greater opportunity to engage on the DCC budget, creates funding certainty for the DCC, which is subject to greater disallowance risks under a pure ex-post model, and greater certainty for customers as well.
- Ex-post price controls, or reopeners, for new programmes will provide the flexibility needed to deliver new programmes with higher cost uncertainty.

<sup>2</sup> Openreach also argues that its majority independent Board makes sure they treat customers equally and ensures investment in better service, coverage and performance. (<https://www.openreach.com/about/how-were-led/our-board>)

#### Key disadvantages (with possible mitigations):

- Under ex-ante price controls there may be less incentive for cost reduction at the expense of investing in quality and performance, without stronger, reward-based performance incentives to rebalance this effect.
- Compared to an industry-owned model, Option A could result in less direct input from its customers. We strongly support the creation of an independent Board, with industry representation, to mitigate this. Together with improved end consumer representation this would provide a healthier balance of interests and expertise without the need for significant structural changes.

#### Option B:

##### Key advantages:

- An industry-owned model, complete with an industry-led board:
  - creates a strong customer-centric institutional design for the DCC;
  - provides direct accountability to a customer representative Board;
  - could see greater alignment between the DCC and industry views; and
  - is more likely to deliver effective, streamlined governance than a public-ownership model.
- A public-ownership model:
  - provides a strong link into wider energy policy;
  - ensures procurement decisions are subject to public sector principles concerning commercial tenders, improving the appearance of DCC contracting decisions;
  - creates ownership independent of industry, reducing the potential for conflicts to arise; and
  - may, with the appropriate licence objectives, be more willing to maximise the societal and consumer value of DCC infrastructure when compared to an industry-owned model.

##### Key disadvantages (with possible mitigations):

- A not-for-profit model would lack strong incentives to keep costs down and improve efficiencies during each budgeted period (once funding was agreed).
- An industry-owned option may have reduced incentives to keep costs down where they apply to all customers equally, who will ultimately pass those costs on to consumers. Both an independent Board and oversight of the DCC's budget by Ofgem would be needed to counterbalance this implication.
- As Ofgem notes, Industry-ownership and/or an industry-controlled Board will disproportionately focus on the views of today's customers, reducing the DCC's ability to evolve and realise value for end-consumers. An independent Board with minority industry and consumer representation may help to mitigate this risk.
- A public-ownership model may not necessarily be able to proceed at pace to deliver Government's decarbonisation agenda or the consumer benefits derived from smart energy networks.
- Reforming the DCC under public-ownership runs counter to Government policy on the creation of new public bodies (as outlined in the consultation).
- Absorbing the DCC into the FSO is unlikely to be synergistic; the DCC is a complex telecoms network which needs to deliver for consumers, whereas the FSO needs to set energy policy.

#### Our conclusion:

On balance, we conclude that Option A provides a stronger foundation for the future DCC, as long as necessary measures are implemented to mitigate the risks outlined above. It best supports the conditions needed to ensure that the critical national infrastructure underpinning the energy sector and operated by the DCC is resilient and governed in the interests of consumers, industry and broader society. Option B

does not provide sufficient focus on current and future consumer or societal needs; nor will it best place the DCC to drive and unlock the benefits of a smart, decarbonised energy sector.

We believe the following features of Option A are particularly beneficial, strengthening the DCC's focus on consumers and broader society, while supporting industry input and engagement:

- **Creating the best basis for cost efficiency for customers and consumers.** Option A envisions a profit-maximising business model with elements of ex-ante regulation, which provides a clear cost efficiency incentive. If this is supported with a targeted performance incentive regime, we believe it can drive cost reduction for industry (and ultimately consumers), while maintaining quality of service above targets. As Ofgem points out, comparatively, industry-owned not-for-profit models under Option B provide less incentive to keep costs down where fees apply to all customers equally. This could see greater costs being passed onto consumers.
- **Maximising potential to be a platform for energy policy and drive societal good.** Option A avoids industry-ownership options which anchor the DCC to today's customer-base and would diminish its interest in infrastructure re-use, maximising asset value or market disruption to enable excellence for end consumers. This is important both as we focus on our core mandated business and any future policy areas where the DCC would be the most efficient and effective delivery body.
- **Ensuring DCC can continue to access commercial, technical and policy skills.** DCC will continue to operate in a technically and contractually complex environment post-2025. It will need the skills necessary to evolve and improve the network into the next licence period to deliver for consumers. Having a majority-independent Board and private ownership can make it easier to access an evolving range of capabilities in commercial, technical, and policy areas.
- **Balancing key interests.** Private ownership drives independent decision making which reflects the views of all stakeholders, avoiding conflicts of interest and a narrowing of interests around a single industry owner or sub-set of industry owners. Option A can also provide a healthy balance of interests on the DCC Board by enabling shareholder, industry, consumer, and independent representation. This accountability to industry and end consumers can be provided with minimal disruption to the operation and current framework of the DCC, enabling a smoother transition.

We are committed to working with Ofgem to ensure a smooth transition to the most appropriate regulatory framework and, if appropriate to a new governing body, that will ensure the DCC can utilise its full potential, leverage the value of its assets, and deliver societal benefit through cost efficiency and high-performance quality.



## Question 2: Do you agree with the way we have applied the principles in our analysis of the options? Please state your reasoning.

We agree in general with the principles set out in the consultation. Ofgem should consider the extent to which the two Options genuinely and tangibly improve the DCC's ability to deliver quality, cost-efficient and secure services, through accountable and decisive governance, for the benefit of customers and consumers both now and in the future. The question of how these principles can be embedded, and achieved in practice, is integral to delivering an improved, high performing, future thinking DCC. We are keen to support Ofgem in finding the best option to deliver this.

Before providing feedback on the application of the principles to the two Options, it is important to clarify how we have interpreted them. We believe there is a risk that the evaluation principles, as currently stated, could favour frameworks which are anchored to issues needing action under the current licence period. While these issues will remain important in the short term, they should not be prioritised at the expense of creating an organisation with the tools to excel over the course of the next licence period. For example:

- The principle to be customer-centric and consumer-focused must not tie the DCC to traditional stakeholder groups or views. As the energy system becomes increasingly fragmented, and as Ofgem notes, the DCC may be required to support new business models, some of which will be delivered by new market entrants. The DCC must be able and have incentive to evolve and reflect the needs of an increasing range of stakeholders as they and their views change. It must be able to support the increasing pace and ambition of Government energy policy, acting as a platform for policy implementation at an accelerated rate.
- The DCC will need to adapt at pace over the next licence period to deliver for an increasingly fragmented energy market with new and varied market entrants with differing business models, services and requirements of the DCC. We suggest increasing the importance placed on principles four and five (evolution of the DCC and re-use of infrastructure), to ensure the future DCC can work effectively in this complex environment. This will also reflect the fact that these principles will have a cumulative effect on the DCC's performance against the other principles, particularly when measured across the length of the next licence period. For example, effective mechanisms to control and evolve the DCC's role will better enable us to focus on our core work and build new services which are needed to provide quality, performance, and cost efficiencies. In addition, a DCC that is better enabled to realise the commercial value of its infrastructure can drive down costs for its customers under its core work. Finally, failure to utilise the DCC network, a national asset paid for by consumers, to its full potential as a platform for policy implementation would not be in the best interests of consumers or society as we look to accelerate the transition to net zero and continue to drive social good.

We have integrated these views into our feedback on the application of the principles to Options A and B and provided commentary in Table 1 below.

Table 1: Commentary on Ofgem's suggested application of the evaluation principles

Principles	Option A	Option B
<b>Drive delivery of a quality, cost-efficient and secure service</b>	External contracting will likely continue to be a significant cost area for the DCC regardless of the Option chosen. Under an ex-ante regime, with an appropriate sharing factor, there will be an ongoing incentive for the DCC to negotiate cost reduction and a mutual benefit for its owner and customers in achieving those efficiencies.	An industry-controlled Board will give certain industry-members direct input into the DCC's operation. However, we do not agree that it will necessarily ensure "alignment of incentives on delivery of required services, new solutions and resource allocation" as not all industry members will reach the same view on delivery and resource allocation.



Guided by the experience of energy transmission, distribution, system operation, and water networks in their respective incentive-based price controls, we believe there are effective and well-balanced incentive mechanisms to maximise the effectiveness of ex-ante regimes. In particular, mechanisms can be calibrated and carefully designed to incentivise cost reduction while maintaining a high-performance commitment to customers. We are confident improvements can be designed working closely with Ofgem and stakeholders.

It is unclear how much Ofgem oversight of business plans would, in practice, counteract the weaker cost control incentives. For instance, Ofgem may be conducting detailed analyses of the proposed budget and push back even after the budgets are approved by the majority of industry-participants and require re-voting after requested edits. This may delay the budgeting process and increase resource burden.

