



DCC Price Control Consultation - Reporting Year 22-23

Smart DCC Response

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1. Executive Summary

We are pleased to submit our detailed response to Ofgem's proposals for RY22/23 and welcome the challenge and scrutiny of the annual Price Control as a means of ensuring that we deliver value for our customers.

However, on this occasion, we have genuine concerns with Ofgem's overall approach. These points are explained further herein.

Strategic and regulatory context for this review

DCC operates in a unique space within the UK Energy Market and sits at the intersection of government, tech and energy, managing different stakeholder demands to ultimately deliver benefits to consumers, customers and GB plc.

As outlined by the recent National Audit Office ("NAO") report published in June 23, significant milestones have been achieved in a relatively short period of time. The smart metering system initially went live in 2016 and grew to one million connected meters by 2019. Since then, growth has accelerated and by the end of RY22/23, there were 27 million meters connected. Smart meters are now playing a critical role at the heart of a smarter, greener, and more secure energy system. For example, last winter, National Grid ESO successfully launched the DFS (Demand Flexibility Service), helping save enough power for c.10million homes, which would not have been possible without DCC's secure network.

Since the Licence was granted 10 years ago, DCC's business model has evolved rapidly from a programme delivery body to a sustainable business operating at scale. The wider energy market context, and Ofgem's role within it, has also changed. The Energy Act adds a specific mandate to Ofgem's purpose, requiring Ofgem to support the Government in meeting its legal obligation to get to net zero by 2050. However, we are concerned that the regulatory processes around DCC's price control have not evolved to keep pace with this change.

Throughout the process this year, DCC does not feel that Ofgem has placed sufficient emphasis on the strategic context in which decisions were made or the relevant facts known at the time when costs were incurred. A number of external constraints and fundamental directions were imposed on DCC during the year, including by the Department for Energy Security and Net Zero ("DESNZ"), which limited our strategic choices and therefore had a material impact on DCC's decision-making and governance processes. These must be taken into account when assessing the associated costs incurred. For example, regarding the SMETS1 Supply Chain, the timing constraints placed on DCC by DESNZ, coupled with the commercial position of our supply contracts, meant there was only one viable option to deliver a solution and prevent a disruption to service, which was achieved successfully. This was clearly recognised by our customers at the Price Control Stakeholder event on 8 December 2023, where energy retailers expressed their 'support and sympathy' to the way this programme was handled and managed by DCC and Capita. For these costs to now be disallowed sets a very difficult precedent and materially increases risks for future activities.

The approach Ofgem has demonstrated in taking a narrow view of individual cost items, without recognition of the impact of government decision making or their contribution towards the broader strategic direction, is likely to lead to unintended consequences, including increased governance and regulatory burden to mitigate the increased Price Control risk that Ofgem is perpetuating. In turn, this is likely to slow down decision-making and constrain investment, leading to adverse customer and consumer outcomes. This would make it impossible for DCC to deliver an equivalent positive outcome at the pace required should similar issues to that in the SMETS1 supply chain arise in future.

Whilst it is clearly right that Ofgem hold DCC to account for ensuring costs are economic and efficient, Ofgem's approach risks undermining its broader obligations to support positive consumer outcomes and

wider public benefits, such as the decarbonisation of the energy system laid down in the Energy Act, which DCC are enabling through its activities (now saving over 1 million tonnes of CO2 emissions per year.)¹

Regulatory approach to consultation proposals

DCC has concerns regarding the approach Ofgem has followed in arriving at its consultation position. The document contains inconsistencies and misstatements which, without further context, would lead to misunderstanding by stakeholders of costs incurred and undermine the consultation process and resulting outcome.

In one case, Ofgem has proposed to disallow costs that DCC did not actually incur. In relation to the SMETS1 supply chain issue, where DCC had to implement an emergency solution to move from one service provider to another, Ofgem has referenced a period where both contracts were in place simultaneously and proposed to disallow a total of £1.7m in relation to this. Whilst it is correct that two contracts were in place simultaneously until July 2023, DCC have evidenced to Ofgem that no costs were incurred under one of these contracts after the end of October 2022. £1.4m of costs believed to be associated with this 'dual running' were therefore not incurred and cannot be disallowed.

