Retail Energy Code Company Ltd
27 Old Gloucester Street
London, WC1N 3AX

Retail Energy Code Company
info@retailenergycode.co.uk
www.retailenergycode.co.uk

Industry Code & Licensing Team,
Ofgem.
By email only: industrycodes@ofgem.gov.uk

16 January 2023

RECCo response to Ofgem's Energy Code Reform, Call for Input

We welcome the opportunity to respond to this call for input ahead of anticipated further consultation on energy code reform. Our non-confidential response, appended to this letter, represents the views of the Retail Energy Code Company Ltd (RECCo), and is based on our role as operator of the Retail Energy Code (REC).

RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation, and competition, whilst keeping positive consumer outcomes at its heart. We are committed to ensuring that RECCo is an "intelligent customer", ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, include those which constitute the REC Code Manager.

As a newly formed industry code, merging its predecessor electricity and gas codes, we have had early opportunity to deliver streamlined operational and governance arrangements for the REC, and continue the work to consolidate arrangements where helpful and appropriate. We consider that all code bodies should be expected to pursue such continual improvement to further facilitate their own objectives and deliver wider benefit to the industry, and ultimately to consumers. Therefore, whilst we agree that energy governance landscape must as whole become more effective to meet the challenge of decarbonising the industry, it will be important to ensure that the proposed reforms do not inadvertently stymie any beneficial change in the shorter term.

We are happy to discuss any of the points raised in this response, and to share lessons learnt from our experience of establishing the REC and procuring services, including those which constitute the REC Code Manager.

Yours sincerely,

Jon Dixon

Director, Strategy and Development

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?
RECCo supports the adoption of Option B as the basis for designing the future regulatory framework of the DCC. Whilst we note the improvements Option A offers over the current regime, we believe that Option B would substantively change the incentives upon the DCC licensee to deliver better service and drive value for money for its users and ultimately for consumers. **Current Issues** Over 80% of those who responded to Ofgem 2021 call for evidence agreed with Ofgem's rationale for exploring more substantial change than can be delivered through a competitive re-tender of the licence alone. We consider that continues to hold true for the incremental improvements offered by Option A. The current model, which essentially employs cost-plus pricing of a monopoly service, has seen costs rise considerably over the term of the licence, with a further 10% increase on forecasts from last year. At £4.4bn over the current 12-year licence term (2013/14 – 2025/26), DCC costs are now 125% greater than the £1.949bn forecast by Ofgem in November 2014[1]. Although the ex-post model enables Ofgem to disallow significant sums, these are small compared to the overall increase. We consider that for any costs incurred it is incumbent on the licensee to demonstrate at the budgeting stage and prior to expenditure that such costs are economic and efficient and in full compliance with the licenced activity. Such an approach would avoid the burden of proof which appears to be asymmetric, with Ofgem being required to identify and justify the disallowance of cost rather than upon the DCC to provide adequate evidence that they are both efficient and necessary in discharging their obligations. The current approach also provides limited transparency of opportunity for funding parties to scrutinise costs and what drives them. The current model and division of internal and external costs places a heavy reliance upon Capita personnel and contractors for the provision of services to DCC. We are keen to understand the processes that are in place to ensure knowledge transfer and retention, and operational continuity, both in the near term and in the event of the licence being awarded to another party. As part of this review Ofgem should also consider the dependency that wider industry functions, programmes and deliverables have upon the DCC. For example, DCC's forecast costs for their ongoing switching service provisions submitted to us at the end of November 2022 are c.80% higher than had been forecast by them in 2021. If unchanged, this will result in an increased 2023/24 budget[2] for REC parties. In line with our role as intelligent customer and having carefully considered the rationale provided by the DCC, we have challenged its estimates and will use the powers available to us under the REC, including referral of the budget to Ofgem for determination, if required, to ensure the costs charged are economic and efficient. We understand that this process is not available under the Smart Energy Code in relation to other DCC costs.

[1] See: DCC Price Control Decision Regulatory Year 2020/21 | Ofgem

[2] See: RECCo Forward Work Plan and 3 year financial projections

We are also concerned to ensure that the DCC is more responsive to requests for Impact Assessments of change to its systems and that those assessments produce accurate and robust estimates of cost, evidence suggests this has not always been the case under the Smart Energy Code.[3]

Option A

This consultation does not provide a 'do nothing' option, which is welcome given the issues highlighted in the 2021 call for evidence. While Option A may offer some improvement overall, we are concerned that such incremental improvement may not fully address those issues and may be a missed opportunity not again available for the remaining duration of this DCC licence, and potentially beyond.

