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Sent by email to: DCCregulation@ofgem.gov.uk

Dear Ayena,

Centrica welcomes Ofgem's consultation on DCC Licence Review, phase 1. Our response is non-confidential and answers to Ofgem's questions are attached in the annex.

We prefer delivery model (option) B for the new DCC licensee. However, ensuring that the detail within the regulatory framework is balanced in favour of end consumers with greater transparency for industry parties is key to the success of the regime.

We strongly believe that no transition period is needed given we have almost 3 years until the current DCC Licence ends, and it can be extended by up to 12 months at relatively short notice.

Please do not hesitate to contact myself or Alun Rees if you have any questions.

Yours sincerely,

Rochelle Harrison

Regulatory Manager
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Annex

Chapter 3
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?

The right regulatory delivery model for the DCC licensee depends on the detailed regulatory framework. Whilst we prefer option B (industry led and not-for-profit) we would need to understand the details to assess whether it ensures end consumer impact is minimised, with transparency and value for money for DCC Users, particularly those users that fund the Licensee.

We need to understand details such as:
- Which parties approve annual budgets and charging statements (regardless of price control mechanism)
- The appeal process for annual budgets
- Level of transparency and engagement in costs, contracted performance, and remediation
- Appointment, scope and number of industry and consumer representatives on the Board and their level of accountability to stakeholders and Ofgem

With option B, an Elexon style model could work well for the new DCC licensee, particularly being non-profit and industry accountable. However, we would not support an Xoserve model, where the entity has limited or no accountability to Ofgem.

In either option A or B, greater transparency to DCC Users and minimising end consumer impact must be included in the governance framework.

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

No, we recommend that Ofgem makes the following changes to the principles:

Principle 1 - we believe that the regulatory or delivery model should be based on outputs consumers need DCC to deliver, i.e., a performant ecosystem - reliable, secure, and scalable, and value for money. As mentioned in the webinar, quality is a subjective term and needs to be swapped with reliable.

Principle 4 - The role of the DCC will evolve as the smart metering infrastructure stabilises and Government / The Authority ask DCC to include further programmes into its mandated business. The evolution to net zero should not be led by DCC but must be supported by its ecosystem and data, once we understand how GB will reach its targets. For the avoidance of doubt, a monopoly business should not use its assets, systems, data, or processes to gain advantage in a competitive or potentially competitive market. We would expect to see this exclusion included in the new DCC Licence.

Principle 5 – allowing DCC to maximise its value of assets leads to distraction from its core purpose, especially in a Shareholder led organisation, which is profit focussed. We believe principle 5 should be removed.

The weighting for principle 3, enable full accountability and clear governance, should be 0.3, given its importance and the final two principles, 4 and 5, should total 0.1, i.e., 0.05 each. Alternatively, principle 5 is removed and principle 4 keeps the weighting of 0.1 (and principle 3 is 0.3).

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 remain unconvinced that option A, even with some licence changes will provide a reliable, secure, and scalable smart metering ecosystem that is value for money. We understand why Ofgem would see this option in a favourable light; with the ability to incentivise performance via profit margins and potentially less regulatory input needed. However, including a consumer and / or industry champion within the Board structure and ex ante price control regime are not enough to ensure all the top 3 principles are met.

Stronger ties to the Smart Energy Code and enabling modifications to impact Service Providers' contracts are required, alongside licence changes that align to Energy Suppliers' and Networks' Licence obligations related to smart metering.

Changes will be needed to ensure that DCC Users have transparency over the costs and perhaps an Authority representative on the Board that can veto non mandatory business (ahead of spend). DCC User categories should also have seats on the Board to help balance user impacts from commercial decisions. For example, 1 seat per category, such Large Suppliers; Small Suppliers; Distribution Networks and Other Users.

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

Accountability will be the key principle to get right. It is difficult to assess without further details.

With the right resources in place a not-for-profit organisation should be able to deliver the balance of system performance and value for money, through being accountable to peers in the energy industry and consumer bodies.

