

DCC Review: Phase 1 Consultation

Consultation on the scope and next steps of Ofgem's review of the regulatory arrangements for the DCC ahead of licence end

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Alternative regulatory models

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?

Capita supports adopting Option A, although with a modified construct, because we believe that the energy industry can get the best value and quality of outcomes from it. Our proposal is to structure the licence as a Service Agreement to better use the skills of a third-party service provider/licence holder. Rather than procure another long licence, we recommend a shorter (for example, 5-7 years) Service Agreement which focuses on outcomes and value for money. The DCC is a technology service that underpins the smart meter roll-out with deployment projects and ancillary services. These activities procured under a services contract will reduce formal structures, save money, increase efficiency and demonstrably deliver enhanced value for energy retailers and the end consumer.

The following comments reflect our views on how this change to a Service Agreement could create a more effective future service, based on the Option A model with these modifications:

- Introducing a Services Agreement, operating under standard ITSM (IT Service Management) style measures (e.g. performance management, continuous improvement, change management, benchmarking) will give Ofgem and the industry a much greater ability to change and evolve.
- A licence which fixes on a specific activity for a long period may not incentivise increased productivity and value.
- Removing the separation between licence holder and service provision will allow the service provider/licence holder greater control of service measures and business efficiency.
- A service provider with relevant industry experience as the licence holder ensures Ofgem has a speedy route to resolving performance issues that occur in the DCC supply chain. The recent distress situation of one company demonstrates the value of having a relevant capability. The risks to service continuity, quality and speed to replacement were avoided as Capita was able to quickly create a replacement service. A licence holder with a different background would have had to undertake a protracted procurement before standing up an alternative service, putting overall delivery at risk.
- For the DCC to maximise efficiencies the licence holder/service provider should have the ability to select and optimise its own supply chain against an overall architectural, security and quality model.
- Implementing an ITSM based performance regime creates visibility and openness for Ofgem and the DCC customer base. It should be responsive, have incentives and demonstrate value through comparative measures. This will encourage governance where the customers are better represented, to DCC.

In consideration of the Option B model, our summary is:

- This substantive change in the ownership, accountability and financial approach would be highly disruptive, result in slower consensus-based decision-making and creates a potential conflict of interest between industry participants and the public interest
- The lack of profit will make investment difficult to achieve and removes incentives to deliver efficiencies

- DCC operates for the public good and should be governed via the public sector, not industry.

Our conclusion:

We conclude that Option A provides a stronger foundation for the future DCC, provided it moves to a Services Agreement. It best supports the conditions needed to ensure that the critical national infrastructure underpinning the energy sector is resilient, reactive and governed in the interests of consumers, industry and broader society.

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

Capita agrees with the way in which the principles have been applied subject to the publishing of clearly stated performance measures related to required service delivery, so that any party bidding/contracting for a licence understands the regime and expectations into which they are operating.

We agree both options have been presented in unbiased manner, highlighting the strengths and weaknesses and outlining the benefits for both customer and client under either guise

It is key that there are trackable targets set that align with Ofgem objectives to ensure parties can deliver effectively against each of the five core principles (whether these KPIs are qualitative or quantitative)

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?

A Services Agreement, as opposed to a licence in Option A, would make it easier to put in place the right incentives. Retendering every 5-7 years (with change control governance), instead of a single 15-year licence, provides the periodic contractual opportunity for revised costing if needed. It facilitates evolution of the programme with any additional services to react to industry changes/trends and keeps the programme competitive.

Additionally, there is also an opportunity for greater licence holder engagement to apply their expertise to deliver more value to the DCC such as best practice, know-how, along with benchmarking of quality, performance and cost effectiveness. DCC's core function should be treated as a platform to deliver policy and technical innovation, e.g. other services can be delivered from the platform for the national good.

In summary our recommendations are:

- Move from a licence to a Services Agreement
- Allow stronger licence holder engagement to deliver greater value from the DCC
- Build in service measures around benchmarking of quality, performance and cost
- View the DCC's core function as a platform to deliver policy, technical innovation and additional services
- Include industry presence in DCC governance

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?