A switch from ex-post to an ex-ante price control may be beneficial, but we believe that neither model is ideally applicable to the characteristics of the DCC systems. There should be greater scope for budget setting through negotiated settlement with the parties who use and fund the service, rather than a regulator that may have an incomplete knowledge of their needs and/or appetite for risk when balancing factors such as certainty of pricing versus adaptability to change.

In addition to any disallowed revenues through Licence, DCC should be subject to a Service Level Agreement performance regime for service delivery, like the Switching Incentives that have been proposed.[4] The principles could be applied to the Smart Meter programme and any future initiatives undertaken by DCC.

Option B

Overall, RECCo support the adoption of Option B. However, Option B currently contains a subset of design options rather than fully defined variations with an assessment of each. We consider that there is merit in greater consideration of each subset where the main characteristics and the implications of each are fully assessed. We provide comment on the elements that make up each subset below.

Option B1 – All or a subset of SEC and REC Parties

We believe development/implementation of this as a model would best address current DCC regulatory framework challenges, leading to a more industry customer/consumer centric delivery focus, significantly increase scrutiny, transparency, and oversight while reducing costs and improving performance.

In developing the framework, it is vital to understand the ownership model as this will no doubt drive other factors such as governance, accountability and price control approach. In our view, this model would consist of a sub-set of industry parties having notional ownership of a not-for-profit organisation with an independent board that includes customer and consumer advocates and an operational executive.

Given that the DCC operates a monopoly service that is not just fundamental to the operation of the gas and electricity markets but is also recognised as being part of the critical national

[3] E.g., SECMP007 as referenced by Ofgem in its consultation on the DCC Price Control for RY21/22, and SECAS response to that consultation noting that only 6 of 26 Preliminary Impact Assessments and Final Impact Assessments from DCC were returned in the timescales set out in the SEC.
[4] Ofgem consultation – DCC Switching Incentive Regime, and accompanying REC Change Proposal R0025: Service Provider Performance Charges

infrastructure, we believe that DCC could suitably be a not-for-profit organisation whose primary duty is to act in the interests of GB consumers and the public rather than of shareholders. Consequently, it should be owned by its principal stakeholders who are responsible for its funding, which is ultimately derived from consumers.

This model has the potential to simplify the approach to the price control regime by moving towards a negotiated settlement approach whereby the parties who use and fund the service can raise robust challenge to costs. Both the Board and Executive in this model would be accountable to its stakeholders for performance. Budgets would be open to greater scrutiny and challenge providing greater transparency to DCC stakeholders. Services to industry could be formalised via contracts and service level agreements that result in service credits or liquidated damages being recovered from service providers where performance fall short.

Option B2 – Public ownership

This option may contain many challenges in its establishment, due to the legislative changes that are likely to be required, an indicator of which may be the separation of the Future System Operator function from NG ESO. We question whether it is efficient and proper for government to have day-to-day operational control over such services, even if indirectly through a public agency. The balance between ownership and operational management, would need to be carefully managed. While this could be supported through the appointment of a body such as an independent Code Manager, acting upon strategic directions from the government or regulator as appropriate, it would crucially need to retain discretion on the selection, procurement and optimisation of service delivery. It would also be important that such a body is itself appropriately accountable. However, it does appear to be a valid option to consider.

Q2. Do you agree with the way we have applied the principles in our analysis of the options?
RECCo agree with the principles and weighting that have been identified to analyse these options. We believe that it is right and proper that some principles such as consumer focus and customer centricity are given greater priority.

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?

Option A assumes that the licence changes could be used to provide different incentives, and that the shareholder model would continue with the current or new shareholder in place. We have identified a range of issues with this model in our response to question 1 above.

If Option A is taken forward, there are several design features that should be considered to ensure the objectives of this review are met, as set out below:

<u>Governance</u>

The current Board constitution is revised so that it includes more independent members and directors, which can better represent DCC customer and ultimately end consumers. This could also include a government/Ofgem representative that can introduce greater transparency and reduce gaming or obfuscation of information.