Whilst a not-for-profit will not have shareholders to deliver a profit for (reducing cost), we believe it could achieve incentive payments (for hitting performance targets), which are ringfenced and invested into future services that benefit energy consumers and net zero. Therefore, well-structured incentives should ensure the right behaviours rather than the threat of Licence breach.

For clarity, we do not advocate the DCC being in public ownership.

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

Whichever model is chosen we expect, and consumers need, Ofgem to be involved with a properly resourced team to support and challenge the new DCC Licensee.

Chapter 4
Question 6: What are your views on the options identified and the associated trade-offs for a possible licence extension?

We believe that no transition period is needed and there is no perfect time to transition given all the system developments and contract changes in the pipeline.

We have almost 3 years to retender for the DCC licence with options to extend the contract by up to 12 months at relatively short notice. The shorter time will focus minds and encourage participation from key industry players. The RECCo was set up and delivered faster switching in a similar time frame and the DCC will not have a standing start with many contracts novating to the new Licensee.

Extending the contract with any transition period will incur duplicate costs of running the DCC and reduce accountability for delivery as both new and old DCC could blame each other for failures. There are no benefits to consumers, except possibly risk mitigation by extending the transition period.

Perhaps the transition period should only relate to certain activities in DCC, or employees / contractors must be TUPE'd into the new licensee. For example, certain contract managers may need an extension for contracts being re-tendered / renegotiated, rather than the whole Commercial function.

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

The consultation periods, policy development and set-up areas appear to be generous in the time estimated. We also feel the selection process in, particularly in option B, could be started much earlier and allow the new entity to start the handover process prior to Sept 2025.

We firmly believe an exclusion period is required in the transition plans to allow a more competitive process, where Capita is excluded from inputting into the Licence process and from renewing or signing contracting with external parties for post 2025/26 services.

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?

The key dependencies are any major industry programmes and contract negotiations with DCC's Fundamental Service Providers that fall within or just after 2025. Therefore, Data Service Provider (DSP) contract, Market Wide Half Hourly Settlement, SEC releases, 4G Comms Hubs and Wide Area Network, which can be well managed, and risks mitigated if the new DCC licensee is quickly established with the skilled and knowledgeable resource.

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 have not considered the incremental changes required in the transition period but happy to support Ofgem once more detail on the regulatory framework is known.

Chapter 5

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

Yes, we agree with Ofgem's proposal and believe that the DCC Licensee should be prevented from engaging in commercial activity in already competitive or likely to be competitive markets unless explicitly mandated by Government or the Authority.

We agree with RECCo's assessment that the conflict in priorities in DCC's Licence objectives and recommend the removal of part c in the second general objective, related to Value Added Services.

Also, one such area that we consider is non-core of DCC's current offerings for Testing Services.

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'?

DCC must concentrate on the delivery of core and mandated services, which can evolve over time for the benefit of energy consumers and net zero. We believe that ancillary services, if offered, should be paid for outside of the fixed charges as are explicit and elective costs.

Any ancillary service must not adversely impact the core or mandated service either from capacity constraints, process changes or additional cost.

We believe that DCC will need to meet certain conditions (to be agreed) before exploring non-core business. These conditions will need to be measured and met to the satisfaction of funding parties.

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 with the first two triggers; change in customer expectations and consumer needs, and new policy or regulatory requirements. However, including the trigger for evolving technology could lead to wasted resources and 'pet' projects, which benefit only the Licensee. Only following a review of a transparent business case and risk assessment with the SEC Panel and Authority could evolving technology be instigated (as seen with 4G CHs and WAN).

We are unconvinced that any of these triggers need an uncertainty mechanism and would welcome more detail from Ofgem.

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?

Whilst we agree that the re-use of DCC infrastructure should benefit end consumers with lower costs, we are concerned that the Licensee will explore re-use / business opportunities which waste resources and potentially conflict with the other commercial organisations.