The same challenges relating to deriving value from external contracts will remain under Option B, but there will be no ongoing incentives to negotiate such efficiencies.

**Be customer-centric and consumer-focused**

Industry (suppliers and networks) and end-consumer expertise will be a welcome addition to the DCC Board. This will provide customer and consumer input for business planning and forecasting under the ex-ante controls, while enabling these groups a better and more nuanced understanding of the choices DCC faces in its operating and policy environment.

Conflict between Board member interests will not be unique to this approach as industry members can still have conflicting views.

Describing the Board as having a shareholder-majority does not reflect how the current Board works in practice (i.e. an independent Chair, CEO and CFO, 3 independent directors and 1 shareholder representative). Our independent directors play a critical role guiding the DCC and we would seek to retain them on the Board alongside new industry and consumer additions.

Under both options, being customer-centric and consumer-focused goes beyond just Board representation. This is embodied as much in approach and ethos, and the DCC has made significant strides to do more in this area, e.g. through the scaling of our Customer Engagement team, and we would anticipate this would continue under either model.

As with Option A we are strongly in favour of creating an independent Board with industry and consumer representation under this Option. This will provide a better balance between being both customer-centric and consumer-focused.

An industry-controlled board creates a disincentive for the future DCC to update its membership to enable input from a broader range of stakeholders and support innovation and evolution for the benefit of all customers and consumers.

<b>Enable full accountability and decisive governance</b>	<p>Full accountability would be achieved through:</p> <ul style="list-style-type: none"> <li>• Industry representation (potentially including both DNO and retail) on the Board;</li> <li>• Consumer representation on the Board;</li> <li>• Customer and Ofgem input regarding price controls;</li> <li>• Wider energy policy input enabled through the Energy Code Reforms.</li> </ul> <p>An independent board, combined with a non-industry owner/s, would provide clear operational independence from Government and industry to deliver the day-to-day service.</p>	<p>Direct accountability to industry would be achieved through the creation of an industry-controlled Board.</p> <p>Wider energy policy input would be provided through the Energy Code Reforms.</p> <p>An independent board could provide a greater balance of voices (inc. for end consumers). It may also provide operational independence from Government and industry. However, we believe Option A will provide a clearer separation from industry.</p>
<b>Allow DCC's role to evolve in an uncertain environment</b>	<p>Both Options propose mechanisms to enable evolution of the DCC as required.</p> <p>A privately-owned, profit-making organisation with an appropriate incentive structure is likely to be more proactive and engaged regarding changes to its role given implications for margin.</p>	<p>Both Options propose mechanisms to enable evolution of the DCC as required.</p> <p>However, an industry-owned model may have less incentive to support changes which do not primarily benefit customers with Board representation (but may, for example, significantly support wider policy objectives or benefit end-consumers).</p> <p>A 'not-for-profit' model would also lack the financial incentive to innovate and evolve.</p>
<b>Maximise the value of DCC infrastructure by enabling the exploration of re-use</b>	<p>As a profit-making, shareholder-owned model, Option A will likely provide greater incentives to innovate and explore re-use of DCC infrastructure.</p>	<p>We agree an industry-controlled Board may create the risk that opportunities to innovate are missed as incumbents may not have an interest in re-use or market disruption.</p> <p>It is unclear whether an independent Board would be more willing to explore re-use of DCC infrastructure, as this may depend on the appetite to conduct the necessary work under a not-for-profit model.</p>

We further suggest Ofgem considers the degree of disruption to the current model, particularly when deciding on the transition period, as an evaluation principle. This is not to say that more disruptive models should not be considered. Instead, we seek to ensure that models requiring significant and complex changes, and therefore longer transitions periods, are fit for purpose for the future environment in which they will operate. For example, the degree to which the adopted option would disrupt the current DCC model is an important factor to understand when the licence will eventually be operating and to what extent legislative time would be needed to make the appropriate changes.

**Question 3: With regard to Option A, to what extent do you think that changes to the DCC licence alone could provide incentives that result in a third party investor-controlled DCC Board providing the quality and cost of service that DCC customers require, and managing DCC effectively?**

We consider the introduction of an ex-ante price control (with an appropriate cost saving gain sharing factor) to be the most significant way of incentivising cost efficiency under Option A. We explore the issues relating to price control later in this document and therefore focus on performance incentives under this question.

The licence renewal is a powerful opportunity to improve performance incentives. The current licence creates a penalty-based mechanism which focuses attention on minimum standards but does not incentivise or reward investment to maximise quality and value for our stakeholders. The narrow range of activities subject to this mechanism can also distract attention from the things that our customers really care about.

The licence should be used to implement a truly reward-based performance incentives, for example, by improving the OPR. A balance of penalties and rewards will create the conditions to incentivise improvement in management and quality while creating backstops to ensure minimum standards are met. Careful consideration will be needed at the design phase to ensure the correct balance and scope of these incentives. We are keen to support this process and engage with stakeholders on the design of future incentives.

Finally, in addition to licence changes, we believe Option A can deliver the cost efficiency and quality standards which customers require through its greater ability to attract third party investment under a profit-making model. Market-based funding would allow the investor to take on greater risk, enabling and accelerating innovation, and can hence reduce unit costs for customers, ultimately helping to keep services cheaper for consumers. This would require an ability to generate returns on this investment for third party investors, but we are confident that there are proven models within the market that demonstrate how this would not distort our operating approach, nor the continued delivery of a quality and secure service.

**Question 4: With regard to Option B, how effective do you think a non-profit-making, stakeholder-controlled or independent DCC Board would be in providing the quality and cost of service that DCC customers require, and managing DCC effectively?**

The consultation suggests Option B would operate within a fixed budget agreed with industry input and/or Ofgem oversight. The complexity of our work, and the degree of cost uncertainty involved, would require the fixed budget to contain a sufficient degree of contingency to effectively manage financial risk. Option A, with an ex-ante regime and appropriate sharing factor, will incentivise the DCC to continue finding cost efficiencies for the length of the budgeted period. However, under a non-profit-making model there would be no further incentive to drive down costs once the budget is agreed.

Under a non-profit-making model the financial incentive for future industry owners to engage with the licence holder would be reduced; and may see the owner prioritise performance and cost improvements in their primary business.

Reduced incentives for the owner to engage meaningfully means the future framework would be more reliant on the Board to drive efficiencies, deliver quality and manage the DCC effectively. Therefore, the future composition of the Board is likely to significantly impact how the DCC approaches quality, cost and management decisions. However, the quality of the Board would not mitigate the need for continued Ofgem oversight, and in some instances approval, of certain DCC activities, e.g. budgets, to ensure the Board represents the interests of all stakeholders. We would suggest this would place an increased burden on Ofgem, both in the design of special provisions and interventions, and the enduring management and oversight required.

Under a stakeholder-controlled Board there will be a lower incentive to drive down overall costs for customers where those costs are shared equally. Furthermore, an industry-controlled board may lack sufficient incentive to innovate and think long term. Therefore, while we believe this Option could strengthen the DCC's focus on the needs of stakeholders in the short term, over time the DCC's ability to drive down costs and improve quality through innovation will be reduced. An independent Board may mitigate some of these issues, however this could undermine some of the rationale of Option B (to increase accountability to industry and improve how the DCC reflects stakeholder views).

We do not agree that Option B in and of itself provides sufficient incentives to deliver high performance or quality. We have some concerns about designing a framework which assumes quality will be prioritised without putting in place tangible and effective performance incentives. Comparatively, Option A - as a stakeholder model with an independent Board, elements of ex-ante price controls, an appropriate sharing factor and well-calibrated quality and cost incentives - appears more effective than Option B (even if this included an independent Board).

## Question 5: Do you have any views on the details of Options A and B?

In Table 2 below, we set out our views on the details of each option. Following Ofgem's lead, we assume a publicly-owned model is less likely and have therefore focused on industry ownership for Option B. We have however highlighted where we are talking about a stakeholder/industry-owned or publicly-owned variant.