<u>Separation</u>

There should be greater separation between the shareholder and DCC, so that the priority is always the delivery of DCC objectives and its core role. DCC services above a certain value should be subject to a full competitive procurement process. The shareholder should not be precluded from submitting a bid, but they should be assessed by an independent panel.

Funding

Operations

A large part of the operational function of the DCC is contract management; to procure and manage external service providers. Therefore, DCC should be able to provide certainty around costs that can be budgeted for via an ex-ante regime with a negotiated settlement approach whereby the parties who use and fund the service can raise robust challenge to costs.

Projects/Programme

RECCo recognise that where there are new long-term programmes or projects it can be difficult to accurately predict the level of costs with reasonable accuracy and there needs to be sufficient flexibility to allow for some uncertainty within the funding mechanism. Nevertheless, a different approach could ensure the same outcome. To increase transparency and manage costs, each new programme or project should be required to produce a needs case which should step through each stage Initial Needs Case/Final Needs Case (similar to Strategic Wider Works projects[5]) so that the whole industry can scrutinise costs and understand benefits. Moreover, where the energy industry has historically delivered large programmes, costs are ringfenced from operational costs and the programme costs are managed by the oversight body projects team. This approach could be applied under Option A.

Assessment of costs

To bolster this approach, engagement of independent auditors or assessors could ensure greater accuracy of costs, the allocation of costs to correct budget lines and most significantly ensure that competitive tendering is undertaken for all material value contracts. This model is successfully applied in the UK Offshore Wind programmes[6]. Only once the independent analysis is complete should the Ofgem 'Economic and Efficient' assessment occur, which would also reduce the Ofgem resource required to carry out such assessments.

Benchmarking

Whilst we recognise the problem with finding a direct comparator for the DCC as a whole, we would welcome further use of benchmarking where practicable for the component services and activities which make up the total cost of the programme, both in terms of capital (external costs) and project management (Internal costs). Such benchmarking would facilitate better cost management and mitigate against costs and reduce the potential for future cost increases.

Contingency

Where contingency is allowed, it should be clear from the outset how and why it may be drawn down, including the processes and procedures to ensure appropriate rigour. Incentives could be applied to ensure contingency spend is only used in line with the parameters set.

[5] Strategic Wider Works guidance | Ofgem
[6] Offshore Transmission: Cost assessment for the Galloper transmission assets | Ofgem

Q4. 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?
RECCo believe that Option B, specifically an ownership model that consists of a subset of industry that is non-profitmaking, with an independent and suitable constituted Board, would provide significantly better quality of service and lower costs to DCC customers. We have experience of having successfully adopted this model to manage the REC, where RECCo acts as an intelligent client of outsourced services. To support its wholly non-executive and independent Board, RECCo has a professional Executive and core team with skills and experience that manages outsourced contractors, delivery operations and change effectively. Option B, as we have described above, would be a significantly different proposition to the current regulatory framework, or that which is proposed under Option A. We believe it would remove the drivers that are set by a shareholder and can re-focus performance for the benefit of customers and end consumers. We would strongly advocate the use of this model and set out our assessment of this option below. <u>Governance and oversight</u> We recommend an independent Board that has better customer representation and a consumer advocate so that stakeholder interests are fully embedded in the oversight regime. The Board and Executive would be accountable for performance of DCC, which would increase the oversight and transparency of DCC. We also support there being a robust performance assurance regime in place, as this will strengthen the Board's capability to assess performance against contracts and service level agreements, offering stakeholders greater transparency of costs and deliverables. <u>Economic and efficient</u> This model would potentially remove the need for a complex price control regime. A not-for-profit organisation would encourage and incentivise DCC to negotiate and manage contracts and internal resources for the longer-term benefits of users, and ultimately consumers, rather than potentially maximising revenue for a shareholder. Operational costs would be established and budgeted upfront (as per an ex-ante model) but would also be subject to scrutiny, challenge and appeal. <u>Funding and Management of uncertainty</u> As with most new programmes or projects that are currently managed by industry, costs could be ringfenced from operational costs for core mandated activity. The new independent Board would provide oversight on new projects and hold the DCC Executive to account. Business/needs case would have to demonstrate the benefits of undertaking new programmes.

Q5. Do you have any views on the details of Options A and B?
Whilst Option A is described in detail, Option B has several options that could be seen as additional options rather than variations of Option B. For instance, a public ownership model would be quite different from a stakeholder Board model.