We have the following comments on each area highlighted in table 5.3 (pages 74 and 75):

- Maturity level – focus on Mandatory Business is essential but we disagree that DCC is 'unlikely to reach a fully stable state'. All organisations are evolving and improving, it does not make them unstable. It should be possible to find guidelines that protect consumers here.
- Governance – agreed. We believe the SEC panel (and sub-committees) could support the approval process.
- Funding – no organisation should receive re-use of the DCC infrastructure for free, especially if it benefits from the resources (system, data, expertise etc.). As a minimum the funding regime should be cost plus. However, if system capacity is at risk, the charge should include the marginal cost of increasing the capacity (regardless of whether the re-use breaches capacity or not).
- Risk – agreed. Any re-use of the DCC's infrastructure must be tightly controlled to not impact the processes of its users or the service to end consumers. Prior to re-use, a performance threshold must be reliably reached over a period of several months. Once live, SEC Panel and / or the Authority should be able to pause the service until any issues have been investigated and resolved.

- Benefits distribution – agreed.
- Competition – agreed.

Chapter 6
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?

The hybrid model should only be used for an option B organisation. DCC will need good reporting systems and clear processes for employees working in ex ante regime and those in ex post. We expect DCC to be transparent about its assumptions and reporting.

An ex-ante only regime should be used for option A, shareholder led organisations. A hybrid or ex-post regime will / has led to perverse incentives to inflate the organisation's size, whilst shareholders' benefit from very low risk.

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 believe very little cost will need to remain ex-post, as DCC and smart metering is already relatively stable and will be more so by 2025. For example, all the following are known entities (by the Licensee):

- SMETS2 spend including 4G and Service Provider costs,
- SMETS1 costs including Service Providers,
- Communications Hubs (costs will need to be provided with price and volume assumptions, split between Single and Dual band 2G/3G and 4G), and
- DCC internal costs including Service Management, Service Desk, Programme teams and back-office functions (Finance, Regulatory Affairs …)

The only uncertainty mechanism could be for the competitive tender of the north CSP region and other Fundamental Service Providers if the contracts end before 2040.

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?

All underspends should be given to end consumers who ultimately fund the DCC and carry the risk.

If DCC has overspent it will need to be transparent with its assumptions in the ex-ante budget, how the market changed and the impact of not resolving. DCC should expect strong challenge and be able to discuss what and how mitigations were used and each mitigation's impact.

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

We would rather the DCC, and its ecosystem worked efficiently and effectively than receive cost savings. Incentivising cost savings has not brought efficiency to the current system as Capita has concentrated on renegotiating finance rates.

The main purpose of the DCC Licensee is to manage contracts with external Service Providers, maximising efficiency, and effectiveness to reduce costs. DCC should not receive addition funds for carrying out its main role / duty.

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)?

We believe underperformance risk is more likely with an option A organisation, as it cuts back on resources to reduce costs and meet its ex-ante budget. Clawbacks for performance failure or Guaranteed Standards of Service may be helpful here, however we still need the performance regime to measure the areas that impact end consumers.

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?

We would expect greater transparency from an ex-ante regime, with detailed budgets by department and project / programme ahead of the Regulatory Year, which DCC funding parties are able to challenge and appeal to Ofgem. The Licensee must be able to explain any movement in the annual budget compared to the ex-ante business plan submitted. For example, detailing changed assumptions, movement in programme delivery, additional resources required and why.

As with the current Licence, an indicative charging statement for the next RY and indicative budgets for the following two years after that (including prices) would be welcome. We would also welcome having a finalised charging statement in August / September for the next RY (starting in April) to help with our financial planning processes.

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.

Yes, we agree that an ex-ante model has the potential to reduce resource burden on Ofgem, DCC and the industry. However, reducing regulatory burden should not be the deciding factor in the new DCC licence regime. Ensuring that end consumers' needs are met from smart metering at a cost that is value for money must be the overriding criteria.