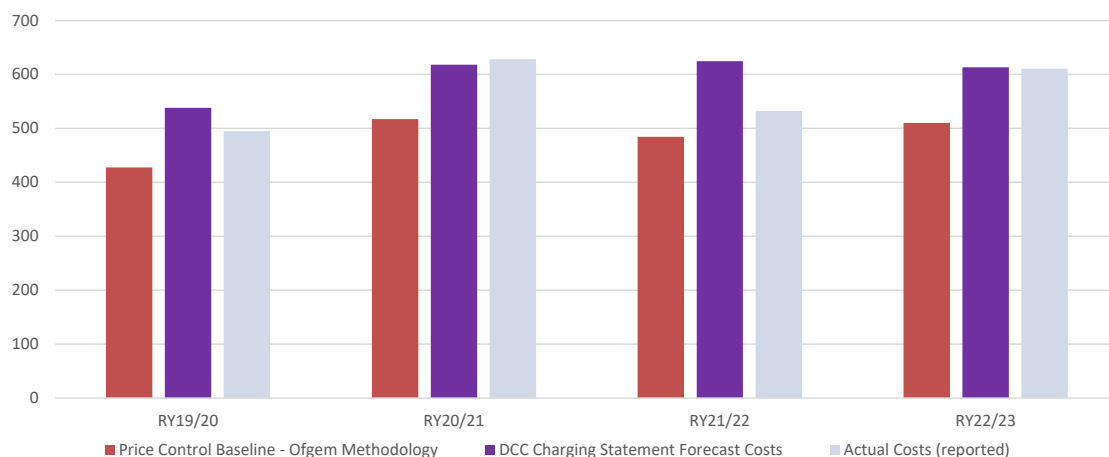
There are also areas where Ofgem has taken the opposite approach to that seen in previous years. For example, in RY22/23, Ofgem has proposed to disallow the costs of delivering the Price Control reporting requirements, something it has never previously done in the previous nine years of the Licence, without providing any specific rationale or reasoning. Regulatory predictability is vital to avoid DCC having to second-guess what Ofgem might disallow each year, which would delay decision-making and result in additional costs being passed on to consumers. This is particularly important in the current *ex post* regime where DCC incurs the cost in advance of the regulatory review.

In its Executive Summary, Ofgem state that total costs in RY22/23 have increased by 24% compared to last year's forecasts. This has the potential to mislead and is clearly open to misinterpretation. The 'forecast' Ofgem's analysis is based on is a construct determined by Ofgem and only includes costs with a high degree of certainty. As such, it does not include all costs that DCC will legitimately incur. Ofgem's approach is therefore bound to generate a lower baseline position against which to measure actual costs, which means the percentage increase derived by Ofgem is artificially high and causes confusion (as outlined by industry stakeholders at the Price Control Stakeholder Event on 8 December).

The chart below shows how DCC's actual incurred costs compare to this forecast, and to the more complete forecasts submitted by DCC in our charging statements. This clearly shows the 'Ofgem methodology' provides a flawed comparison on which to base the analysis, with the RY22/23 costs incurred actually being very close to those provided to industry through our charging statements. This is a point DCC has consistently made to Ofgem. Unfortunately, this has yet to be addressed, and is an illustration of a lack of action from the Regulator in adjusting a regulatory framework that no longer seems fit for purpose.

¹ Source: [Smart meter statistics and network coverage](#) | Smart DCC

Ofgem Methodology Baseline, DCC Charging Statement Forecast Costs & Actual Costs RY19/20 -RY22/23 (£m)



DCC is concerned that this forecasting issue will be repeated in RY23/24 (next year). It is apparent from the Consultation that Ofgem proposes to disallow significant costs, for entire activities, for future years, from the relevant forecasts. However, it is accepted by Ofgem that these disallowances relate to activities which must be undertaken. For the most part, Ofgem's reason for seeking to disallow costs from these forecasts is that it would prefer a different way of providing the activity (e.g. through external competitive tender). However, the activity will need to be carried out, which means a cost will be incurred. Creating a zero-cost baseline against which DCC will be judged cannot be the correct approach. In effect, it renders forecasts non-meaningful.

Key Achievements in RY22/23

Turning to the specifics of RY22/23, DCC incurred costs of £611.0m (compared to £525.2m in RY21/22). As stated previously, these costs are in line with (and slightly under) our business plan and charging statement provided to customers and Ofgem in March 2022, and the preceding Quarterly Finance Forums. They reflect the clear step change in complexity, progress of, and investment in DCC's operations across a number of domains.

During RY22/23, DCC delivered a number of key achievements:

- Continuing strong levels of delivery and performance across the increasing scope and scale of our Mandatory Business, recognising our role as deemed Critical National Infrastructure ("CNI").
 - 7.3m meters, including 2.5m SMETS1, were added to the network during the year, connecting over half of homes in Great Britain.
 - Network availability for this year was 99.99%, significantly outperforming benchmarks from both UK and EU comparators and an improvement on the 99.94% from last year.
- Improving our business to support the scale and complexity of our ongoing operations more efficiently, while meeting the needs of our customers and stakeholders.
 - Our cost per meter continues to decrease as the scale of our network grows and the compound effect of our transformation initiatives takes effect (from £33.03/meter in 20/21 to £14.29/meter in 22/23).
 - Our customer engagement scores are markedly improved, previously assessed by SEC Panel as 1.0 out of 3 (and amended by Ofgem to 1.4) in RY21/22 and increasing to 2.0 in 22/23.