To ensure each option is fully and properly considered, Ofgem should look at Option B as several separate options, which are then assessed individually. This will ensure the greatest understanding of each model and potential impacts rather than bundling all possible solutions into one heading. Please refer to our response to Question 1.

In addition to this, we think further consideration should be given to the different roles the DCC has in relation to the Switching services and how they are best delivered in these options. There are essentially two roles:

- it procures technical services (Registration Service and Address Service which together make up the CSS); and
- delivers the Switching Operator (SO) function that supports the robust and efficient operation of the switching arrangements e.g., through its service desk and incident resolution.

We consider there should be a segregation of these two roles to ensure that any potential conflict of interest is removed and that the SO treats all service providers, including the Switching Data Service Providers (e.g., DNOs, EES and GES) in an equitable manner. This could be achieved through a formal separation between the CSS and SO services; or, at the very least, requiring a compliance statement evidencing the controls and enacted measures to ensure that DCC is performing it’s SO role in an equitable way to best meet consumer requirements.

More fundamentally, we believe that the CSS should be separated from the Smart Meter licence provisions, therefore allowing the future funding of the CSS to be undertaken on a fully ex-ante basis, and potentially ahead of the wider licence review. We discuss this more fully in our response to Question 6 below.

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

RECCo believe that an early decision on the options is preferable, and that delivery of the option should be undertaken within the current licence period, at least with the shortest possible extension. It is critical that improvements to the current model are made swiftly so that a new, more effective regulatory framework is operational and able to bring benefits to both customers and consumers alike at the earliest opportunity. If Ofgem decides to extend the prevailing licence, it should consider how incremental changes could be made in the interim to deliver early benefits and support the transition.

Incremental changes should be considered more fully, and the transition options redesigned with these mapped out more clearly, potentially to be adopted on an agile basis. We believe there are several issues that could be resolved earlier than projected in the current options.

- <u>Central Switching Service</u> – the licence provisions and therefore the funding of this service should be changed to an ex-ante model in its entirety as soon as possible. This, potentially, would not be dependent on the more substantive changes to the DCC regulatory framework. This is an operational service that does not require an uncertainty mechanism and consequently would work well in an ex-ante regime. Early transition would greatly improve cost management and could be achieved by separating the CSS licence conditions from the Smart Meter Communication Licence. Whilst we would favour

- this early separation, it should be noted that RECCo is not proposing further Code consolidation, which is subject to a separate consultation.
- Shareholder uplift – as DCC is now largely in operational mode, it would be appropriate to review the shareholder's uplift fee for the provision of resources to DCC. We consider that the service fee uplift could be removed by the end of the current licence period rather than at the end of the transition period.
- Contracts with DCC – external service provider contracts with DCC can be novated and carried forward with any regulatory regime. Considering this, DCC could be transitioned to a new ownership model while the licence and consequential code changes take place later. The re-procurement of contracts is of course a significant exercise, given the value and size of the contracts involved. Transitioning to a new model would need to be managed carefully to ensure these activities are not undermined.

We note that Ofgem has identified other considerations that may impact any transition, such as the role of BEIS in the future of the smart meter roll-out programme. Early decisions on the level of engagement that will be required by BEIS and extent of any new activities they may propose for DCC, would mitigate any negative impact upon the transition.

Energy Code Reform[7] has also been highlighted as a consideration. The direction of travel indicated in the Ofgem and BEIS consultation is for DCC to be treated as a Central System Delivery Body. We do not consider that the licensing of the central bodies is necessarily the most effective means of improving the responsiveness or accountability of those organisations. Licenses and regulations generally are in effect a substitute for the consumer power that would ordinarily determine outcomes in a properly functioning market. To that extent, it would only be necessary to licence the central system operators if they cannot be effectively governed and made accountable to their customers through other contractual means.

The REC is already delivering much of the governance mechanism that is being proposed in the Energy Code Reform and could assist policy makers in developing the new approach, leveraging our knowledge and experience to help deliver the requisite changes at pace.

Q7. What are your views on the assumptions we have made for Options A and B transition periods?
We note the assumptions Ofgem makes for the transition period of both Options. While the assumptions appear reasonable, we would urge Ofgem to consider whether incremental changes could be made in the near-term, facilitating a shorter transition to a long-term solution. The assumptions made do not consider what, if any, elements of change could be segmented and delivered agilely in stages. Incremental changes, whilst working in parallel on the longer-term solution, could enable a quicker transition period and bring forward benefits to customers and consumers. An increase in transparency and management of costs, for example by changing the costs regime associated with the CSS, could be achieved without the need to await the delivery of the new regime. We would also ask that Ofgem consider whether the consultation phases would need to be extensive given that the DCC role and deliverables will largely remain the same as the current well-established practice.