Option B carries with it risks that could lead to skills shortages, operational constraints and delays, failure to meet performance targets and poor responsiveness to change. With no profit to feed into investment, funding would have to be agreed among the stakeholders, which would slow down future evolution, if 20 different bodies are needed to form a consensus

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

Should a Service Agreement be adopted, we envisage a governance construct similar to industry best practice, whereby a multidisciplinary team of client (Ofgem and industry) and supplier (prime and key subcontractors) have shared visibility of clear and specific outcome-based goals

Transition period considerations

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

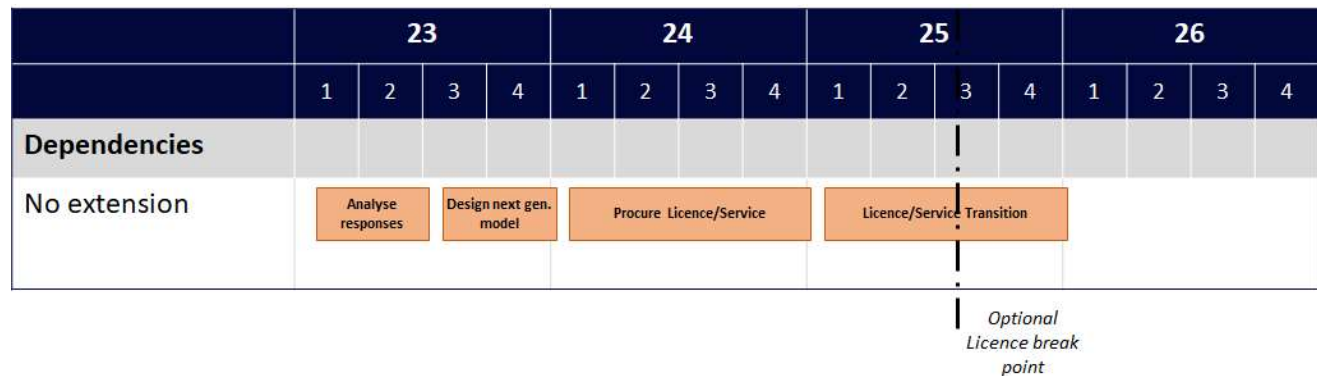


Figure 1 - likely lead time before a replacement were in place

The current licence has an option for Ofgem to extend it for up to six years. Our recommendation would be to extend this on a modified basis, moving to the measures suggested in question 1

The lead time for procuring and transitioning to a new service provider or licence holder will be at around six months beyond the current optional break point (Figure 1). The considerations we identify below assume a process of this length, starting mid-year 2023. Figure 2 below shows other events occurring within the industry that might impact the success of the new arrangement.