Table 2: DCC view on the detailed characteristics of Option A and B

Parameter	Option A	Option B
<b>Ownership</b>	<p>A shareholder-owned, profit-making model (with price and margin controls) is the most effective means of ensuring cost efficiency.</p> <p>It will also enable the DCC to evolve and innovate more effectively, avoiding the risks set out for Option B.</p>	<p>If Ofgem were minded to adopt Option B we believe ownership by multiple industry parties would be the best approach. This would better reflect the range of views of relevant industry parties to drive benefits for the entire sector (not just a select few industry actors).</p> <p>A publicly-owned model is less likely to have the same flexibility in funding, operational agility or access to skills and capabilities as a private sector body.</p> <p>We believe there are viable (non-public) options for the DCC. Public-ownership models for the DCC would not therefore pass the government's test for creating new public bodies.</p>
<b>Accountability &amp; Control</b>	<p>We are in favour of including industry and consumer representation on the Board as a minority addition to our independent representatives. This will be an effective way of improving accountability to industry and consumers &amp; therefore improve the way we reflect their needs in the future.</p> <p>However, changes to our licence objectives need to be carefully considered in the context of the next licence period. The next iteration of the licence will run well after the DCC has delivered an improved and stable core service. Narrowly defined objectives which reflect the current views of DCC customers will restrict our ability to evolve over time, thereby hindering our ability to deliver for customers &amp; consumers in the future.</p>	<p>An industry-controlled Board would narrow the range of expertise &amp; opinions on the board and lack sufficient incentive to innovate and evolve the DCC. We therefore agree Ofgem would need the right to:</p> <ul style="list-style-type: none"> <li>• Appoint, approve or remove the DCC chair and possibly the CEO; and</li> <li>• Oversee/approve certain DCC activities (such as business plans and costings).</li> </ul> <p>While needed, these mechanisms would add administrative complexity. We also question the extent to which these powers would fully mitigate the concerns about an industry-controlled board (see Table 1).</p> <p>A fully independent Board (with an appropriate appointments process and end consumer representation) may overcome some of these issues. However, this would undermine the primary rationale for an industry-owned model, adding little more industry accountability/input than Option A.</p>
<b>Cost control &amp; Incentives</b>	<p>A hybrid ex-ante &amp; ex-post price control is the most effective way of controlling prices and appears the most suitable approach for the next licence period. (Technical and operational enhancements currently</p>	<p>An industry-owned model will have less incentive to keep overall shared costs down.</p>

underway will have taken effect by this time and current mandated activity will move towards a more stable level of activity).

Ex-ante controls have demonstrated they can act as a mechanism to improve customer engagement while increasing visibility & transparency of planned development & projected costs.

Ex-post controls will provide the flexibility of funding needed to support new mandated activity at pace and manage the inherent risk involved with forecasting.

The Operational Performance Regime should be revisited, in particular, to create both upside and downside incentives which ensure quality continues to be delivered under an ex-ante regime.

In addition, a not-for-profit model will have no incentive to drive cost efficiencies once a budget is agreed.

Industry players may have different views on the associated trade-offs between quality and cost. To mitigate this, Ofgem would need the power to remove directors. However, this could create an additional burden on Ofgem and would be potentially destabilising to the DCC and its management of critical national infrastructure.

## Funding

Funding for our current mandated services should remain primarily through charges on our users.

We strongly believe that under this option the DCC should also be able to raise third party funding when it helps accelerate delivery, reduce the burden on customers and thereby ultimately help reduce unit costs and mitigate risks for end consumers.

Our rationale rests on the concept of 'fairness': services that are needed by all Suppliers and that can be reasonably forecast should be paid for by the customers, and this can be achieved through ex-ante allowances. However, when the risk can be more efficiently borne by outside investors and cost efficiency can be achieved, third party funding should be utilised. This could also be used to spread the cost for our customers over an extended period of time.

For example, if there is a commercial re-use opportunity with a new/larger customer base, or where demand is not yet certain (if the new service will create its own demand after being offered to the market), it may be best for institutional investors to undertake the anticipatory investment risk in exchange for market pricing and returns once demand materialises.

Third party funding also enables competitively priced delivery, and has hence been considered in many industries, such as the water industry with the Direct Procurement for Customers approach or the telecoms market with the Virgin Media O2 or BT Openreach fibre network investments.

We agree the DCC should be able to raise capital under Option B as well, but we have concerns about the practicality and feasibility of raising external funding. Particularly without sufficient operational and Board-level independence from industry-owners, there may be insufficient investment in future facing work needed to ensure quality over time. While an industry-controlled model provides a mechanism to focus on performance wanted by today's customers, it may not sufficiently prioritise innovation or the needs of future customers/consumers. In particular, industry interests may not be the same as those of consumers or those set out by Government energy policy.

We are confident that there are proven models within the market that demonstrate how this would not distort the DCC's operating approach, nor the continued delivery of a quality and secure service. We are supportive of creating appropriate governance procedures to put this in place.

**Operational Model**

The current operational model (primarily procuring services from External Service Providers with a discretion to decide on in-house provision) will remain the correct approach for the most part. This will support good outsourcing decisions and enable the DCC to focus on critical services in-house.

However, we suggest Ofgem considers ways to provide greater Board discretion, where this is appropriate, to ensure the DCC can remain agile and continue to take effective management decisions.

We do not follow the rationale which suggests Option B will allow for a relaxation of restrictions.

We suggest Ofgem should consider providing greater discretion to the DCC Board under either option, to enable agile and effective management decisions.



## b. Transition period considerations (questions 6-9)

### Question 6: What are your views on the options identified and the associated trade-offs for a possible licence extension?

Ofgem acknowledges that the proposed timeline for the next few years includes a significant number of activities and market changes, with the need to develop, implement, and transition into a new regulatory framework, at the same time as other planned changes such as transition to 4G and ongoing contract management. In this context, Ofgem explores a possible licence extension to be able to (a) design and implement more extensive changes to the framework, and (b) have a lower-risk transition which minimises operational disruption. On the other hand, the shorter the transition period, the earlier the potential benefits from the new regulatory framework may be reaped.

We agree with Ofgem's presentation on the advantages and disadvantages of a licence extension. Given this, we are in favour of a licence extension, for a minimum of one year and longer depending on the scale of changes proposed, which should optimally balance out the advantages and disadvantages.

The DCC's current licence is due to expire in September 2025 with a possible extension of up to 6 years to September 2031. Ofgem thus explores three 'extension options' ranging from zero to six years, which we present our views on, below:

- **No licence extension:** Under this option, any changes to the framework need to be designed and implemented, and the successor licensee selected, appointed, and be ready to provide Authorised Business by September 2025. We do not believe this expedited timeline (coupled with all the other changes that are planned) is realistic. The next licence will be in place for c.15 years, during a time of significant change in the industry, and needs careful consideration. This option could severely restrict what is achievable, introduce unnecessary scheduling and operational challenges and - if the design is rushed - risks sub-optimal outcomes for industry, consumers and wider energy policy. The limitation in changes that can be implemented, as well as the increased risks in the design, licence drafting, licensee appointment, and business handover will already minimise the benefits that can be expected from the 'new' framework. Therefore, in terms of the trade-offs, there would not be sufficient benefits to be reached early by virtue of a quick transition.
- **Extension of up to 3 years:** Under this option, all activities listed above would need to be completed with the new licensee delivering Authorised Business under the full new framework by September 2028 at the latest. We believe a minimum of a one-year extension is necessary, with longer to be determined based on the scale of the changes proposed. This would provide the flexibility to schedule the transition alongside other milestones and dependencies. We are supportive of creating a phased approach within this period. This way, we can avoid overloading all changes at once and the related resource-burden, disruption and increased risk, as well as implementing learnings from earlier phases on later phases.
- **Extension for the maximum of 6 years:** The new licensee would begin delivering Authorised Business under the full new framework by September 2031. We believe an extension longer than three years would represent a significant delay to the implementation of the future DCC and would not be in the interests of our customers, end consumers or society. A long extension and transition period also risks the design of the future DCC becoming redundant before it comes into effect. While it is foreseeable an extension of longer than three years may be needed for practical reasons (effective scheduling with critical dependencies, for example) it should generally only be used to achieve a specific objective with value proportionate to the delay. Interim changes would add complexity to the regulatory environment, increasing the burden on the DCC, customers and Ofgem.

Finally, we believe that a single appropriate extension covering the length of the necessary transition period should be granted, rather than a series of shorter extensions. This will provide greater certainty for

transition planning, business handover and contract management, and provide maximum benefit to all concerned, including Ofgem.

## Question 7: What are your views on the assumptions we have made for Options A and B transition periods?

We broadly agree with the assumptions set out in Ofgem's figures 4.1 and 4.2 and the following discussion. In summary

- Choosing to have a fast transition may be guided by the motive of reaping the benefits from the new framework. However, those benefits would not exist unless the new framework is fully and carefully designed; and/or they may be negated by significant operational risks if the implementation and transition is rushed. This makes us wary of an expedited transition.
- On the other hand, we also agree that too-long of a transition period would delay the implementation beyond reasonable timelines and limit effective governance.

However, we believe further discussions are necessary to refine the steps and timelines.