[7] Energy Code Governance Reform: call for input

We believe that Ofgem should also consider the installation of a neutral/government representative on the Smart DCC Board. Given that they are a licenced monopoly, there should be no issues of confidentiality regarding the operation and finances of DCC.

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?
Whilst all the considerations identified are relevant, we do not consider that any of them in isolation or together should necessarily delay the proposed reforms. There is unlikely to be a time when the energy industry does not face significant challenge and upheaval. Delaying necessary reform while awaiting some external dependency to crystallise is likely to create a hostage to fortune, as emerging issues supersede older ones and the cost of doing nothing continues to mount. We also consider that there is opportunity to shape the direction of travel, not just of the DCC but the wider regulatory landscape, by giving early signal of some key principles rather than waiting until all the finer detail is developed and seeking to give effect to it in a big bang approach. <u>Change in BEIS role</u> It would be appropriate for BEIS to set out a clear exit strategy, confirming the conditions which it expects to have been met for the SMIP to be substantively completed and in a state of day-to-day operations. Those conditions and the expected timeline to achieve them will need to be congruous to the development of the more industry-led governance that is expected to replace them. However, we recognise that in practice and as alluded to in the consultation, it is likely that BEIS will retain some informal oversight. We therefore consider that this is a parallel activity rather than a dependency that must be completed as a pre-condition of the DCC reform. <u>Energy Code Reform</u> There is nothing proposed in the Energy Codes Reform that would warrant a delay to the separate reform of governance as proposed in the DCC licence review. The Energy Codes Reform is concerned primarily with code level governance such as more effective modification procedures and does not go into reform of price control arrangements and incentives, which is the focus of the DCC licence review. To the extent that the Energy Codes Reform also envisage strengthened governance for the central systems providers, this is likely to bring other parties closer into line with the DCC insofar as it is already a licensee. We consider that the DCC would be a beneficiary of Energy Code Reform as more effective governance would give it greater certainty and enable it to progress with the development of its services more effectively than under current arrangements. <u>Procurement landscape</u> There are pertinent lessons from the creation of the DCC itself that should be applied to the forthcoming procurement activity, insofar as it is not ideal for the body responsible for procuring a service not to then have responsibility for effectively managing the service. This can lead to, amongst other things, a lack of ownership and accountability. Ideally, the outcome of the DCC competitive re-tender would be known in advance of long-term contracts being entered into, so the party responsible for overseeing those contracts can have a key role in their procurement. However, this may not always be practicable. Any risk associated with the novation of contracts

could be mitigated if their effective periods extend for a relatively short time into the new DCC licence period, or otherwise provide for a break, allowing any new DCC licence to take ownership early into their tenure, rather than being encumbered with legacy arrangements for a prolonged period.

Sunsetting of 2G and 3G technology

We agree that any programme of work to phase out 2G and 3G would be continued by any incoming licensee, referred to in the consultation as DCC2. In practice, the DCC is undertaking this work on behalf of the wider industry and as such should be operating in accordance with requirements determined by its stakeholders. Therefore, while there may be change to the leadership team overseeing certain activities, there should be continuity of the replacement programme itself.

Similarly, we recognise that Ofgem may be concerned about the impact of a change in the DCC upon programmes such as MHHS. For the same reasons as above, we do not consider that a change in licensee should necessarily have any impact upon external programmes. While there may be a change in personnel etc, these are all manageable business continuity issues.
It is important to have regard to the context of this DCC licence review, and its track record of delivery to date. While there may be some risk of disruption, Ofgem must appropriately consider whether all the dependencies it has highlighted, including the delivery of wider industry programmes, are likely to be further advanced through a continuation of the status quo DCC arrangement or the implementation of one of its proposed options for reform.

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 to the regulatory framework during the transition period would be very beneficial by not only potentially reducing the transition time frame, but also by bringing forward other benefits. This may also provide any future licensee candidates with greater clarity on the role and scope of DCC and increase interest in any re-procurement.