- Transforming our network to remain fit for the future, as first-generation technology reaches end of life and the demands on, threats to, and expectations of the network evolve. The changes we are making will provide the accessibility, flexibility and speed of change expected of a modern network and commensurate with the scale of the net zero challenge.
 - We received non-objection for the final 4G Communication Hubs & Networks (CH&N) Full Business Case (FBC) in September 2022, awarded contracts in October 2022, and remain on track to deliver against our joint industry implementation plan.
 - Considerable progress on the highly complex Data Services Provider (“**DSP**”) programme with the Strategic Outline Business Case (“**SOC**”) shared and discussed with DESNZ in May 2022 followed by extensive market engagement to inform options.

Given our commitment to delivering these benefits while demonstrating the economic effectiveness of our services, we are disappointed with Ofgem’s consultation proposals on cost disallowances. We summarise our key objections below.

Recurring process issues

DCC is concerned that, on this occasion, Ofgem has gone beyond its mandate and is proposing to make a series of unfair and incorrect determinations. The Price Control process is governed by the Conditions of the Licence. Ofgem is also subject to its principal objective.

Instances whereby Ofgem proposes to disallow costs on a basis that goes beyond its powers or has otherwise failed to account for the types of matters prescribed by the Licence, Ofgem’s Guidance, and/or its principal objectives include (by way of example only):

- On SMETS1 supply chain, Ofgem has not taken account of the necessary trade-off made between cost and timeliness to ensure service continuity (which was achieved, but with only weeks to spare). It has also failed to take proper account of the factors that were entirely outside DCC’s reasonable control, the information available to DCC at the time, and the direct instruction imposed by DESNZ. As a result, this approach is not in accordance with the Licence, the Guidance or in the wider interests of consumers, specifically in ensuring service continuity, which has achieved successfully in extremely challenging circumstances.
- Ofgem has adopted inappropriate counterfactuals, including counterfactuals based on errors of fact, which fail to account for costs that fundamentally alter the economy and efficiency of the counterfactual, which are unsubstantiated, or in some cases, have offered no counterfactual whatsoever. By way of example, in respect of SMETS1 service stabilisation, Ofgem proposes that DCC should have recovered the relevant consequential costs from its supply chain. However, Ofgem fails to account for the fact that DCC’s contracts do not provide for the pass through of consequential costs to the supply chain (which is normal industry practice) as to do so would significantly increase the price of contracts. The supply chain would need to price in the additional risk. Duplicated across the whole supplier base, such cost increases (which would be passed through to consumers) would outweigh the relatively small cost of service stabilisation.
- Ofgem has also proposed to disallow up to the entire cost of procuring the Component Integrator service, which is required as part of the 4G CH&N programme, on the basis that it was a direct award procurement. In that regard:
 - First, direct award of contracts is not a ground for excluding cost. Ofgem can only disallow cost that has not been economically and efficiently incurred.
 - Second, in any event the licence does not compel DCC to go to tender in all circumstances and specifically permits DCC to directly award a contract in certain circumstances, including (i) in respect of Relevant Service Capability that is not Fundamental, where it would be most

economic and efficient or would be immaterial in terms of value and resource within the context of DCC's activities and (ii) in respect of Fundamental Service Capability, where competitive procurement would be impracticable and disproportionate. The position taken by Ofgem seems to be that DCC should competitively tender activities even where it is impracticable or disproportionate for it to do so. That is not in accordance with the express terms of the Licence and is not in the interests of the consumer.

- Third, Ofgem has recognised the need for this service, and must therefore accept there is a cost to it. If Ofgem considers that the cost incurred is not economic and efficient, it should be comparing costs actually incurred to a reasonable counterfactual. The Licence does not grant Ofgem the power to 'zero cost' and entire necessary activity.
- Ofgem has similarly proposed to disallow the entirety of some internal costs where Ofgem must accept that the associated services contain some value, including the Executive Leadership Programme and Customer Engagement Portal. The same point as above applies.
- Ofgem has proposed to disallow 50% of the salary costs of the Service Delivery function working on the various Network Evolution-related programmes purely because we exceeded the forecast provided more than a year earlier. This is not sufficient justification that costs were not economic and efficient. Ofgem should consider whether the costs were economically and efficiently incurred.
- Also, in respect of forecasts, Ofgem has repeatedly proposed to disallow entire forecast amounts where Ofgem must accept that a cost will be incurred, meaning Ofgem and DCC will be left with an overall forecast that is not robust, is unrealistic, and which falls significantly below what the reasonable cost of DCC's business could ever conceivably be. This runs the risk of fundamentally misleading stakeholders.
- Ofgem has followed an inconsistent approach to prior years, with limited or no prior discussion or warning, such as proposing to disallow the costs of Price Control support which have previously been allowed. This undermines the integrity of an *ex-post* review process.