For example:

- Under Option A, there would be a competitive tender for the next licensee. The potential candidates invited for tendering could realistically expect to review the business plan and the decisions around the first ex-ante price control. At a minimum Ofgem's final guidance document, even if not the determinations, and the draft business plan, may need to come ahead of the tendering process to provide the necessary inputs. Furthermore, lessons learned from the last process, where the tender could not gather a large number of bidders, need to be implemented to encourage and stimulate competition. For instance, allowing commercial re-use of the network under certain provisions may be one.
- A business handover to the successful licensee will involve complex migration of services and data, and a possible reorganisation of staff depending on how the owner wants to run the future DCC.<sup>3</sup> Given this, and the need to continue to run seamlessly during this period, the 3-6 month handover period as currently suggested under Option A appears very challenging.<sup>4</sup> While a typical, straightforward transition for outsourced activity might be delivered over 4-6 months, a change in ownership for a body like the DCC will be more complex, including associated licence/code changes, handover of contracts and commercial relationships and the essential need to maintain continuity of the CNI service. We suggest at least 12 months is more realistic, but this should also be informed by bids from potential future owners and further consideration in detailed design.
- More generally, the initial budget for the future DCC may be informed by the engagement/appointment process under Option B. If a draft budget is decided through these processes, the formal budget determinations can come in at a later stage.
- We suspect the process and scheduling under Option B is unlikely to be the same for a stakeholder-owned model as a publicly-owned model. The decision on ownership under Option B may therefore impact the process set out in Table 4.2.
- As Ofgem has acknowledged in paragraph 4.15, we believe it would be possible to phase in elements of the future framework to avoid a 'big bang' type approach and achieve incremental

<sup>3</sup> DCC staff are currently employed by Capita. Any change in ownership would need to take this into account, with DCC possibly becoming the employer for the next licence period.

<sup>4</sup> In particular we note the transition period for BETTA took approximately two years. This is a similar length of time planned for the FSO, at two years. While the creation of the FSO is likely to be more complex than a DCC ownership transition (given it involves a separation) we believe the associated licence/code and regulatory changes are comparable. In addition, the systems operator represents a physical asset-light business within a thin RAB, with complex digital infrastructure comparable to the DCC.

benefits. These need to balance pace, and scale of change, with the continued requirement to deliver our services under the current licence.

- Another example of a ‘concurrent change in this period’ is the rollover of external contracts. The DCC manages several large contracts and agreements due to expire over the period of 2025-31. Any new licence holder must be able to conclude ongoing programmes or re-procurements alongside negotiating new contracts to support new capabilities. We agree with Ofgem that there will be no perfect point in time for the handover, but the new licensee will have a significantly easier process if things are not further complicated by repeated small extensions, and instead, a handover plan is set out over a fixed transition period.

Any transition of the sort contemplated by Ofgem will create risks of disruption, with models such as Option B (embodying more complex changes to the current framework) posing the greatest risk. We have spoken about potential disruption to operational delivery and timeframes above, however the potential for staff churn during these changes will be an added challenge (particularly in such a competitive recruitment market). Whichever Option Ofgem adopts, we will seek to minimise disruption to the day-to-day operation of the DCC and will put in place dedicated teams to support the licence renewal and transition processes to provide for consumers through the next licence periods.<sup>5</sup>

We finally acknowledge that the optimal design of the transition process and timeline to be dependent on (1) the results and timeliness of this consultation and the price control design consultation to follow, (2) the ultimate ownership model and design of the future DCC, and (3) the scheduling of dependencies covered in the next question eight.

<sup>5</sup> The DCC needs to service smart meters in 15-year cycles, and given the base of SMETS1 and the swap to SMETS2, this will mean we need to contract to provide service for some households for nearly 30 years. Therefore, the certainty of the DCC operating model in either the Option A or B is essential to running a smooth CNI service for our customers and end consumers.

**Question 8: In your view, which of the considerations we have identified for the transition period are the key dependencies and why? Are there any other dependencies that should be considered?**

Of the dependencies listed in the consultation we believe the Energy Code Reforms are the most critical. The Reforms will reset the regulatory context for the DCC and should be sequenced ahead of the changes relating to the DCC Licence renewal. Potential owners need a clear understanding of this context before making bids or agreeing to take on the role. Furthermore, the Reforms should have direct implications for the design and implementation of the future DCC. More specifically:

- If the outcome of the Reform process is to combine code management and central system delivery obligations into a single Licence,<sup>6</sup> there will be significant interdependencies between the renewal of the DCC Licence and the implementation of licence requirements for a regulated SEC Manager.
- New governance mechanisms under the Reforms (such as the DCC and code managers working together to deliver Code changes and the strategic direction set by Ofgem) could provide key routes to deliver and support changes related to the licence renewal.

While we do not consider the other dependencies listed in the consultation to be as significant, they are worthy of consideration when designing the transition process:

- The BEIS transition: Over the course of the next licence period, we would expect less direct involvement from the SMIP team at BEIS. We therefore expect our engagement with BEIS to change during the transition period, potentially with greater focus given to different teams as new policy priorities emerge, such as SSES (Smart and Secure Electricity System), and other organisations. BEIS will continue to be an important stakeholder and we have worked hard to upgrade the quality of our engagement. We have also shown our ability to work with other organisations outside of BEIS to deliver mandated services through the successful delivery of the Switching programme for example.
- External contract management: There must be sufficient certainty around the timing of the transition period to ensure proper management of contracts from one licence period to the next. The DCC manages several large contracts with external service providers, including agreements with the Fundamental Service Providers (FSPs), SMETS1 service providers, and other key contracts (for example to maintain security of the infrastructure). A number of these contracts are due to expire over the period of 2025-31. We agree there will be no perfect time to handover with respect to contract management however the process will be significantly easier if there is early clarity and commitment on the length of the extension and transition.

In addition, several critical DCC programmes will be running during the transition period. While this may not be possible to do in every case, it would be helpful to factor these into the scheduling for the transition. This will help to minimise clashes between significant milestones and enable the DCC to focus on operational, day-to-day delivery of projects already in train. The key work to consider in this regard is:

- Sunsetting 2G and 3G: We currently deliver smart metering services over 2G and 3G to enable both SMETS1 and SMETS2 services. Maintaining smart functionality over the longer term will require the introduction of new communications hubs covering both SMETS1 and SMETS2 meters which use the 4G network. An efficient transition to 4G communications hubs is important for our customers and will minimise the risk of creating surplus 3G communications hubs and avoid complexity for installers. Avoiding transition to a new regulatory model at the same time as the 4G programme moves to enduring operations may minimise potential risks to delivery.

<sup>6</sup> Such as Elexon, which currently manages Balancing and Settlement systems as well as administering the Balance and Settlement Code.

- Delivery of MHSS: Industry are currently conducting a replanning process, due to be finalised in January 2023. Until this concludes our exact role in delivering MHSS will remain uncertain. It is possible the work will be significant enough to warrant consideration in the context of the transition period. However, by mid-2025 the main DCC role may have stabilised enough to make MHSS delivery less of a dependency for the transition period.
- Outcome of the SSES consultation: The DCC has been identified by BEIS as a potential delivery body for the cyber-security systems needed to protect smart EV charge points, and other types of connected loads in the home, such as domestic batteries. We are working with government and industry to define the cybersecurity requirements for a smart and secure electricity system, ensuring that the sector benefits from the lessons and expertise we can share from the rollout of the secure smart metering network. The outcome of this consultation may therefore impact the future core work of the DCC and thereby have implications for the transition period.
- Broader projects to deliver net zero transition: The DCC has partnered in several innovation projects under various public funding structures, which support the transition to net zero.<sup>7</sup> Our participation enables innovative organisations to develop proposals that build on existing capabilities within the smart metering system, ensuring that the expertise DCC holds on the operational constraints and opportunities within the system are fully understood by developers, allowing for more efficient use of funding resources. We expect that several innovation projects will run throughout the transition period; and suggest there is value for consumers in the DCC being allowed to continue to participate and contract for these projects during the transition, where again, early visibility and certainty on the length and nature of the extension and transition will support effective decision making for DCC and its partners.

<sup>7</sup> This includes BEIS Net Zero Innovation Portfolio (NZIP) which provides funding for low-carbon technologies and systems seeking to decrease the costs of decarbonisation and help enable the UK to end its contribution to climate change; and a recently submitted proposal to Ofgem's Strategic Innovation Fund (SIF) which seeks to find and fund ambitious, innovative projects with the potential to accelerate the transition to net zero.

**Question 9: What is your view on implementing incremental changes to the regulatory framework during a transition period? Which parts of the regulatory framework would be most suitable for such changes and why? Do you have suggestions for their implementation?**

The transition period will provide an opportunity to implement incremental changes to the DCC. While this can have benefits and enable lessons learned, we are also keen to ensure the implementation of incremental changes are carefully considered to avoid adding operational complexity at a time when the continued effective and efficient delivery of the smart metering programme is paramount.