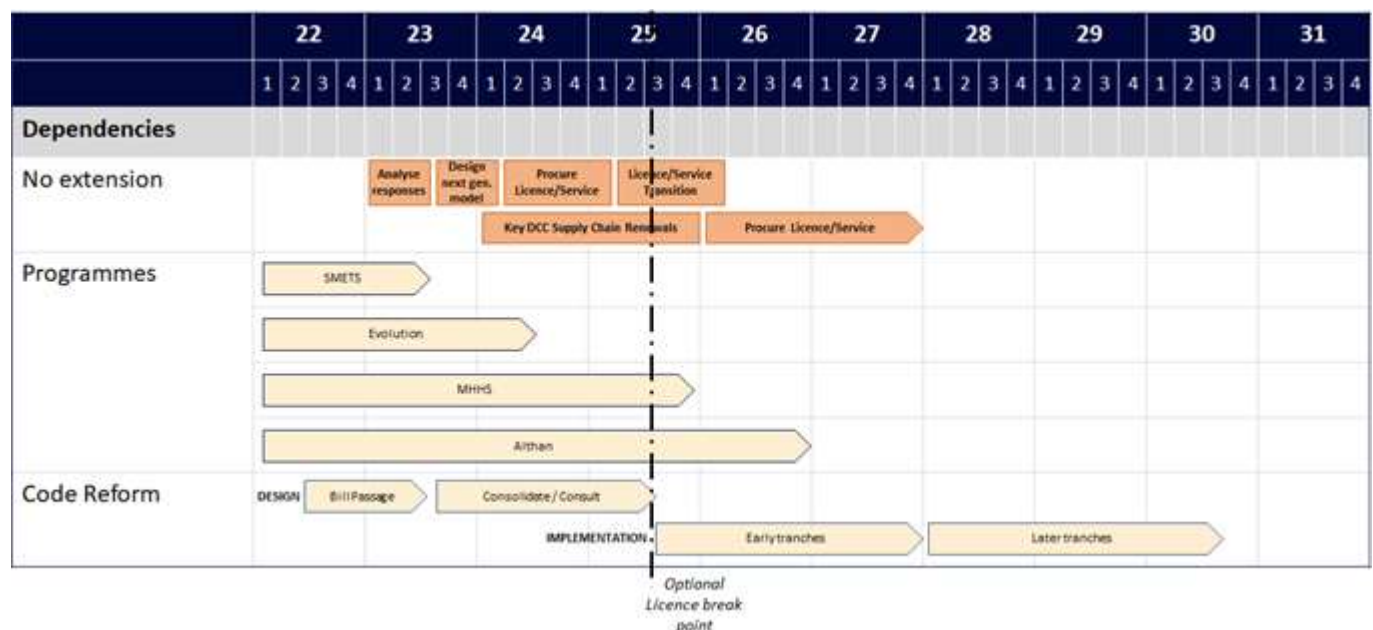


Figure 2 - events which could affect licensee review

The final and most complex part of the rollout of smart meters is due to occur shortly after 2025. Any new licence holder/service provider will be ill prepared for the risks and challenges likely to occur during that period.

Key supply chain renewals will occur in the period 2024-2025. To provide these suppliers with the ability (and incentive) to adapt to a modified regime will require appropriate term future contracts which can only be achieved with a sufficient extension duration.

Over the next few years, the energy industry will also be focussed on addressing key challenges such as:

- Renewables/net-zero
- Adopting a model for code reform and restructuring between essential and optional functions
- Network price controls (RIIO-ED2, RIIO-T2 and RIIO-GD2) rolling through to 2028

Each of these programmes could have a profound impact on the structure, processes and pricing approach of the service delivered by DCC today.

The impact of some of these will not be fully understood until 2028, or beyond, and as such any procurement of a new licence or Service Agreement in advance of 2028 risks being focussed on the wrong model, requiring significant change, making forward pricing difficult and may not as a result deliver the best value outcome.

Ideally any new licence holder or service provider should be brought on stream once code reform, half-hourly settlement and critical phase of Smart Meter Rollout is complete allowing for a stable operation. Based on current knowledge, this could be up to a year after 2028 completion of key events. A flexible arrangement can be found that supports this transitional period, while capitalising on the know-how of the incumbent licence holder, that will deliver the best value for money and certainty for Ofgem and the DCC customers. This creates an opportunity for Ofgem to run a competition for the service when a lot more is understood about the shape and needs of the energy industry in the UK.

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

We agree with the assumption that neither option can be fully achieved within 18-24 months following design (Fig 1). The competition and handover phase under Option A is likely to be similar in duration to the legislative change, licensee or service provider selection, consultation and board appointment process under Option B. The latter has more variables and complexity and therefore the time assumptions may be ambitious.

We anticipate that from the point of design, there is likely to be a thirty-month lead time for change to be tested, iterated, baselined and incrementally embedded into BAU.

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?

In our view the three key dependencies fall into three categories.

1. Programmes

When the current licence comes up to the optional break point in 2025, several critical programmes (including SMETS, Marketwide Half Hourly Settlement (MHHS), Evolution and Althan) will be in flight. The risk of disruption to these activities would manifest itself in terms of delayed ability to launch time-sensitive tariffs, to balance the grid as heating and transport become increasingly electrified, and to prevent some of the most vulnerable members of society from accessing the smart meter network.

2. Code reform

Whilst DCC can propose and be consulted on code change, it is ultimately the role of the code manager to determine DCC's priorities. We assume that due to the time required for the passage of the bill through parliament and the subsequent need to consult on options for consolidation and appointment of the code manager, limited code reform is anticipated prior to the time the current licence potentially expires. We further assume that early tranches of code reform are likely to be implemented within the first three years of the current licence break option.

