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DCC Oversight and Regulatory Review
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Email to: DCCregulation@ofgem.gov.uk

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Dear Ayena

DCC review: Phase 1 Consultation

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewables, including onshore, offshore wind and solar generation, and energy storage. With around six million electricity and gas customer accounts, including residential and business users, EDF aims to help Britain achieve net zero by building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

We welcome the opportunity to respond to this consultation on the future licensing arrangements for the Data Communication Company (DCC). The smart metering communications network managed by DCC, and the services that network provides to suppliers and other industry parties, will be critical to the achievement of net zero. It is therefore vital that that governance arrangements for DCC are fit for purpose to achieve this aim.

The key points we wish to highlight are set out below:

- EDF does not have a clear preference for either of the governance models proposed at this stage as there is insufficient information to be able to select a preferred option.
- While there are benefits and drawbacks to both options detailed in the consultation it is not clear which of them will best address our key concerns, which are DCC's operational performance and the instability of their costs.
- We are concerned by the view expressed in the consultation that some level of instability should be expected when it comes to DCC's services, and especially their cost. We do not agree that this is the case and the focus should be on achieving the stability that we

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require rather than accepting and accounting for instability in the governance arrangements.

- While we agree that re-use of DCC's services should be allowed where this can reduce costs and provide benefits to consumers, such re-use should not occur until DCC has addressed the issues with its operational performance and is consistently delivering a high quality of service across its network.

- We remain concerned that commercial considerations around additional services continue to be a distraction for DCC. Ofgem should consider whether DCC could be split into two entities; one which is focused on delivery of the core communication services and another which is more commercially focused. This could be similar to the model implemented by Xoserve and Correla.

- DCC undertakes a critical role in the operation of smart meters, providing services that provide direct benefits to consumers, therefore mitigating potential risks that might arise from any change to the governance arrangements, including any transition period, is essential.

- An ex-ante price control mechanism should be implemented as soon as possible, and ideally in advance of the new DCC licence coming into effect.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Paul Saker, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely

Denise Willis
Senior Manager of Industry Change

Attachment

DCC review: Phase 1 Consultation

EDF's response to your questions

Q1. 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 to you to this choice?

While we welcome Ofgem's intent to consider more significant reform to the DCC licence arrangements, we do not have a clear preference for either of the models proposed at this stage. The two options are too broadly defined to be able to make any decisions. It is the lower-level detail of how they might be implemented in practice that will determine whether either model will deliver the outcomes we and other stakeholders are seeking from this licence review.

In our view, the critical outcomes of this licence review must be an improvement in DCC's operational performance and stabilisation, and ultimately reduction of its costs. It is not clear from the information provided which of the two models would best deliver these outcomes. As noted in the consultation, DCC costs and performance are driven in part by its external service contracts, limiting the scope of either option to address these fundamental concerns. It is also not clear what the costs of implementing and operating either of the options would be, which will be a key factor in deciding which option should be progressed.

As noted in the consultation, both options presented have benefits and drawbacks:

- **Option A** has the benefit of implementing enhanced incentives and the introduction of an ex-ante price control framework, while still being operated by a third party with relevant expertise. However, both the incentive regime and the ex-ante price control would need careful design to ensure the right outcomes are achieved.
- As noted, better DCC user representation on the DCC Board could help address some of the issues that currently exist around DCC's understanding of the needs of DCC Users and end consumers, however there is the potential for conflict in a shareholder-majority Board with competing priorities.
- It is not clear what the costs of Option A would be in terms of potentially increased costs for the DCC licence holder. The more challenging the licence is made in order to achieve what DCC's Users need, especially in terms of system performance, the more risk premium potential licence holders will apply to their bids – if anyone wants to tender at all.

- **Option B** seems nominally more attractive as it would address one of the key issues that we have highlighted with DCC; its lack of engagement with and responsiveness to its key stakeholders, especially those that provide the funding for their services.

- However, we have not seen an industry led model work in practice for the delivery of services of this level of cost and complexity. The learning curve and implementation costs for industry to be able to manage the DCC effectively could be significant. It should not be assumed that industry parties could just step in and run DCC 'as is' using existing resources.
- Option B also places an additional resource burden on industry which would not be welcome.
- As we understand it, Option B removes the need for a price control process; however, it is not evident that industry would have the expertise to be able to understand and control costs through the alternative mechanisms set out in the consultation. The nature of the services provided by other industry run organisations (such as Alt HAN) have shown that this governance model is not always the optimum method for delivering something technically complex in a cost-effective manner.

We would welcome further engagement with Ofgem to understand and develop these options further to be able to come to a decision.

Q2. Do you agree with the way we have applied the principles in our analysis of the options? Please state your reasoning.