There are three areas which we believe may lend themselves to implementation during the transition period:

- Amendments reflecting the Energy Code Reforms (such as the new role of the code managers);
- Changes to the DCC Board could be made during this time to increase industry and end consumer representation; and
- Procedural changes could be made to facilitate more efficient onboarding of new DCC users ('Other Users'), given the likelihood that new market entrants will appear as the market becomes increasingly fragmented, which can in turn drive innovation supporting better outcomes for consumers

Due to the complexity and risk involved in forecasting costs we suggest new price controls should be piloted before implementation. Some testing could be done under the current licence to inform the design of the future framework. It may also be useful to conduct a test run of any agreed price control framework the first time under the new licence. This will help to manage risk effectively and enable a smoother transition overall. We acknowledge this may impact when and how the price control is fully implemented, however, it will be critical to ensure the DCC remains effectively funded as it transitions towards an increasingly fixed price regime.



### c. Future role of DCC (questions 10-13)

#### Question 10: Do you agree with our proposed scope of future DCC's Core Mandatory Business?

Yes, Ofgem's suggested scope for DCC mandatory business provides a sensible approach for our future remit. In particular, we agree our mandatory business should continue to include DCC core functions, such as services which relate directly to ensuring the continued provision of a secure, reliable and efficient smart metering service.

Overall, it is important that the scope of the DCC's mandatory business can evolve through the next licence period as the market and the needs of our stakeholders will not remain static. This can be enabled through a clear and transparent mechanism to adapt the DCC's core business, however a continued and strengthened obligation to support innovation and re-use infrastructure will also be critical as part of the Core Mandatory Business. The road to 2050, and net zero will be complex and challenging. We need the agility to deliver services and undertake activities which can respond to changes in technology and market evolution, acting as a platform for policy implementation during these critical years. This will enable us to improve the network, address key Government priorities and ultimately deliver quality and cost efficiencies for our customers while supporting wider societal objectives, such as decarbonisation. We believe there should be specific accountability to allow reasonable expenditure on innovation or related activities. This could be either through a specific innovation expenditure category or a de minimis percentage of turnover (both common in other ex-ante price control frameworks).

### Question 11: Should the future framework permit DCC to carry out any services additional to its Core Mandatory Business? What are your views on the concepts of ‘mandated services’, ‘ancillary services’ and ‘additional services to users’?

Ofgem notes in the consultation that as the energy landscape evolved over time, the DCC has been asked to deliver services beyond the original scope at the licence award in 2013. Considering the scale of change required over the next licence period, we believe this will continue to be the case and therefore agree that a future framework should permit DCC to carry out services additional to its Core Mandatory Business.

There may be elements of future activity where it is appropriate to not be contestable *at the time of undertaking* but with a view to make the services contestable after a period of time. This could apply to services where the DCC is the best vehicle to deliver policy and establish a market. As a licenced monopoly we can establish the model and drive a market for the service or activity, taking it from something only the DCC could do to something that other players may undertake. This may also then drive returns for our customers helping to reduce unit costs over time.

We provide our views on the three categories of additional services below:

#### **Mandated services:**

The DCC is uniquely placed to act as a platform and enabler for critical public policy outcomes and our remit has already changed to support Government energy strategy. For example, we successfully implemented a new Switching regime which creates savings on energy bills for consumers and efficiency savings for energy suppliers while improving competition in the energy market.

As we look to 2025 and beyond, we believe the DCC can be a platform to enable and accelerate future BEIS and Ofgem policy objectives, such as the delivery of SSES. Wider than this, the DCC could be asked by other central Government departments, local authorities, and devolved governments to support key local priorities, combatting fuel poverty for example. DCC could also play a role supporting wider industry obligations, specifically those of our current customers, e.g. to support the detection and prevention of energy theft through the use of DCC central anomaly detection capability. All these roles could fall under the category of Mandated Services.

We strongly support enshrining in the licence the category of ‘Mandated Services’ and that this should form part of our future mandatory business. This must however be developed with:

- A transparent, well documented design and approval process;
- A clear funding mechanism with in-built contingency and flexibility to manage the inherent financial uncertainty in carrying out new programmes of work (such as ex-post review of expenditures, fixed price contracts, or if applicable, re-openers within an ex-ante regime).
- An opportunity for the DCC and other stakeholders to be consulted and input into the proposals.

#### **Ancillary services:**

Ancillary services can enable better management and support optimisation of the network. We believe ancillary services should be used to enhance the role of the DCC as a systems coordinator, so that it can continue to optimise network performance. For example:

- Proactive dynamic optimisation of the network. This is vital to ensuring the DCC can reduce inefficient data flow, thereby improving network performance and helping to ensure continuity of service. For example, currently our customers are responsible for shutting down disconnection messages from smart meters under the SEC. If they do not do this in a timely manner the meters will continue to send messages which, at scale, can significantly slow the network, affecting overall

performance. Small changes could be implemented to incentivise suppliers to shut off messages efficiently (such as the publication of performance league tables) alongside a backstop mechanism for the DCC to step in if this is not done.

- Adapter services. This activity is an integral part of how energy suppliers bridge between the DCC and their own systems. However, there are some challenges and risks inherent in the current provision of adapter services: 1) the possibility of adapter services exiting the market poses a risk to smart services; and 2) if an energy supplier goes into administration all their customers need to be migrated onto a new adapter. The DCC could provide more choice and stability in the provision of open source or general adapter services and minimise the need for migration of customers to new adapters. This would also help to optimise the network and improve quality as third-party adapters are not always built to work effectively with on the DCC system. However, given there are already market providers for this service, any stipulation for DCC to enter into adapter services needs further consideration.
- The DCC has established the Technical Operations Centre (TOC) and Security Operations Centre (SOC) at our Brabazon House office. The TOC and SOC continually monitors the performance and security of our network. It supports consumers through an anomaly detection function and provides insights for our customers through standard and custom reports. It is well placed to support enhanced systems coordination through the next Licence period.

If ancillary services were disallowed, the DCC's ability to drive improvements and optimisation would be severely limited, impacting performance and services for our customers. This could, for example, restrict work relating to testing and services delivered as part of a 'DCC Boxed' tool, all of which could be seen as 'contestable'.

#### **Additional services to users:**

There is a benefit to enabling the DCC to provide services to customers that are not value generating. We therefore agree that the concept of elective communications service (ECS) should remain in the licence. However, the limited scope of the ECS and the likely high cost to return created by the short six-month exclusivity period, has created understandable barriers to this activity.

If the ECS is to be retained, the funding structure should be re-examined to ensure additional capacity can be added and paid for by new users of that service following the exclusivity period. This will enable the DCC to scale ECS requests efficiently and fairly, rather than requiring the initial requesting party to pay for a system capable of supporting all DCC users.

## Question 12: Do you agree with our proposed drivers for a controlled change in DCC's role? What are your views on the ways in which evolution of DCC's role can be managed?

We agree there needs to be a mechanism in the framework to allow for a controlled evolution in the DCC's role. This should be:

- Flexible, to enable the DCC to keep pace with evolving expectations and requirements;
- Transparent, to ensure the DCC and stakeholders have clear roles and routes to input into proposals;
- Controlled, so that we can evolve in a targeted and effective manner that recognises the importance of maintaining the security and resilience of the core network; and
- Manageable, so that new roles can be transitioned effectively and in phases over an appropriate period of time.

Table 5.2 provides a useful overview of how this might work. However, we think Ofgem and non-DCC customers should be added to the list of stakeholders. Ofgem will have a clear role in evolving the DCC under the Energy Code reforms, with an ability to set the strategy and make direct changes to the SEC and REC. Non-DCC customers with a potential/future interest in DCC services should also have a route to propose changes. Our evolving role needs to consider the broader perspectives of such stakeholders to ensure we are future facing. This will support the effective and efficient use of DCC infrastructure going forward, helping to deliver net zero, driving cost efficiencies and empowering consumers within more efficient, smarter GB networks (e.g. improving their choice and control over energy consumption, delivering optimised energy performance and costs, and providing new products and services).

Furthermore, we think the 'new policy or regulatory requirements' trigger should include specific examples to highlight the DCC's role in the delivery of net zero and an efficient, smart GB energy sector as a platform for policy implementation. In the short term, this trigger will most likely be initiated by BEIS, but in the longer term, different Government Departments and/or local authorities may also seek to utilise the DCC network. For example, we can foresee greater involvement from the Department for Transport should the DCC have a role in delivering smart EV charging points, as well as a role for the DCC and local/devolved powers in the delivery of smart cities.