In respect of all of these, DCC considers that Ofgem is at risk of making a decision that is contrary to the Licence, outside its powers, and/or open to formal challenge. DCC trusts that Ofgem will consider this Response in full and endeavour to exercise its powers in a manner that is consistent with the Licence, its own Guidance, and its principal objective.

We have expanded on these points in Section 3 and Annex 2 of this consultation response.

External costs

Ofgem propose to disallow a total of £6.8m of external costs in RY22/23 relating to the successful resolution of a SMETS1 supply chain issue (£4.1m) and required stabilisation of SMETS1 FOC service (£2.7m). The detailed evidence in relation to these costs is provided in Section 4 of this document.

Of the £4.1m proposed disallowance of costs relating to the SMETS1 supply chain issue, £2.4m related to solution build costs, and £1.7m to dual-running costs as the service was moved from the distressed service provider to the replacement. These costs were incurred in response to an emergency situation that required rapid and decisive action. DCC successfully delivered the new solution with no interruption to service, a fact accepted by Ofgem and our customers.

The disallowance of costs relating to the build of the new solution fails to take proper account of the strategic context and external constraints imposed on DCC by stakeholders, including government. The time constraints imposed by DESNZ were such that there was only one solution available, and the commercial reality of the situation (with the financial distress of the incumbent visible to all parties) removed the potential for risk sharing in newly renegotiated contracts.

Of the £1.7m dual-running cost, £1.4m was not actually incurred and the remaining £0.3m relates to a five-week period of dual running. This is much shorter than would be expected in this kind of project (3 months would be more typical) and was essential for the security of the service, something our customers have supported.

Of the £2.7m proposed disallowance of SMETS1 Final Operating Cohort (“**FOC**”) stabilisation costs, £1.4m related to maintenance releases and bug-fixes and £1.2m related to costs Ofgem claim are “unjustified”. It is important to note in relation to these costs that DCC had advised government several years ago of the risks of the proposed SMETS1 approach, instead preferring an alternative design that would have seen the build of a new head-end, removing the need to have a Dual Control Organisation (“**DCO**”). Had this been adopted, the migration issues would have been significantly fewer and less costly to resolve. We are disappointed by what appears as a lack of alignment between DESNZ and Ofgem, and we expect greater coherence in decision-making in the future. In the interim, it is not appropriate that DCC be unfairly penalised.

In relation to the £1.4m of costs related to maintenance releases and bug fixes, DCC have shown that the fixes themselves were paid for by the supplier at fault; the costs identified by Ofgem are the consequential costs to other suppliers. DCC's contracts do not provide for these costs to be passed through as the overall cost of doing so (with suppliers pricing in the increased risk they face) would be higher than the cost of retaining the risk and paying for the small number of such incidents as they occur. Additionally, it is important to understand that the alternative approach to fixing defects as they occur would have been to build a pre-production environment for testing migrations. The cost of doing this would have been prohibitively expensive and still not be guaranteed to identify all the faults. The counterfactual to the costs incurred would therefore have been higher and actually imposed greater costs on industry. As a result, DCC had elected the economic and efficient way to deliver the activity.

Of the £1.2m ‘unjustified’ costs, DCC have shown that £523k of these were miscoded in the accounting software and do not relate to FOC costs at all, and we have provided in section 4.2.3 below further evidence to Ofgem as to why the remaining £746k were necessarily incurred and economic and efficient.

Ofgem has also said it is minded to disallow up to £2.9m of costs in RY22/23 related to CH&N Component Integrator. DCC had planned to deliver this service in-house and, having presented a business case to DESNZ, obtained a ‘non-objection’ to do so. However, a subsequent request from customers for DCC to conduct the associated testing led to a change in requirements (which DCC was not permitted to deliver). This meant a third-party procurement was required in a timescale that could only be delivered through direct award, which was successfully delivered. DCC has shown that, whilst this was a direct procurement, the rate card used by this supplier was competitive, being below benchmark rates on an equivalent project. In conclusion, the process was compliant with our Licence and was the most cost effective for our customers, and we have provided more detail in this response.