Q10. Do you agree with our proposed scope of future DCC's Core Mandatory Business?
We agree that the DCC's Core Mandated Business is the provision of communication and enabling services and that these should continue as a core role under any new regulatory framework. To the extent that DCC also has an objective to promote innovation, this should not be to the detriment of its primary objective. For instance, when assessing the merits of Elexon's potential diversification from its core activities as part of BSC modification P284[8], Ofgem considered that certain criteria would have to be met as follows: • BSC Parties should benefit from any diversification; • the arrangements should not place disproportionate risk on BSC Parties; • standards of service under the BSC should be maintained; and, • Elexon's BSC role should not give it any undue competitive advantage in a contestable activity. These principles were again referenced in the Authority's decisions to accept BSC modification P330[9] and P390[10]. They were also referenced by the Authority when considering changes to

[8] P284: www.ofgem.gov.uk/sites/default/files/docs/2012/09/p284d_0.pdf.
[9] P330: www.ofgem.gov.uk/system/files/docs/2016/05/p330d.pdf
[10] P390: www.ofgem.gov.uk/sites/default/files/docs/2021/03/authority_decision_to_accept_p390_0.pdf

Xoserve's governance to facilitate a potential role in delivering the Central Switching Service.[11] We consider that these remain reasonable criteria and could be adopted more widely, including for DCC value added 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'?
Core Mandatory Business should take precedence over other duties and obligations. This is particularly important as the roll-out of smart meters has been extended by several years, and at greater cost than forecast. However, we agree that there is value in re-using infrastructure to maximise benefits. The roll-out of smart meters is vital to our transition to net zero, as they will support innovations such as Market-wide Half-Hourly Settlement (MHHS), Time of Use (ToU) offerings, and management of smart home energy assets. Delivering this programme on time is critical and diverting resource or costs to other areas of potential development of DCC services should be a secondary consideration and undertaken only when there is a clear demand for such services from parties who commit to covering the additional cost of providing them, together with a contribution to the DCC core costs, thereby returning value to customers of DCC core services.

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?
DCC's role will evolve and change as the energy industry moves towards net zero. That change needs to be well managed and structured to ensure DCC remains focused on core activities, whilst supporting the growth and development of wider programmes. It is appropriate to ensure that the right drivers have been identified to enable DCC to evolve to deliver these wider benefits. Whilst we agree with the proposed drivers and criteria for the triggers of change in DCC's role, as set out in Table 5.2 of the consultation document, we question whether these should be delivered through the provision of an uncertainty mechanism. The energy industry has experience of delivering large industry wide programmes where these are undertaken with costs projections from the outset that are transparent and challengeable by stakeholders. A similar approach should be taken with DCC. The triggers identified in Table 5.2 of the consultation document would all be deliverable without the requirement for an uncertainty mechanism.

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? (See table 5.3)
Overall, we agree with the considerations that are set out in Table 5.3 of the consultation document. <u>Maturity level</u> We agree that DCC must be focused on delivering its Mandatory Business and must therefore have reached and be able to safeguard a satisfactory level of system performance before exploring re-use. This could be made explicit in licence, ensuring there are no conflicting objectives that could distract from this primary role. <u>Governance</u>

[11] See: "UK Link and the proposed Central Switching Service", Ofgem, July 2017

We agree there must be a transparent procedure for initiating, developing and approving any re-use activity. This will require robust governance and should require a viable business case, with clear threshold criteria before any such activities are approved. Any new governance body will need robust systems and processes to ensure that each business case meets threshold criteria and is fully assessed. It would be beneficial to undertake regular performance assurance to review both the progress of deliverables and have oversight of costs to ensure any permitted activity remains on track for delivering the original intentions and benefits. This approach lends itself well to the Option B model, whereby a sub-set of the energy industry, independent Board and Executive can oversee applications for the re-use of the DCC systems and platform. <u>Funding/Risks/Benefits distribution</u> We agree there must be a clear route for funding, and have set out elsewhere options including: • each new programme or project being required to produce a needs case, (similar to the arrangements under Ofgem's Strategic Wider Works[12] arrangements) with costs to be agreed in advance with DCC customers; • allowing a discrete budget for innovation and or development of future services; and, • an approach like those applied in the RIIO price controls could create pots of innovation funding that DCC can apply for. Under Option A, risks would continue to sit with customers while rewards accrue to DCC and its shareholder(s). If the DCC was governed under a not-for-profit variation of Option B there would be no expectation of a return for the shareholder and, subject to its procurement strategy, the risk and benefits could be more equally distributed. <u>Competition</u> We agree that DCC must not benefit from its monopoly or privileged position in any competition with its customers or persons involved in commercial activities associated with energy supply. Therefore, any procurement process implemented will need to be robust, with clear criteria and thresholds that must be met to ensure that DCC is correctly incentivised.