Finally, we believe there is a need to provide a fast-track route to deliver iterative changes to the DCC. Lengthy procedures to amend the SEC/REC will hinder the DCC's ability to adapt and could negatively impact its ability to deliver public policy objectives and provide for customers and consumers in the future. To make sure the DCC can evolve in an effective and timely manner we suggest small changes should be capable of being agreed through a bespoke, rapid mechanism. This could, for example, be in the form of a time limited consultation where proposals come into effect by default, unless a member/group of members object.

### Question 13: Do you agree that the future framework should enable exploration of re-use of DCC's infrastructure? What are your views on the specific conditions and measures that may need to be in place to enable it?

The DCC's current Licence already has a provision for exploring the re-use of the network. However, in practice, we have observed that Ofgem has repeatedly disallowed investment in this area, which has significantly limited our ability to explore re-use. In addition, the DCC's 'value-added services' are subject to a maximum threshold of £500k, which does not correspond to the scale of the challenge required to achieve net zero. This situation needs to be addressed. The future DCC must be supported to conduct exploration and innovation through improved, robust and unambiguous provisions in the Licence and the ability to fund these activities effectively.

There is increasing interest and demand in the capabilities of the DCC to support a growing range of use cases. We are already seeing an increasing number of enquiries from both existing and new/potential market participants relating to re-use and innovation. 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 of the smart meter system and the data that it carries.

To date our work has included:

- Participation in Government funded innovation competitions that are directly designed to enable innovation upon the smart metering system (for example, the Smart Meter Energy Data Repository and the Smart Meter Internet of Things competition);
- Wider innovation projects that can be delivered through smart meter data and system data (for example, the Modernising Energy Data Applications fuel poverty project (MEDApps) and the Green Homes Finance accelerator)<sup>8</sup>; and
- Projects seeking to increase access to smart meter data (systems & consumption) to respond to policy, market demand and Ofgem and government needs.

In all these cases, the regulatory mechanism through which DCC can deliver this activity is not always clear. There needs to be robust provisions in place, without risks of ambiguity in interpretation.

Under the current Licence, continuation and/or scaling of this type of innovation activity (i.e. as projects move beyond feasibility studies into more extensive development or trials) would likely require SEC modification and/or Licence change. This would be extremely challenging in the timescales set for innovation project phases (second and pilot phases are typically restricted to 6-9 months with very limited flexibility). It would require significant resource allocation from both the DCC, Ofgem and industry to progress, whilst holding the risk of abortive costs (as not all innovation activity of this nature is likely to succeed).

We need a better mechanism to explore commercial re-use and fund innovation. We therefore strongly support Ofgem's proposal to include in the new framework specific provisions allowing exploration of commercial re-use of the network, on the basis that lessons learned from the current licence are considered and the provisions reflect the importance of this work in both driving down unit costs for our customers and accelerating efforts to decarbonise and drive social good.

<sup>8</sup> Ofgem helpfully granted a 'permitted purpose' derogation for the provision of smart meter system data as part of the MEDApps project and the DCC's subsequent participation in innovation competitions are being delivered under the category of Minimal Services, however this comes with a turnover threshold of £500k per year.

However, the conditions for re-use set out in Ofgem's consultation do not achieve this. They will disproportionately restrict innovation and exploration by reducing clarity around when re-use can be explored. For example:

- The reference to DCC's maturity is set out without objective measures. We are confident that by 2025, many existing issues will have been addressed, such as the transition to 4G and the delivery of improved business accuracy. However, new challenges are likely to emerge as the network evolves. This is an inherent part of building and managing complex infrastructure which needs to keep pace with technological change. It should not hinder exploration which will release greater value for our customers and end consumers.
- Generating benefits for DCC customers may not always be the *primary objective* of any re-use. This could significantly restrict how our infrastructure is used in the future, undermining its potential to support net zero and unleash the benefits of a smart energy sector. i.e. We agree we can drive down costs for our customers by exploring re-use, but our primary objective may be to support broader public benefits.

This consultation should focus on strengthening the DCC's ability to explore re-use, rather than identifying further restrictions. The DCC network has the potential to accelerate decarbonisation and drive social good. Our infrastructure represents a multi-billion investment to date, which has been enabled through industry fees and ultimately paid for by consumers. This investment must be leveraged to maximum effect. Consumers must not be left to pay for infrastructure that, once built, goes underutilised. Neither should our customers expect to pay higher fees to maintain such a network when those costs could be shared through reutilisation of the infrastructure. The opportunity to utilise our infrastructure to drive tangible benefits in our core business, improve the energy sector and support net zero ambitions for the benefit of consumers and society cannot be overstated; nor should it be missed.

Ofgem has a responsibility to ensure the energy sector delivers for GB consumers. While we understand the need for a clear and transparent mechanism to underpin future re-use, the current proposals act primarily as barriers which will restrict the DCC, sub optimise the investment already made and underdeliver for people and society in GB. As we look forward to 2025, with a more mature organisation operating a more stable service, we firmly believe perceived risks and misconceptions associated with re-use can be mitigated to fully deliver the transformative possibilities offered by the network. As part of our future role, we would expect and commit to DCC continuing to drive cost efficiency for core activities, alongside any action taken to enhance income from new services and alternative funding sources. It is anticipated that this will also be reflected and supported by the proposed move to an ex-ante price control for existing services under the new licence.

## d. Price control change considerations (questions 14-20)

Based on previous stakeholder engagement, Ofgem came up with five initial criteria to assess the effectiveness of ex-ante versus ex-post price controls. We respond to the questions set out under each criterion below.

### Criterion 1: Dealing with cost uncertainty (Q14-15)

**Question 14: Do you consider that a hybrid model, where some costs are regulated under an ex-ante regime and some under an ex-post regime based on the level of cost uncertainty, would be appropriate for DCC?**

Yes, we consider it appropriate to have a price control model where the more stable costs relating to the DCC's mature activities are regulated ex-ante, with built-in flexibility for less-predictable costs relating to new activities or extensions of scope. This built-in flexibility can be a part of the ex-ante regime in the form of uncertainty mechanisms (such as re-openers) or can come in the form of ex-post reviews for ring-fenced categories of costs.

Our rationale is shaped by our decade-long experience in our current price control model, the benefits and drawbacks of ex-post and ex-ante regimes, and our view on the trajectory of the DCC's roles and business maturity.

Our current price control model of annual ex-post reviews was well-suited for the DCC as a nascent organisation tasked with the first-ever rollout of a complex technological infrastructure. The evolution of the energy landscape since the licence award, as well as the nature of the smart meter rollout challenge meant that the DCC had to adapt and address unexpected technical problems along the way. This moved the DCC's role from slim contract management to an enabler of a complex telecommunication infrastructure. As the scope, timing and level of costs were highly uncertain, ex-post price control allowed the DCC to directly and fully intervene to solve emerging challenges and to deliver the smart meter rollout.

Despite this key advantage of ex-post price control, disadvantages also emerged relating to heightened risks for us and stakeholders:

- **Disallowance risk for DCC:** The DCC has been facing increasing uncertainty on the ability to recover costs, despite intervening as necessary to deliver against the responsibilities set out in the Licence and the Smart Energy Code and exploring innovation opportunities to increase efficiency. A continued disallowance risk may naturally lead an organisation to only undertake minimal interventions that are sufficient in the short-term but may not be the most efficient in the long-term. This would lead to missed opportunities to increase our service quality for customers at lower overall long-term costs, to the ultimate loss of end-consumers.
- **Annual frequency of reviews** was appropriate to contain our customers' budgeting risks and the DCC's disallowance risks outlined above<sup>9</sup>. However, annual reviews also significantly raise the resource burden for our regulator and the DCC. Currently, we submit granular cost information each year to Ofgem, and we make a mostly unredacted version of our submission to our customers available ahead of Ofgem's consultation on price control decision. We also update our customers on our forecasts through our Quarterly Finance Forums (with indicative charging statements and indicative three-year budgets), in advance of producing our charging statements. While we value the contribution these efforts have towards transparency on our spending, we also recognise that they spread our teams thinly to prepare. Considering the future challenges for the energy system on the road to net zero and the DCC's role at the heart of many reforms required to transition, we will need to have a forward-looking perspective. Our preference is for less frequent but much more

<sup>9</sup> Otherwise, expenses that were accumulated across multiple years would have more serious impacts on the 'financability' of the DCC if they were disallowed, or on our customers' fiscal budgets if they were allowed but were over our ex-ante forecasts which our customers originally based their budgets on.



effective and deeper stakeholder engagement exercises on our forward-looking spending plans with a multi-year price control period, which is not feasible under an ex-post regime.