Internal costs

Ofgem proposes to disallow a total of £11.5m of internal costs in RY22/23 (or £12.5m including the Shared Service Charge). DCC's detailed evidence in relation to these costs is provided in Section 5 of this document but we have summarised below some of the key areas of concern.

It should be added that more than 50% of the proposed disallowance for internal costs (£6.1m) relate to items where Ofgem is proposing to disallow all the costs of a particular contract (instead of disallowing the differential between the actual amount incurred by DCC and the amount deemed to be economic and efficient by Ofgem). As mentioned in Section 3 and Annex 2, this is not compliant with the Licence, which only permits Ofgem to disallow costs which have not been economically and efficiently incurred. It is also inconsistent with Ofgem's own guidelines and not good practice. We are further concerned as to the

reasonableness of Ofgem's approach in circumstances where Ofgem have not provided in the consultation document any clear counterfactual. The proposed disallowances affected by these issues include:

Business Accuracy Programme (BAP): Ofgem proposes to disallow 100% of BAP costs (£3.8m). We are extremely disappointed by Ofgem's decision as it is proposing to disallow the programme that intends to address some of the regulatory reporting issues that Ofgem (unfairly in our opinion) outlined in the Price Control consultation document. Moreover, Ofgem has recognised the importance of the BAP programme but is nonetheless proposing to disallow all of the costs (and without providing any viable counterfactual).

Regulatory Business Cases (£1.2m): Ofgem proposes to disallow £1.2m for Regulatory Business Cases, which represents a large majority of the internal costs to process regulatory business cases in accordance with Government's guidelines. It should be noted that DCC's decision to set up a Centre of Excellence for Regulatory Business Cases followed an amendment made by DESNZ (BEIS at the time) in June 2020 (which DCC is required to strictly comply with) and the clear guidelines set by HMT. As mentioned above, we would urge Ofgem and DESNZ to show greater alignment in decision-making.

Direct Award Procurements (£1.2m): Ofgem proposes to disallow £1.2m of direct award procurements which DCC undertook for certain urgent activities to ensure efficiency, deliver value for money for our customers, and reduce the risk of widespread failure of the network. As outlined in Section 3, not only do we strongly disagree with Ofgem's interpretation of DCC's Licence Condition 16 around procurement, but we also believe that our approach is compliant with best practice, including those adopted by the Government – hence delivering best value for our customers.

DCC Payroll Costs & Advisory Services (£2.1m): We are extremely disappointed to note that, for the first time, Ofgem is proposing to disallow costs related to managing some of our core programmes – including CH&N and DSP (£1.3m), and we have provided further evidence in section 5 of this document to support these costs. Ofgem has also proposed to disallow 50% of the legal cost to support the CH&N Programme (£0.6m), which was a very modest and reasonable cost incurred for a total programme that itself cost in excess of £1bn over several years – and again without providing any counterfactual.

Performance incentives

The Operational Performance Regime ("OPR") is designed to incentivise DCC to run a high-quality service for its customers by placing Baseline Margin at risk. In RY22/23 £7.6m was placed at risk. The detailed evidence in relation to performance incentives is provided in Section 6 of this document.

On the System Performance element, we welcome Ofgem's recognition that DCC has met all system performance targets in RY22/23 and awarded 100% of the available margin. On Customer Engagement, we are also pleased that Ofgem and SEC parties have recognised our improvements in this area.

However, on Contract Management, we are disappointed with Ofgem's proposal to downgrade the scores provided by the Independent Auditor appointed to review performance under the NAO framework and against agreed criteria. DCC have not been provided with the rationale for this reduction - it seems to be arbitrary (and at best based on a subjective assessment) which undermines the integrity of the process.

On Project Performance, related to SMETS1, we agree with Ofgem's minded-to position to accept the overall performance achieved but disagree with its position to not distribute the margin adjustment over three years, which we believe we have made a compelling case in support of.

Baseline Margin Adjustment and External Contract Gain Share

We note Ofgem's position on Baseline Margin Adjustment award but would again reiterate that the application process is extremely onerous. DCC is now incentivised to apply for extremely small amounts of expenditure to avoid them being ineligible in future years. Given that DCC's activities are now dramatically

different to what was assumed at the time of licence award, the application process is no longer fit for purpose and should be reviewed.

Switching Programme

We acknowledge Ofgem's position that the forecast costs of delivering the Switching Programme do not yet meet Ofgem's certainty threshold, although it is important to recognise that costs will be incurred. Now that the programme is in-life, DCC believes it would be sensible for Ofgem to revisit its position on this proposed disallowance to enhance stakeholder certainty and reduce future regulatory burden. Assuming a zero-cost base for an activity that will be delivered, and must incur cost, will not assist transparency.