Yes, we broadly agree; we can't see any clear issues in the way that the analysis has been carried out. It is, however, disappointing that the application of those principles does not seem to have resulted in a clear preference or solution being identified.

We request clarification on how Ofgem will decide on next steps in the next stage if there is no consensus on a preferred option across stakeholders as a result of this consultation.

Q3. 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?

Any changes to the incentives in the DCC licence would need to be supported by changes to the Smart Energy Code (SEC), such as inclusion of a Performance Assurance Framework and greater powers for the SEC Panel to scrutinise DCC's costs. This would provide SEC Parties and DCC Users with the tools to be able to better hold DCC to account themselves for the quality and cost of service that we require from them, rather than relying on Ofgem oversight and intervention.

Q4. 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?

In our view, it would be possible for a stakeholder controlled DCC Board to provide the required quality and cost of service. However, further work is required to understand how this model might work in practice and what influence that Board might have over DCC service provider contracts that are already on place, which are the key drivers of service quality and cost.

Q5. Do you have any views on the details of Options A and B?

We do not have specific views on the details of the two options at this stage but would welcome further engagement with Ofgem to understand and develop them further to be able to make a decision on the way forward.

Q6. What are your views on the options identified and the associated trade-offs for a possible licence extension?

Our views on the three options identified are:

- **No licence extension**: While we prefer to move away from the current, sub-optimal DCC governance arrangements as soon as possible, we recognise that doing this within the life of the current licence will be very challenging. As a supplier, we already face several resourcing challenges given the current energy crisis, as well an ongoing project such as Market-wide Half Hourly Settlement (MHHS). The detailed design of the new licence arrangements will require input and scrutiny from DCC Users and other industry parties which will take time. Any transition from the current framework to the new one will also need to be carefully managed to ensure there is no impact on the services that DCC Users, and ultimately energy consumers, receive from DCC. It may not be possible to achieve a high-quality licence framework and an effective transition by the time the current licence expires in 2025.

- **Extension of up to three years**: Given the challenges noted above, we agree that an extension of up to three years is likely to be required, however this extension should be as short as possible and not necessarily fixed at three years. We should not retain a governance framework that has been determined to be delivering poor outcomes for any longer than is absolutely necessary. We expect that an extension could be as short as one or two years.

- **Extension of up to six years**: We can't see any reason an extension longer than three years would be required and would not support any extension beyond that point. It should be possible to deliver an effective transition within those timescales. We note that industry is expected to deliver changes like MHHS which are more complex within shorter timescales.

Q7. What are your views on the assumptions we have made for Options A and B transition periods?

We broadly agree with the assumptions that are set out for the transition periods for both options.

The detailed design of both proposed new frameworks is estimated to take up to two years, and while this may seem like a long time, this activity will require a significant amount of industry input and engagement. As previously noted, industry parties are already facing numerous resource challenges, which will only increase as the MHHS Programme develops its legal text over the next two years, which will also require a great deal of industry engagement and scrutiny.

For option A it would be useful to understand what the transition timeline would look like if Capita were to re-secure the licence following the tender process; or even what the timeline for the tender process would look like if they were to be the only bidder. Also, where there is a handover from DCC to a new licence holder under Option A, we would like to see any period of overlap where costs are being incurred by the both the old and new licence holders minimised as far as possible.

Option B is a more fundamental change than Option A and the complexity of any transition should not be under-estimated. We note that the implementation and handover period appear shorter for Option B than Option A, we would expect it to be longer for this option. The handover will not be as simple as the existing DCC staff simply moving across to the new entity, which seems to be the assumption.

Q8. 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?

In our view the key dependencies are the 2G/3G sunsetting and the associated Communications Hubs & Networks (CH&N) activities, as well as DCC’s Data Services Provider (DSP) re-procurement activity. The successful completion of these projects is critical to the effective operation of the smart metering infrastructure, the completion of the smart metering rollout and the programmes (such as MHHS) that rely on robust communications with smart meters. It is vital that these major programmes do not impact the ability of DCC Users to meet their rollout obligations while continuing to provide services to those consumers that already have smart meters.

The role of BEIS regarding DCC will also be a key factor in the transition. BEIS continues to have a very active role in the direction of DCC, and there is no sign that this is likely to change. Clarity on the role of BEIS and their expectations not only of the DCC licence but of any future DCC licensee is required to understand how this could impact the transition, especially if BEIS is planning to direct any changes to DCC's scope within the transition timelines.

Q9. 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?

We agree that incremental changes should be made to the regulatory framework. It is not necessary to wait until the new governance arrangements are implemented to make changes that will benefit DCC Users and end consumers.