Success of ex-ante price controls relies on robust business planning and forecast accuracy. DCC is already investing to mature operational planning and forecasting capabilities to drive greater accuracy across our organisation and transparency for our wider stakeholder community. We are confident that these efforts, combined with greater engagement across our stakeholder group, will drive significant improvement over the course of the remaining licence period, such that by 2025 we are ready and able to adopt a more sophisticated budgeting/ price control approach. With a more stable network, we expect to encounter less technical surprises and have more stable costs in our core business, helping to drive greater forecast accuracy.

In this context, we view the key advantages of ex-ante controls over our core business as follows:

- Limiting the budgeting risks, i.e., customer bills overrunning forecasts or disallowed expenses for the DCC, which may create distorted management incentives, choosing efficiency over investment for the best service over the long-term.
- A move to multi-year price controls will enable us to focus on deeper and higher quality stakeholder engagement and business planning efforts, and in turn reducing the resource burden for our regulator
- Incentives to innovate and enable cost efficiencies to achieve outturn costs below the pre-set allowance (N.B. This incentive exists if there is an efficiency sharing mechanism, (similar to other ex-ante controls, e.g. Totex Incentive Mechanism), whereby the DCC will keep a share of the underspend and absorb a share of any overspend. Under a profit-maximising business model, pre-set revenues will mean reducing costs is the only means to achieve profits.);

However, there remain important points that should be carefully considered to avoid disadvantages:

- Cost categories subject to the ex-ante regime should be clearly and correctly identified based on expected stability and forecast accuracy. The DCC needs to be able to keep data preparations and submissions distinct for ex-ante controls versus ex-post (or re-openers) to avoid resource burden and repetitions in submission requirements or assessments.
- Efficiency sharing factor, which is the underlying driver of cost reduction incentives in the ex-ante regime, should be carefully set considering the share of exogenous risks outside of the DCC management's control. All incentives must be against activity that is within DCC's control.
- Following examples from other ex-ante price controls for natural monopolies, such as energy networks RIIO and water networks Price Reviews, there should be balanced incentive mechanisms with both an upside and a downside to ensure performance and quality over and above the minimum standards set out in our Licence and Code. These mechanisms would be instrumental in mitigating some of the cost reduction incentives of an ex-ante regime which could encourage extreme cost reduction at the expense of reduced performance. They may include price control deliverables (PCDs) – which tie sums of allowance to the delivery of pre-identified outputs, as well as output delivery incentives (ODIs) – which set service quality thresholds and offer rewards for exceeding the upper threshold and penalties for not reaching the lower threshold, with a deadband in between. RIIO-1, RIIO-2, PR19, as well as the final methodology announced for PR24 all favoured symmetric incentives for penalties and rewards, whereas the DCC is currently subject to only a downside approach with margin-at-risk. Another example could be Openreach's ex-ante price control with allowed charges that is currently on the table for revisions.

Overall, the DCC aims to be a forward-looking organisation and a platform for policy implementation through its telecommunications infrastructure. By our next licence period, we will reap the benefits of our continued efforts to mature operational planning, forecasting capabilities, and our Business Accuracy

Programme<sup>10</sup>. Therefore, we will be ready for more mature price control approaches in the form of multi-year ex-ante reviews, which will be well-aligned with our forward-looking and improved business planning ambitions.

We acknowledge the risks to be mitigated through a careful design of the regime. The first mitigation is clearly distinguishing stable cost categories from those that are less predictable (because they relate to new or additional roles which the DCC may assume throughout the price control period). This will be key in avoiding unnecessary resource burden due to conflicts and confusions between ex-ante and re-opener/ex-post elements of the new regime. The second mitigation relates to the creation of appropriate incentive mechanisms for reducing costs and increasing performance and quality. Sharing factors and balanced upside/downside incentives should be arranged based on the nature and distribution of risks. During the early period of transition to the new regime, DCC's downside risk may be contained more than the upside potential, to be then brought to symmetry.

<sup>10</sup> The Business Accuracy Programme will deliver the enhancements we need to create a business planning and performance management framework.

**Question 15: What elements of DCC's Allowed Revenue are stable (with low risk of forecasts being either under- or over-estimated) and would benefit most from an ex-ante approach by 2025?**

We appreciate the uncertain landscape we face in our core mandated business e.g., 4G/5G and sunsetting of earlier technologies, resilience against and responding to potential cyber threats, and increasing use of data and packet size over the network that will require increasing network capacity. Yet, we consider them comparable to the uncertainty and challenges faced by other natural monopolies. For example, future of natural gas/hydrogen for gas distribution networks; extreme climate events for water networks; or increased need for flexibility management for the system operator as the economy is electrified and generation becomes more decentralised and intermittent. We are already investing in our capabilities and processes to ensure we have a more transparent and accurate forecasting process and are confident that by 2025 this will have matured significantly.

Therefore, we consider the majority of our cost centres relating to our core operational and functional costs, and for programmes that have moved beyond detailed design, suitable for ex-ante reviews post-2025, with re-openers or annual ex-post reviews suitable for cost centres relating to new lines of business that the DCC may be given.

We are eager to work with Ofgem through the detailed design process to review cost line items (e.g. through Ofgem's RIGS categories or at sub-category level) and ascertain suitability for either or. By the time we move to the next consultation on the technical design of the price control, we will also have a greater historical set of programmes on which to benchmark costs to ensure efficiency in ex-ante allowance.

## Criterion 2: Incentives to control or reduce costs (Q16-17)

### **Question 16: What are your views on the different ways in which risk (i.e. the benefit of underspending and the cost of overspending) can be shared between the DCC and its customers under an ex-ante regime?**

We consider the most important mechanism for fairly distributing the risk is an 'efficiency sharing factor' as suggested by Ofgem, which has a strong track record of usefulness demonstrated in other ex-ante regimes (e.g. referred to as 'totex incentive mechanism').

One of the primary benefits of ex-ante price controls is incentivising cost efficiency, given revenues will be set in advance and the key driver to generate returns is to reduce costs. The higher the share of over/underspend kept by the regulated entity, the higher the incentive. We consider that this benefit will be most pronounced for business models with a for-profit design, akin to those described by Ofgem's Option A, which we elaborated further in our response to Question 1. The incentives may be relatively limited in not-for-profit or publicly-owned models.

Assuming an Option A style, profit-maximising business structure, ex-ante allowances should incentivise DCC to be as cost efficient as possible. The benefit of any underspend and the loss due to any overspend will depend on efficiency sharing factors with customers.

The optimum values for the efficiency sharing factor should be based on the unique risk profile.

Having a high efficiency sharing factor means DCC would absorb more risk in the event of an overspend and more reward in the event of an underspend. In this case, it makes sense to set the factor according to the risk profile of DCC's cost categories and forecasts. To the extent that cost uncertainty and forecast risk is exogenous (cannot be controlled by DCC's management), it would make sense to have a lower efficiency sharing factor for the DCC. For instance, for RIIO-T1, the factor was set at 45% uniformly for all three transmission operators in GB. At RIIO-T2, the factor was updated downwards to 33% for National Grid Electricity Transmission and 36% for Scottish Hydro Transmission, whereas it moved up to 49% for Scottish Power Transmission, based on the unique risk profiles and T1 experiences of the networks. Asymmetry in the sharing factor for underspend versus overspend should also be considered at the design phase, particularly for the initial transition period.

### **Will the efficiency sharing factor be symmetric for overspend and underspend?**

In principle, we are open to a balanced/symmetric sharing factor that recognises and rewards performance and penalises underperformance. However, acknowledging the significant transition the DCC will go through in the first years of the new regulatory model, we suggest lower downside risk to be allocated to the DCC in the near term with a clear path to full symmetry over time. This should include the ability to reopen and review this as appropriate given the early stages of this regime.

### **Will the DCC price controls remain annual, and how should this affect the efficiency sharing factor?**

Our suggestion to move to multi-year controls for the ex-ante part of the regime is driven by our concerns over the regulatory resource burden, and the need to invest in much higher quality business plans and forecasts for the ex-ante regime to be successful. National Grid Electricity System Operator, a similarly physical asset-light technology-based entity is subject to 2-2.5-year price controls (through two business plan submissions and final determinations within the 5-year RIIO regulatory cycle). The introduction of two business plans and two determinations within one cycle was introduced to acknowledge the System Operator's separation from the previous 'Transmission System Operator' and to support the ESO through the business transition. For instance, the DCC may also start with 2-3 year ex-ante price control cycles to minimise risk, and over time move to the full 5-years of a regulatory cycle.

**Will there be Business Plan quality incentives for accurate forecasting?**

We consider such a mechanism excessive in the initial stages. Considering that the DCC has never submitted ex-ante Business Plans, penalty-mechanisms for forecast accuracy would be premature, and might negate the effect of incentives for cost reduction and performance quality if they are perceived to wipe off any potential rewards.