We welcome Ofgem's recognition that the final delivery milestone for this programme was achieved in full and its decision to allow additional switching margin through the Discretionary Data Reward ("**DDR**") and Discretionary Recovery Mechanism ("**DRM**").

Future Baseline Margin and Shared Service Charges

Finally, Ofgem is consulting on proposals to amend the future Baseline Margin and Shared Service Charges. We are concerned that Ofgem has chosen to propose fundamental changes to the framework through the annual Price Control consultation. Using the Price Control consultation as a vehicle to deliver policy change sets a worrying precedent. We have expressed concerns before that Ofgem is delivering fundamental policy change without the right for DCC (as licensee) to challenge via an appeal to the Competition and Markets Authority.

Conclusion

We fully recognise that the Price Control process is a necessary and important part of ensuring that DCC's expenditure is economic and efficient. However, we firmly believe that our actions have been in line with our Licence obligations and in the best interests of our customers, and ultimately end consumers.

We have genuine concerns with Ofgem's overall approach, including (but not limited to):

- Ofgem has exceeded its mandate to assess whether DCC's costs have been incurred economically and efficiently and sought to propose disallowances that are outwith its mandate under the Licence (and outwith the intention underlying the Licence terms).
- The manner in which Ofgem has conducted the Price Control process – which has resulted in factual errors, misapplication of the Licence, a variance of compliance with Ofgem's own guidelines, and an inconsistent approach to counterfactuals.

In this response, we provide further detailed evidence to aid Ofgem in assessing the Price Control position, focussing on clarifying our rationale and enhancing our analysis to demonstrate economy and efficiency. On the basis of the additional information set out in this response, we request that Ofgem reconsiders the proposed disallowances.

2. DCC Journey – the Wider Context

Summary

- DCC, and the network we run, has evolved rapidly over the last ten years. While live smart metering communications operations have been in place for a number of years, the reality of operating at scale has only been achieved relatively recently.
- Operating at scale requires enhanced levels of technical support to remain fully compliant from a security and operational performance perspective. Legacy technology choices have also provided additional challenges, as evidenced by the SMETS1 supply chain incident and ongoing supplier performance issues.
- Our efforts to ensure we evolve and continue to deliver high levels of performance do not appear to be recognised by Ofgem; the proposal to disallow the entirety of the costs associated with the Business Accuracy Programme provides a compelling example of this.
- DCC operates at the centre of a complex and varied stakeholder landscape. Decisions on the future state of the network remain subject to very intense scrutiny and, in many instances, firm direction from a variety of stakeholders (including the Department for Energy Security and Net Zero). There seems to be limited recognition of the impact that this has on forecasts and costs.
- With Ofgem's now statutory duty to protect existing and future consumers interests related to Climate Change, we urge Ofgem to consider DCC's costs in their true context. The costs DCC has incurred have resulted in significant benefits for existing and future consumers. Failure to consider the consumer benefit derived from costs that are proposed to be disallowed would not represent the best outcome for the smarter, greener Britain we all wish to see.

As we highlighted in our original response, DCC as an organisation, and the smart metering network that we run, has evolved rapidly since original conception ten years ago. While we are pleased Ofgem has recognised the pace of change over that timeframe, Ofgem repeatedly references its expectation that our operations should have reached a more mature and stable phase.

While we have recently celebrated 10 years of the DCC, it is worth recognising that the system only went live three years after this, in 2016. The first SMETS2 meters were only connected in 2017, and SMETS1 migrations only began in 2019. In May 2019, only 1 million meters were connected to the network. It was not until September 2020 that the network was really operating at any sort of scale with 5 million meters, and by November that year 2 million SMETS1 meters had been migrated. By the end of RY22/23, there were 27 million meters, a 270% uplift from only four years prior. Therefore, while it is true to say live smart metering communications operations have been in place for a number of years, the reality, and consequences of, operating at scale has only been achieved relatively recently.

The period since 2020 has been marked by significant turbulence in the broader energy market. The soaring price of wholesale energy saw 31 supplier exits over the course of 2021 and early 2022, with implications for additional operational complexity as meters from defunct suppliers' transition over to new owners. Again, while a level of acquisition activity should be expected in a functioning market, this unprecedented level of insolvency provided new challenges and to a certain extent is still felt today.

