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Consultation Response: DCC Review Phase 1

Thank you for the opportunity to respond to your consultation regarding the future of the DCC Licence arrangements. The DCC provides a vital role for the energy industry and getting the governance and choice of service provider right is critical to ensuring that it delivers the service that is expected from it.

We originally supported the choice of a competitive tender for the appointment of the DCC. Competition is often the best way to deliver the optimal levels of service and efficiency. However, experience from the past decade has demonstrated that this logic does not apply to the DCC. This is a consequence of the unique nature of the service that the DCC provides.

The DCC is an asset light, relatively small, people organisation. It has two core functions; to procure and manage service contracts to deliver the smart metering communications infrastructure and secondly, to provide insight and understanding about this infrastructure to the energy industry. There can only be one DCC provider.

Developing a suitable price control framework to incentivise the best performance from this type of monopoly organisation has proved a challenge and been an administrative burden for Ofgem. It isn't clear from the DCC performance over the past ten years as to what value has been delivered from the involvement of the commercial service provider organisation.

What it has introduced is a lack of transparency regarding the commercial contracts for services and suspicion amongst customers regarding the value for money that is being provided. This is not helpful for the industry and can be seen to be a barrier to the development of new services.

It is for these reasons that we believe that the arrangements should change at the next licence award. We would support the transition of the DCC to a new not for profit, industry owned, special purpose vehicle organisation. There are many other similar examples to this already in existing within the industry, such as Elexon and RECCo.

The transition to these new arrangements and the final structure for the new organisation should be aligned with the Industry Code Reforms that are being implemented over the next few years. This will help customers of the DCC, and the wider industry, better understand its governance processes and ensure that new structures, such as the Ofgem strategic oversight function, can include the DCC and the services it delivers from the outset.

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Responses to specific consultation questions:

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 to you to this choice?

We prefer Option B.

Experience from the current DCC licence period has shown no identifiable advantages from the use of a competitively procured third party vendor. It has introduced a lack of transparency regarding service contract management and a very unclear process for addressing service failures. This has led to frustration from SEC parties. The end of the current licence period provides an opportunity to address these issues.

The DCC is an entity with two core functions; firstly, to procure and manage external contracts with service providers who deliver the smart meter communication network, secondly it is a valuable source of expert knowledge for the industry regarding the technical aspects of the smart metering infrastructure. It will always be an asset light, relatively small scale, people organisation. Focused on commercial (contract management and procurement) and specialist smart metering expertise.

The initial tender exercise for the DCC found there to be very few potential candidate organisations that met the criteria of being able to provide this specialist service. It is highly likely that another competitive tender exercise would result in a very similar outcome. Any potential new provider would look to TUPE key staff into the new organisation and ultimately there would be very little change in outcome, except for the management team and controlling entity.

A move to Option B would provide the users of the service with greater control and say over who and how the organisation delivered against its objectives. Users could prioritise areas that are important to the industry, such as the recruitment and retention of the right people. Users could set the areas of innovation and development that met their needs and any conflict with the priorities of the third party contractor would be avoided. It would provide much greater transparency to users of its operation and ultimately deliver a more sustainable business model.

Competition in this option will still be at the core of the DCC's activities, as it would continue to be required to outsource most of the services that it provided.

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

Yes, we agree with the analysis of the options against the principles set out in the consultation.

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?

The limitations in how far incentives could go in Option A are well articulated in the consultation. The DCC activities, by their nature, are difficult to reflect in any performance formulae.

The option suggested, to increase the incentive based on user and SEC party engagement and feedback, sounds attractive. However, it may lead to unintended consequences. A third party service provider who sees no or very limited profit from providing the service might see little interest in investing in improvement.

Ultimately, if the sanctions are too great, it may be motivated to look for an exit. Other sectors where monopoly services have been outsourced with overly challenging financial models, such as rail franchises, have experienced this situation. Resolving a service provider termination would result in a period of service decline for users and uncertainty for DCC employees. This would not be a good outcome for the industry and should be considered in the design of the next DCC licence award.

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?

If the independent DCC Board is properly constituted and answers to the service users, and broader industry, in an appropriate way then it could work well. Similar examples exist with Elexon, RECCo and Xoserve. None of these are perfect and developing the future organisation's governance in Option B will be critical to ensuring its enduring success.

Similar issues will be faced by any of the new Code Managers that are appointed in the proposed reforms to industry codes and that operate in a not for profit licenced manner. It would seem sensible to align the structure of the new DCC licenced entity to these. Having similar governance structures and reporting lines will make it easier for DCC Users to understand and engage with it.

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

No additional comments to provide at this stage on the details of the options.

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

We agree that either option will require changes to the existing DCC licence.

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

We agree that another competitive tender for the DCC licence will probably necessitate an extension to current licence. The process that would be undertaken for the procurement is clear but the initial stages of scoping the changes to the licence may take more time than described in the consultation.