The incremental changes that we would like to see made are:

- implementation of an ex-ante price control framework covering as much of DCC's costs as possible.
- inclusion of DCC User representation (including at least one energy supplier and one consumer representative) on the current DCC Board.
- increased transparency for DCC Users on the key content for DCC's Service Provider contracts. Not only will this enable better understanding of the contractual challenges DCC faces, DCC Users could potentially provide commercial and legal expertise and support when addressing challenges with those Service Providers.

Q10. Do you agree with our proposed scope of future DCC's Core Mandatory Business?

Yes, we broadly agree with the proposed scope of DCC's Core Mandatory Business as set out in the consultation. The primary focus for DCC should be, and should remain, the provision of reliable communication services to and from smart metering systems installed in consumers' premises.

We agree that MHHS should be part of DCC's Core Mandatory Business only to the extent that DCC's core communication services will be used to obtain the consumption and other data required by the MHHS arrangements from smart meters. DCC's role in MHHS should be limited to the provision of those communication services.

Q11. 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'?

Yes.

However, any additional services provided by DCC must be aligned to and provide synergies with its Core Mandatory Business. Too many activities that DCC has undertaken, or has been asked to take on, do not meet those criteria.

Mandated Services

We do not agree that mandated services should be included in the future DCC licence. These services are not related to DCC's Core Mandatory Business, otherwise they would be defined as ancillary services. If that is the case, it is not clear why DCC should be required to provide these services, which risk serving as a distraction to the delivery of the core services.

DCC's role in the Switching programme is a good example of this; there is no synergy between DCC's roles in smart metering and switching. It is not clear why DCC was asked to provide these services in the first place, and we would welcome a review of whether they should continue to operate them now that they have gone live. There would seem to be more appropriate mechanisms for managing these services, for example RECCo and the Retail Energy Code arrangements, with the contracts being directly between RECCo and DCC's switching service providers (such as Landmark).

Ancillary services

We agree that ancillary services should be included in the future DCC licence, but only if provision of those services has a direct link to the core services. If DCC can provide a service to the market of a higher quality or at a lower cost, then industry parties should not be prevented from benefiting from that. Provision of such ancillary services must be subject to a clear cost benefit analysis, be complementary to and not distract from the provision of the core services. It must also be done with the active consent of DCC Users or at their request; as we have seen through the price control process DCC has, on several occasions, speculatively funded the development of services for which there is no clear demand by the users that pay for it. While we expect DCC to be thought leader and to propose new services and opportunities, no money should be spent until it is agreed there is a clear demand for those services.

A potential model for delivering these ancillary services could be one similar to that followed by Xoserve and Correla where the delivery of the core services has been separated from the contestable commercial services. This sort of separation could allow greater scope for commercial services to be provided without any impact on DCC's Core Mandatory Business. While these remain under one entity, there is a potential risk of competing incentives, a situation which we see with DCC today.

Additional services to users

It is not clear what types of service might fit into this category. We do not want to preclude DCC from providing additional services that are beneficial to users who wish to pay for them, however it is difficult to see what these additional, user specific services might be.

There are several reasons why elective communication services have not been progressed to date. Not only are most suppliers still focussed on the rollout of smart metering to their customers rather than offering bespoke services, but the prescriptive nature of the technical specifications for smart metering, and the high service levels set out in the SEC, mean that there is little space for additional services to add value.

For example, an elective communication service could be a new function on a smart meter that can only be accessed by the supplier that has procured an elective service. Not only would both DCC and the supplier be required to develop and implement new service requests, but the meters themselves would need to be upgraded, likely via a firmware update, to provide the new service. Given the technical complexity and likely cost of such changes, it is not surprising that suppliers and other DCC Users have focussed on innovation within the current scope of the capability of DCC and smart meters, rather than seeking to implement extended functionality.

Q12. 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?

Yes, we agree with the proposed drivers that could result in a change in DCC's role.

It is important that DCC can evolve to meet changing customer needs and evolving technology to ensure that it is able to deliver the services the market requires as part of the transition to net zero. That evolution needs to occur in partnership with industry, as there is little value in DCC delivering changes or services that its users are not yet capable of using.

While DCC should change to reflect updated policy or regulatory requirements, we remain concerned about how these decisions will be made, and what input DCC Users will have in the process. We are concerned that Ofgem and BEIS are currently able to instruct DCC to deliver additional services/projects which may not be aligned to their core services, and without the agreement or consent of DCC's Users, as was the case with the Switching Programme. DCC Users must be consulted before any decisions are made and alternative options must be explored. DCC should not become a home for projects and initiatives just because the licence has national coverage and covers both fuels. It must be the right place to deliver these changes, not simply the expedient one.

Q13. 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?

Yes, we agree that opportunities to re-use DCC's infrastructure should be explored to maximise synergies and reduce the cost to serve.