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?
A hybrid model could be more flexible and used to achieve different aspects of DCC role. It will be important to ensure that any replacement model strikes an appropriate balance between risks faced by investors in the licensee, and those borne by consumers who ultimately pay for the service. Some aspects of the DCC role are genuinely uncertain while others carry limited risk. That regulatory model should be tailored to match these differing risk profile rather than applied on a one-size-fits-all basis, as they would seem to facilitate the most equitable outcome.

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?
The operational function of the DCC is largely to procure and manage external service providers, DCC should therefore be able to provide certainty around costs that can be budgeted for via an ex-ante regime. This could be achieved by ringfencing these costs. It may also be appropriate to cap these costs for the years to 2025 – given that many of the uncertainties are now addressed and the SMIP should be able to predict costs more accurately.

12 Strategic Wider Works guidance | Ofgem

Q16. 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 current regime DCC has limited commercial and financial risk. DCC customers are required to pay both its costs and baseline margin upfront and are only compensated in arrears if Ofgem determines that an adjustment is necessary (c.18 months later). This upfront provision of cash is in contrast to the position taken by Ofgem in relation to consumers money held by suppliers. We agree that an ex-ante model will bring in much more certainty of costs, particularly operational costs. These can be decided upfront and fixed for a duration and in turn reduce the amount paid by customers. The DCC 'budget' would then be set, incentivising it to keep to budget, or share in the risk of it being exceeded.

Q17. What are your views on whether DCC can be effectively incentivised to reduce costs at scale under an ex-ante regime?
A large part of DCC's role is to contract managing external service providers. Maximising cost-efficiencies should be fundamental to this role. An ex-ante regime would allow costs to be determined upfront, with the DCC expected to manage risks to remain within budget. The introduction of incentives under an ex-ante regime can also bring the risk of unintended consequences e.g., budgetary control must be balanced against the need to react to changing circumstances, such as deliver unforeseen change requirements.

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 of underperformance under an ex-ante regime (e.g., provisions to allow clawback in case of delivery failing to meet specifications)?
A profit driven organisation will naturally seek to increase returns, and in the absence of being able to raise prices under the ex-ante regime, would instead look to reduce cost. Whilst this will drive efficiencies, it could also impact upon the delivery or quality of services. Clear service standards will therefore help ensure that the appropriate balance is struck, with accompanying incentives that offer greatest reward for meeting service expectations. Such an arrangement has been proposed for the DCC in relation to switching services, placing its margin at risk if it fails to meet certain service level agreements. We consider that such an arrangement should suitably apply to all the DCC services. Ofgem should seek to ensure that the DCC's customers are able to determine its priorities and exert an influence that is as close as practicable to a normal commercial relationship, focused on achieving mutual success rather than allocating the costs of failure.

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?
As DCC moves to an operational phase its internal costs and therefore budget setting should be significantly easier to predict than the high levels of programme uncertainty of previous years. Publication of the indicative budget together with some comparators with relevant industry benchmarks would help inform funding parties and provide an early opportunity to raise any

issues or concerns. Once this feedback is received, a full budget could be published with a right to appeal any cost items not yet legally committed to. This would offer more transparency, and more certainty to both funding parties and DCC itself that the current retrospective review and potential disallowances.

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.
The parties currently involved in the ex-post arrangements are best placed to make this assessment, but in principle we agree that the ex-ante model should be more proportionate than the inevitably more adversarial ex-post review of past performance and expenditure. While DCC are required to justify its costs, the greater burden appears to be on Ofgem to understand whether they were economic and efficient, or in some cases actually incurred. However, negotiated settlements for budget setting and consultation would mean that costs can be more readily agreed by parties themselves. We further consider that emerging variations to the prevailing operating model can more appropriately be managed through a robust change management process, with decision-making informed by targeted impact assessments being largely devolved to stakeholders, including those who will ultimately pay for the change. If the process works smoothly and with goodwill and reasonableness on both sides, it should also mitigate the need for referral to the regulator as the arbiter.