3. Re-procurements

The DSP procurement will coincide with key phases of preparation for licence potentially expiring, in terms of tender, legislation changes and/ or board recruitment, depending on whether option A or B is pursued. There are also risks associated with undertaking critical design phases of DSP procurement soon after the appointment of a new operator, should DCC2 have a different owner. Finally, the flexibility of some of the other contracts gives potential to extend and co-terminate, allowing DCC2 to streamline the procurement of its supply chain

Based on these assumptions and considerations we make the following observations:

No extension

Exercising the optional break point in the licence in September 2025 and replacing it with arrangements under Option A or B, while speedy, presents the following risks:

- The lead time for re-procurement and transition would truncate the design period which might be suboptimal
- Change will be constrained by the timing in which it will be implemented
- Running DSP procurement concurrently is likely to create distraction.
- A new service provider will need to manage the safe and successful conclusion of some of the most complicated aspects of the programmes, such as MHHS and Althan

Extending for up to 3 years

Deploying and testing aspects of a new model, prior to retendering after 2028 represents an effective balance between rapid change and risk mitigation. It is in all stakeholder's interests to migrate to an improved model prior to competing the next licence/Service Agreement to validate the future model.

Assuming that at least some early tranches of code reform are likely to be implemented between 2025-2028, the design of DCC2 could better reflect the code management system and code manager's determination of DCC2's objectives. At the same time the industry will be focussed on key challenges such as the network price controls (RIIO-ED2, RIIO-T2 and RIIO-GD2) rolling through to 2028. Each of these changes could have a profound impact on the structure and pricing approach of the service delivered by DCC. The impact of some of these will not be fully understood until 2028 or beyond and as such any procurement of a licence which starts in advance of 2028 risks being focussed on the wrong priorities from the outset.

Extending for 3 to 6 years

We note Ofgem's observation that extension to 2031 is perceived to be unpalatable to key users of DCC unless the changes that can be effected in the meantime are material. Changes to governance, pricing regime and service management approach can be provided in this period to mitigate users' aversion to delay. They de-risk the long-term future of the DCC's services and provides a model for future competition. Early tranches of code reform are likely to have been implemented and later tranches will be taking shape. CSP procurement will have been completed and there is scope to extend some of the other key contracts to make them co-terminate

As a final point, it is worth reiterating the external dependencies on the smart metering programme. Success of this programme has ramifications for key areas of government policy – net carbon, critical infrastructure, civil contingency etc. The cost-effect of a failed or disruptive transition could far outweigh short term incremental savings from a hurried approach.

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?

We view the potential for evolving the regulatory framework before and during a transitional period as the best outcome for all parties. Our responses to your questions reflect our suggestions for potential change.

Future Role of the DCC

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

Yes, we agree with the proposed scope of the future DCC's Core Mandatory Business (CMB). As part of the UK's critical national infrastructure (CNI), any activity that is necessary to maintain the DCC service should be CMB. The essence of delivering the core service includes the comms, and then its maintenance, security, enrolment, onboarding and switching are reasonable.

There must be flexibility in what is defined as CMB, which is why we believe a services contract should replace the license as it provides opportunity to update the scope regularly and appropriately as new technology and energy sources emerge, and industry and government priorities change.

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'?

The future framework should allow the DCC to undertake additional services when it is logical to do so for economic, effectiveness or speed reasons.

It is not possible to predict the scale of change during / after transition period and as we progress, for example, towards net-zero. There must be contingency to provide additional services to best support and achieve the core outcome for customers. Change should be an intrinsic part of the framework to allow DCC to evolve and add new services aligned with altered consumer demand and national interest.

It is key that the 'mandated services' deliver any activity that is necessary to support the DCC's CMB. 'Ancillary services' are critical to driving improvement to the CMB that is not otherwise covered by the 'mandated services'. The DCC is required to provide some non-core services at their discretion with the aim to improving customer outcomes.

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, the proposed uncertainty mechanism (Change Control) detailed in section 5.26 should provide the flexibility to react to developments that may require change in the DCC remit. It also has the governance and stage gates to ensure any change is managed appropriately.

As part of adopting ITSM, a well-defined Change Management process will allow this to be managed appropriately and take into account major drivers such as: impact, customer expectations, policy / regulatory change and technology evolution.

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?

UK energy consumers have made a huge investment in creating the DCC network, its data sets, and wider capabilities. Encouraging wider utilisation and reuse of DCC capabilities further leverages this investment and the creates the opportunity for self-funding.