We disagree with the suggested timeline for the implementation of a not for profit option B. This could be implemented in a much quicker timescale than option A and would not be dependent on the requirement for a procurement exercise.

The proposed timeline for option B seems to be extended due prolonged consultation and consideration periods by Ofgem. Unlike procurement timescales these are not fixed and

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could be significantly shortened. All that would be required to do this would be the allocation of sufficient resource within Ofgem.

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?

There will always be significant programs and procurements that the DCC will be involved in. This is inevitable and simply needs to be considered and managed in the process for DCC licence transfer. There are none that are so intrusive that they should dictate the timeline for the DCC licence transfer.

Alignment with the Energy Code reforms will be vital and is the key dependency for this project. Any changes to the DCC licence need to be aligned with the future of the SEC and how code governance will evolve in the future.

The DCC licence award needs to be included as part of the broader BEIS/Ofgem energy code reform project and not managed separately. It could be a discrete sub-project but only with close alignment will it ensure the most productive eventual outcome.

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?

Excessive focus on short term change and quick wins is not helpful and will act as a distraction from implementing fundamental reforms of the DCC licence.

There are aspects of the price control for the DCC that could be considered for change in the short term, as these are set on an annual basis. However, we would caution against radical reforms, instead focus effort on enduring change and alignment with the broader Code Reforms.

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

We believe that the switching services, that the DCC acquired the mandate to deliver after the current licence was granted, should not form part of the enduring core service provision.

The contracts for the provision of these services should be migrated to RECCo and the obligations removed from the DCC licence.

Having the DCC provide these services rather than RECCo confuses the governance arrangements for retail switching. The recent REC modifications, and clarification from Ofgem regarding the split of performance assurance activity, highlights the issues with a licenced entity such as the DCC undertaking these functions.

It would be far better for the industry for RECCo to manage these service contracts in the same way that they do for the EES and GES services.

This would leave the DCC core service being the provision of smart metering communication activity. The reason why the entity was created in the first place.

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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'?

If these services were related to the provision of smart metering communication infrastructure, then there should not be a problem with the scope of its mandatory services increasing over time. There have been good examples of this expansion during the first phase of the DCC licence, such as the inclusion of the requirement to provide services for SMETS 1 meters.

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?

Yes, having the flexibility for the services to evolve is essential to support innovation in the market. Deciding upon what future services might be included in the core DCC activity will always need sufficient consultation with parties and the development of a robust business case.

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?

Yes, this was included in the original scope of the DCC licence and in theory there is no need to remove it.

However, the limitations in the performance of the smart metering infrastructure may make the delivery of this unrealistic in practice. Already there are concerns around how the existing technology will cope with the needs of the energy sector. This will only expand and change rapidly during the next DCC Licence period as a transition to net zero ushers in new business models that will rely much more on data provision.

It is likely therefore that the DCC's resource will need to be focused on this rather than considering the potential opportunities of the re-use of the system for alternative non-energy sector activities.

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?

Probably not, most of the DCC costs are fixed and dependant on long term contracts with service providers. Those costs that are under their direct control are influenced by project activity and new requests for services, and these are often outside of their control. An ex-ante model is unlikely to be able to determine what these costs are with any degree of accuracy.

The business model for the DCC lends itself better to the current ex-post regime of price control.

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?

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We are not sure there are any based upon the experience of the DCC budget estimating to date. All estimates have proven to be wildly wrong, not as a fault of the DCC estimation process, but because of new projects and activities that the DCC has been asked to undertake. It is difficult to see this situation changing in the future.

Question 16: 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?

It would be very difficult to see this working in the best interests of the industry and consumers.

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

It would be challenging to see how this would work without a risk of either excessive profits being made by the DCC or the service levels to users reducing to an unacceptable standard.

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)?

It might do although this may lead to unintended outcomes. The standard of DCC services is derived from the quality of the people that it employs. A regime that incentivised rapid turnover of staff and the excessive use of contractors is unlikely to provide the level of service that users would want.

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?

As much detail, shared with as much advanced notice, would be needed for DCC customers to understand whether ex-ante price controls were working.

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.

Maybe, although the resource burden from the regulator or DCC should not be a priority for the development of the price control arrangements. These should be focused on what would best deliver an outcome for the DCC users, industry and energy consumers.

A debate regarding the overall administrative burden of managing a price control for an organisation of the size and type of the DCC is better linked with the initial consultation question regarding the future nature of the DCC Licence.

We agree that the nature of the current DCC price control does incur an excessive administrative burden on Ofgem. This is a reason as to why we prefer option B and the transition of the DCC licence to a not for profit organisation. Budget control and managing efficiency moves in this option to become a continuous business as usual activity for the DCC Board.