This volume of change activity, combined with ongoing operational management, requires a more mature and stable organisation. Inevitably, the focus in the early years of the DCC was to ensure the technology worked and could successfully deliver against the Government's requirements. This was undertaken through a programme lens. Ultimately, this approach was successful. The SMETS1 challenge, as outlined above, has largely been solved. Switching was successfully delivered and operates to a high level of

performance. Network availability for the regulatory year was 99.99%, significantly outperforming benchmarks from both UK and EU comparators and an improvement on the 99.94% last year.

The challenge of migrating SMETS1 meters was one of the most complex technology projects undertaken in the UK. Largely, and as acknowledged by the National Audit Office (“NAO”) in June, this has now been addressed, with two cohorts successfully closed down during RY22/23. Nevertheless, the challenges of operating this complex estate at scale continues and requires enhanced levels of technical support in order to ensure we remain fully compliant from a security and operational performance perspective. Legacy technology choices have also provided additional challenge, as evidenced by the Civet incident and ongoing supplier performance issues.

However, our efforts to ensure DCC can evolve to continue to deliver high levels of performance do not appear to be recognised by Ofgem, despite criticism that the organisation should be more mature and stable. Business Accuracy provides the most compelling example of this, disallowing the entirety of costs on a project designed to improve predictability and accuracy of delivery and costs while simultaneously criticising DCC (unfairly in our opinion) for its inability to forecast effectively.

A further example is the drafting of Regulatory Business Cases. DESNZ made significant changes to Licence Condition 16.6 in June 2020, which introduced the requirement for government not to object on spend over £10m. Given our role as deemed Critical National Infrastructure and with costs attributable back to consumers’ bills, we are supportive of the role professional, considered, and articulate business cases can play in agreeing a course of action. In order to meet this demand, at the pace required given the importance of ongoing programme activity and contract renewals, DCC needed to stand up additional capacity from professional business case teams who had experience of delivering this for similar entities. Recruiting these roles would not have been possible in the time required. Following a competitive procurement, [REDACTED] were selected, and DESNZ have acknowledged the improvement in the quality of business cases submitted. Despite this, Ofgem has chosen to disallow 81% of this contract, equivalent to £0.6m. At the time of writing, there are 14 business cases in DCC’s pipeline.

Ofgem also argues that we now have much greater ability to manage our business, forecast costs and scope work effectively, but at the same time, criticises DCC for costs exceeding forecasts. This fails to acknowledge the extent to which decisions on the future state of the network are subject to intense scrutiny and in many instances firm direction from a variety of stakeholders. DCC operates at the centre of a complex and varied stakeholder landscape, each with competing tactical demands and expectations, each evolving and progressing at a different pace, and often with a different strategic view on the potential of the smart metering network to support a smarter, greener energy system. As a result, DCC’s ability to manage its own business and forecast costs is not that of a standard commercial enterprise. Its business is subject to direction from stakeholders, which will have an impact on costs and forecast accuracy. For example, on the 4G Communications Hubs and Networks programme, DCC pressed for a resolution as far back as 2017, but the requirements imposed on us from DESNZ (BEIS at the time) have meant that the programme is only now progressing at pace, with implications for certainty on time and cost.

DCC’s costs need to be understood in the context of the broader smart metering programme, the challenges of managing legacy technology and our stakeholder environment. They also need to be considered in the context of the broader realisation of benefits. The NAO report outlined that both the costs and the benefits of the programme are likely to be higher than first anticipated and planned for. This is true for suppliers, consumers and the energy system overall. For example, the NAO highlights that people with smart pre-payment meters automatically received bill support payments over winter 2022-23, providing greater convenience and financial security compared with those on traditional pre-payment meters (it should be noted that had DCC delayed plans related to Civet this would not have been possible).

The recent *edie* Net Zero award for DCC's participation in the Modernising Energy Data Applications programme¹ provides further recognition of the benefits smart metering can have in accelerating efforts to address some of our greatest challenges, including the transition to a net zero economy. With Ofgem's now statutory duty to protect existing and future consumers' interests related to Climate Change, we urge Ofgem to consider DCC's costs in their true context.

The increase in costs reflects a relatively recent move to operating at scale in a varied and complex stakeholder landscape. However, those costs have resulted in significant benefits for existing and future consumers. Failure to consider the consumer benefit derived from costs that Ofgem now seeks to disallow would not represent the best outcome for seeking to achieve the smarter, greener Britain we all wish to see.