A key aim for the smart metering programme should be to maximise benefits (in the form of decarbonisation, policy delivery, supply resilience, economic growth, lower consumer costs and equity between demographic groups) that can be derived from this infrastructure and data, rather than be

limited by the narrow definition proposed, that “The primary objective of any commercial re-use should be to generate benefits flowing back to DCC customers.”

The short to medium term will see another step-change in industry data volumes and storage which can be harnessed to further benefit the decarbonisation of the economy and economic growth while being mindful of equity between different demographic groups. We are agnostic about which organisation(s) should be responsible for enabling this benefit to be derived but can see a role for DCC2 in facilitating secure data exchange to drive change, foster an innovation ecosystem and enable technology-driven transformation in the energy sector and beyond.

The key considerations would be: target operating model, funding mechanisms, principles of re-use and governance.

Price control change considerations

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?

A hybrid model seems to be a sensible way forward where the decision for choice of a specific model is driven by the cost certainty, identified through baselining, risks and predictability of demand within the service.

It is possible to move from ex-post to ex-ante, as stability is achieved.

While the preparation of a firm price regime takes time to agree and involves regular processes of monitoring, it should simplify and speed agreement when 'unknowns' occur.

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?

If the activities of DCC were broadly split into operations and programme, then the operations component probably lends itself to a firm or unit pricing approach (ex-ante). Included in operations for the purpose of this exercise might be security, technology, support operations.

The more variable elements would include programme work, such as set up, rollout, programme management, new scope, innovation or agreed continuous improvement projects (i.e. ex-post).

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?

Under the construct of a 'Service' model, whereby core elements are known and understood, it should be entirely reasonable for DCC to bear risk, whilst being incentivised to innovate and deliver efficiencies back to customers. A mechanism whereby customers are protected via a capped level of exposure, and DCC are incentivised via a form of gain-share for effective controls could be deployed.

In our opinion the use of a mechanism, such as a 'Target Cost, Incentive Fee' (TCIF) contracting model, would incentivise DCC to control overspend, but be rewarded proportionally for innovation and cost control over the known core services.

As new, non-core opportunities emerge, these can be added via change control, and be subject to similar TCIF arrangements, providing a continuation of the incentivisation for cost control over the life of the Service contract.

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

Continuous Improvement (CI) can be core to any service management regime. Pricing on a firm basis and showing how CI can reduce charges over time, for a stable volume, predictable, service is quite possible. It incentivises the provider to apply innovation. To do this the provider needs control of its supply chain and the freedom to incentivise the supply chain to behave in the same way and to optimise it at will. For Ofgem and the customer base the construct of the supply chain under DCC should be irrelevant if service quality, security and obligations are being met

Embedding the culture of CI in service management regime will always work best if supported via an incentivised contracting model that rewards the service provider for effort in improvement, as well as returning savings (at scale or otherwise) to the consumer. If there is no improvement 'upside' for the service provider, there is a risk that CI will achieve the low hanging fruit only, and not address potential areas of most gain. This would require additional effort, which should attract commensurate reward for that service provider effort.

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 (eg provisions to allow clawback in case of delivery failing to meet specifications)?

A move away from the licence model to a Service Agreement approach should provide protections against underperformance.

By setting a floor level of service performance required, with Performance Indicators (PI's) and Key Performance Indicators (KPI's) suitably structured to incentivise high levels of performance, the need for potentially complicated clawback provisions can be negated.

Additionally, within a service-based approach, the culture of TCIF and CI are naturally embedded within any agreement, this incentivises current performance and drives an on-going performance improvement culture.

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?

A TCIF ex-ante model is a well understood and we recommend standardising submissions related to operating expenditure, volumes, outturns and risks to be assessed against the baseline cost model structure.

The best way to prove value for money is to independently benchmark DCC service delivery every 2-3 years. The supplier terms and remedial actions in relation to benchmarking can be mutually agreed as part of introducing the mechanism. Any client mandated, or licence constraints in the service should be factored into the benchmark as should regulatory or other business change.

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?

We think this is unlikely as performance management is required across all levels and therefore a move to ex ante would swap the work effort from disallowance discussions to forecasting with accurate projections and change control mechanisms. As the core stabilises and a baseline has been established, management of the core may become less onerous and the focus for performance management will naturally shift to change and evolution.

It is important to consider appropriate timeframe for trueing up ex-ante reconciliation, likely annually, with in-year impact assessments for recalibration of material changes.