However, this activity must only occur when DCC services have achieved complete stability when operating at full scale, which is unlikely to happen in the short or even medium term. In the meantime, DCC must remain completely focussed on delivering its core services in the most effective way possible. The recent price control process indicates that DCC is already spending time exploring these sorts of opportunities, which is inappropriate at this time.

The consultation recognises that DCC would need to reach a certain maturity level before commercial re-use would be considered. However, it also notes that '*Due to ongoing maintenance and improvements to DCC systems in response to changing customer requirements and evolving technology, DCC's 'business as usual' operations are unlikely to reach a fully stable state*.'

We do not agree that this is the case; there is nothing inherent in DCC services that mean that they can't be made stable. It is concerning that it is assumed that a level of instability in DCC's services is acceptable or unavoidable. If it is the case that DCC's 'business as usual' operations are not stable, then the focus should be on addressing those issues and achieving the stability that DCC Users require, rather than just accounting for instability.

Q14. 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?

No.

We do not agree with Ofgem's assessment that the complexity of DCC's operations mean is impossible to create certainty around the scope, timing and level of costs that DCC will incur over a price control period. In our view, it should be possible to assess and manage all DCC costs through an ex-ante price control regime.

As noted previously, where instability or unpredictability exists regarding DCC services the focus should be on resolving those issues and making the scope and cost of DCC services more predictable, rather than finding a way to account for them in the price control regime. The level of uncertainty should not be such that it can't be managed through appropriate uncertainty mechanisms in the price control. If that is not possible then there would appear to be a more fundamental issue with DCC's costs that needs to be addressed.

Q15. 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 do not have enough of a detailed understanding of the components of DCC's Allowed Revenue to be able to answer this question.

However, there needs to be a clear distinction between those costs that are impossible to forecast accurately, and the inability of DCC to be able to undertake accurate forecasting. As we have seen through the price control process, and through previous reductions in DCC's fixed charges to return money that has been over-recovered from users, DCC has a poor history of forecasting its costs accurately which has not improved over time.

As noted previously, there should be a focus on achieving cost stability across all the components of DCC's Allowed Revenue before the new DCC licence arrangements come into effect. Whichever option is taken forward for the new licence, it must start from a stable foundation of high performance and predictable costs.

Q16. What are your views on the different ways in which risk (ie the benefit of underspending and the cost of overspending) can be shared between the DCC and its customers under an ex-ante regime?

The appropriateness of any sharing factor and whether that sharing factor is symmetrical for overspending and underspending will depend on the nature of the costs and their predictability and stability. If the costs can be forecasted accurately and there is a limited scope for them to be reduced over the price control term, then a sharing factor that favours DCC where such efficiencies can be obtained would appear appropriate. However, such cost efficiencies must never come at the expense of operational performance.

Similarly, where costs are stable, the sharing factor should require that any overspend should also fall mainly with DCC, as the failure to achieve the forecast costs is more likely to rest with them. We recognise that this needs to be balanced; should all of the risk of overspend fall on DCC then this could result in a risk premium being applied to their costs to account for that risk, increasing costs overall.

Q17. What are your views on whether DCC can be effectively incentivised to reduce costs at scale under an ex-ante regime?

We recognise that the nature of DCC costs may mean that the opportunities to reduce costs at scale may be limited. However, one of the key benefits of an ex-ante regime is that it provides predictability of the costs that DCC Users will incur. One of the key issues we have with DCC costs at the moment is their volatility, which makes any internal forecasting or budgeting that we undertake for these costs very difficult.

Even if costs could not be significantly reduced as the result of an ex-ante regime, moving to a model where our share of DCC costs is much more predictable would deliver significant benefits on its own.

Q18. 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?

There is a small risk that moving to an ex-ante regime could adversely affect the quality of service. However, a well-designed incentive regime that applies penalties for failure to meet service standards and operational targets should be able to mitigate this risk.

The consultation refers to the Operational Performance Regime (OPR) that is currently used to incentivise DCC by placing its margin at risk. While this might be used as the starting point for a future incentive regime, it would need to be significantly enhanced to be fit for purpose for an ex-ante regime. There is currently a clear disconnection between the way performance is being measured for the OPR and the user experience of DCC performance, with the DCC continuing to retain margin where our experience of their service levels is very poor.

Q19. 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?

The best way to assess costs is to make as much information open and subject to scrutiny as possible at the earliest opportunity, subject to commercial confidentiality. As a minimum this should include a detailed forward work plan and associated budget for consultation.

Q20. 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.

Yes.

It is clear that the current ex-post price control process is burdensome for both DCC and Ofgem, driving additional costs. An ex-ante model that operates over a period longer than a year has the potential to reduce this burden, while providing the benefits of predictable DCC costs that DCC Users like ourselves are seeking.

EDF
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