Nonetheless, the DCC is critically aware of the need for robust business plans and increased accuracy of forecasting. We are already undertaking our Business Accuracy programme to improve our forecasting.

### **Question 17: What are your views on whether DCC can be effectively incentivised to reduce costs at scale under an ex-ante regime?**

As detailed in our response to Question 14 on the benefits expected from an ex-ante regime, we believe the DCC can be effectively incentivised to reduce costs at scale under a for-profit business model and efficiency sharing factors that are set with fairness and with consideration of the relevant risk profiles. There are three further points we would like to clarify:

- The Efficiency Sharing Factor under a new ex-ante regime should be designed so it does not go against (and potentially replace) the existing External Contract Gain Share (ECGS) mechanism. ECGS only relates to the cost savings from efficient management of external costs. Conflicting share scenarios should be avoided (e.g., where ECGS were shared with customers as achieved, but there was an overall overspend at the end of the period – all gains from external and internal cost categories regulated ex-ante should be accumulated together and one single sharing factor should be applied at the end.)
- Planned expenditure on innovation should be considered favourably in line with its ability to unlock cost efficiencies.
- Both upside and downside incentives should be determined by activities within DCC's control with adjustments for any exogenous factors that might objectively limit DCC's ability to control final costs.

Additionally, we would point to Ofcom and their approach to cost controls in relation to regulated networks via a price limit set against which Openreach must operate. This imposes an efficient operating framework in relation to running a network and still allows for new capital projects such as Fibre Roll Out to be cost controlled via a regulated return.

### Criterion 3: Incentives to deliver the right level of performance/quality of service

**Question 18: Do you think that moving to an ex-ante regime could adversely affect the quality of service? What mechanisms could be used to reduce the risk of underperformance under an ex-ante regime (e.g. provisions to allow clawback in case of delivery failing to meet specifications)?**

On balance, no, moving to an ex-ante regime does not necessarily adversely affect the quality of service as reputational incentives are likely to remain. There are established mechanisms in ex-ante price controls to safeguard and indeed incentivise higher levels of service quality and performance, including PCDs and ODIs as presented above in our response to Question 14 and proven models from other industries including telecommunications.

However, it is important to note that all of RIIO-T/GD1, RIIO-T/GD2, RIIO-ED1, PR19 have so far adopted symmetric quality and performance incentives. The regulated entity can unlock a reward if it delivers above an upper threshold, whereas it would be subject to a penalty (clawback) if it falls below a lower threshold (with a standard quality dead band in between).

Based on our past experience, we do not believe penalty-only mechanisms provide the right incentives for driving quality. For example, the existing *Operational Performance Regime (OPR)* puts margin at risk (i.e. down-side only) against certain parameters that are mirrored in the SEC. This narrowly-focused mechanism ends up being more of a distraction: instead of focusing on improving performance overall, it creates a distorted incentive to not lose margin on a narrowly-defined OPR. There are elements of OPR which could be built on, but it would need improvement, notably in the following areas:

- more quantitative metrics with less scope for misinterpretation, especially around customer engagement and contract management; and
- focused on activities solely within DCC control (this is not currently the case for SRV8.11 for example)
- upside/ downside should only be incentivised/ penalised once, the current regime allows multiple penalties for the same item



## Criterion 4: Transparency and stakeholder engagement

**Question 19: What are your views on how best to assess costs under an ex-ante approach? For example: What level of detail on costs and benefits would be appropriate? How early should DCC share details of costs with customers? How should this information be shared and evaluated?**

Currently under our annual ex-post review, the DCC:

- submits costs at a higher granularity than Ofgem-set RIGS categories. This granularity has tended to increase year on year,
- shares the submission with the customers (largely unredacted, c.400 pages) ahead of Ofgem's annual consultation on disallowance decisions
- publishes indicative charging statements four times a year, indicative three-year budgets four times a year,
- holds Quarterly Finance Forums to review forecast costs.

We are keen to maintain close engagement with our stakeholders and based on our review of other ex-ante regimes, we understand that Ofgem places a strong emphasis in stakeholder engagement in business planning. We envision presenting our plans, holding surveys, and conducting workshops with our customers and other stakeholders on our Business Plans throughout the drafting stage. We are eager to leverage these opportunities to have more meaningful and future-focused engagements, as opposed to a backward-focus on changes from the last control.

- Given ex-ante reviews will place a strong emphasis on forecast costs, we believe the data tables should be at a higher-level than prepared currently. For instance, they could be forecast at high level building blocks which are then disaggregated according to Ofgem's RIGS categories. These expectations should remain stable and well understood across the stakeholder landscape, reducing the need for frequent requests for more data
- We believe the properly redacted version of our Business Plan and the data tables can be shared with our stakeholders at the same time of submission to Ofgem.
- The DCC as well as all stakeholders should be able to respond to indicative decisions/draft determinations by Ofgem. This would ensure all parties have an opportunity to contribute, but ultimately it is Ofgem's role to collect all responses and decide within their remit.

We must note that, on top of the price control model adopted and its stakeholder engagement processes, we expect our proposed Board composition described in response to earlier questions (independent Board with representation from DNOs, retail customers and consumer groups) to enable an improved process for sharing costs and benefits of future plans with all our stakeholders.

## Criterion 5: Regulatory and resource burden

**Question 20: Do you agree with our initial view that an ex-ante model has the potential to reduce the resource burden both for Ofgem and DCC? Please state why.**

As long as cost categories that will be subject to an ex-ante review are distinguished clearly and remain stable, the price control cycle is increased to multi-year, and outputs/incentives are set without ambiguity, the model can lead to more efficient regulatory/resource costs for Ofgem and the DCC.

We would encourage Ofgem to consider how to balance rigour and simplicity with associated impact on the resource burden, drawing on examples (both positive and negative) from other regulated industries to inform the detailed design.

However, the transition period will be very important. If there is confusion over activities being subject to ex-ante and ex-post, or extensive reliance on uncertainty mechanisms with a hybrid model, the regime can quickly spiral into a continuous price control with heightened resource burden for both parties.

### 3. Appendix A – Variations and case studies considered by the DCC

As stated in the executive summary, we conducted a robust and thorough evaluation of the Options under consultation. To provide a more detailed and informed response we considered a number of variants or sub/options to test the practical implications and potential designs under the two high-level Options. These are introduced below in tables A1-A3.

#### 1. Option A sub-options: We identified two variants of Option:

Table A1: Sub-options of Option A (shareholder/private owner models)

Option	Key characteristics
<b>A1: Institutional investors</b>	<ul style="list-style-type: none"> <li>Owner is purely interested in financial return</li> <li>May not bring any specific capabilities or synergies to the deal, aside from long term infrastructure management expertise and a stronger ability to raise additional external funding</li> <li>May be more likely to be a consortium of investment groups</li> </ul>
<b>A2: A single private owner</b>	<ul style="list-style-type: none"> <li>Corporate owner who would look to provide additional capabilities or synergies with its current portfolio</li> <li>Likely to be more in line with existing corporate purpose and services than A1</li> <li>Capability to raise additional external funding could be constrained by own Balance Sheet</li> <li>More likely to be a single owner</li> </ul>

#### 2. Option B sub-options: We considered industry and publicly owned models separately, using various existing institutions as examples to stress-test and analyse the potential designs.

Table A2: Sub-options of Option B (Industry-owned models)

Option	Key characteristics
<b>BI1: Elexon-type model</b>	<ul style="list-style-type: none"> <li>An industry-funded not-for-profit organisation</li> <li>Single industry owner</li> <li>The annual budget is agreed by the industry-led Board, in consultation with its members</li> </ul>
<b>BI2: Electralink-type model</b>	<ul style="list-style-type: none"> <li>An organisation with industry-funded not-for-profit core mandated business and for-profit additional commercial services</li> <li>Multiple industry owners</li> <li>Users of its core service (Data Transfer Service, DTS) have oversight and auditing rights over the relevant budget and may refer disputes to Ofgem</li> </ul>
<b>BI3: Xoserve-type model</b>	<ul style="list-style-type: none"> <li>A not-for-profit organisation with multiple industry owners</li> <li>Funded by the industry</li> <li>Budget goes through a three-stage consultation with members before getting agreement from the industry-led Board</li> </ul>

Table A3: Sub-options of Option B (Publicly-owned models)

Option	Key characteristics
<b>BP1: DCC absorbed into the FSO</b>	A public body within the Future System Operator, funded through industry charges.
<b>BP2: Creation of new Public Body</b>  (e.g. akin to Nuclear Decommissioning Authority (NDA))	A public body funded directly through BEIS. The public owner (for NDA, this is UKGI) assesses the annual plan, and monitors quality and performance.