¹ <https://www.smartdcc.co.uk/news-events/dcc-and-urbantide-win-edie-net-zero-award-for-ai-software-to-tackle-fuel-poverty/>

3. Licence overview

Summary

- The Price Control process is governed by the Conditions of DCC's Licence. Ofgem is required to comply with the terms of the Licence. It is also subject to its overarching principal objective.
- DCC considers that there are several instances in the Consultation where Ofgem proposed to disallow costs on a basis that goes beyond its powers or has otherwise failed to account for the types of matters prescribed by the Licence, Ofgem's Guidance, and/or its principal objectives.
- In respect of all of these, DCC considers that Ofgem is at risk of making a decision that is contrary to the Licence, outside its powers, and/or open to formal challenge.
- DCC trusts that Ofgem will consider this Response in full and endeavour to exercise its powers in a manner that is consistent with the Licence, its own Guidance, and its principal objective.

Introduction

DCC has included, at Annex 2 of this Response, an explanation of the legal context of the Price Control process, with reference to the terms of the Licence, Ofgem's own Guidance, and its principal objective, in order to determine what Ofgem must do, and what it cannot do, when conducting its Price Control procedure.

In this section 3 of the Response, DCC summarises Annex 2 and identifies instances where Ofgem has made a proposal that is inconsistent with its powers.

Summary of the Price Control process

The Price Control process is governed by the Conditions of the Licence. It must be conducted in accordance with those Conditions. Ofgem would also be expected to comply with its own Guidance on the operation of the Price Control process, albeit the Guidance is not legally binding and – as such – cannot alter the terms of the Licence or create additional obligations. In addition, Ofgem is subject at all times to its overarching principal objective, and the duties imposed upon it by the Gas Act 1986 and the Electricity Act 1989.

Taking the above together, the Price Control may be summarised as follows:

- Condition 37 places a positive obligation on Ofgem to monitor and assess DCC's costs, which includes considering all evidence and explanation DCC provides to justify expenditure. However, the Authority will (and should) use its own initiative in collating and considering relevant evidence, including the types of information described in the Guidance.
- DCC is entitled to receive Allowed Revenue, which includes, amongst other things, the "*actual amount*" of its External Costs and Internal Costs. The only exception to DCC's entitlement to the actual amount of those costs is the extent to which Ofgem may exclude costs that were "*not economically and efficiently incurred*", under Part B of Condition 37. There is no other power to exclude (or disallow) reimbursement of External Costs and Internal Costs to DCC.
- The words "*economically and efficiently incurred*" are not defined in the Licence. As such, Ofgem must consider all information which points to the economy and efficiency of DCC's costs. According to Ofgem Guidance, that will include (amongst other things) any evidence and explanation of trade-

offs DCC has made between cost, quality and/or timeliness of activity, what was within DCC's reasonable control, and the information available to DCC at the time when costs were incurred.

- If an External Cost or Internal Cost is not economically and efficiently incurred, there is no automatic disallowance of the cost. Ofgem "may" (rather than must) disallow the cost. It may instead accept an undertaking in respect of that cost or take no action. Ofgem must make an independent determination as to which is appropriate.
- When making that determination, Ofgem must take into account the factors set out at paragraph 37.9 of the Licence but should also take into account:
 - a) Paragraph 3.9 of their Guidance, which calls for Ofgem to take into account the impact that excluding any cost could have on the operation of DCC's activities.
 - b) Its 'principal objective', which would require it to (i) consider the interests of existing and future consumers as a whole, rather than by reference to any short term cost implication – this might include for example their interest in service continuity or in the reduction of emissions of targeted greenhouse gases (ii) conduct the Price Control in a manner that is transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

Ofgem's deviation from the Price Control process

As stated, the only circumstances in which Ofgem may disallow External Costs or Internal Costs is where those costs have not been incurred economically and efficiently. As a result of this and the above explanation, the Licence does not allow Ofgem to exclude a cost:

- In its entirety where Ofgem considers that the associated service was reasonably required, and so a cost (of some amount) was properly incurred. See Annex 2 paragraphs 7.5 to 7.7.
- That was (in whole or part) not in accordance with an estimate or forecast. See Annex 2 paragraphs 7.8 to 7.9.
- Purely because Ofgem considers that DCC has failed to establish in its own evidence that it was economically and efficiently incurred. See Annex 2 paragraphs 7.10 to 7.12.
- That was incurred in breach of procurement obligations. See Annex 2 paragraphs 7.13 to 7.23.

DCC considers that there are several instances in the Consultation whereby Ofgem proposed to disallow costs on such grounds or has otherwise failed to account for the types of matters prescribed by the Licence, Ofgem's Guidance, and/or its principal objective. For example, and without limitation:

Ofgem has proposed to disallow £4.159m in incurred External Costs and £12.406m of forecast cost relating to DCC's procurement of a new solution for hosting the DCO, which is critical to continuity of the SMETS1 service. As explained more fully in section 4.1 of this Response, DCC procured that new solution in an emergency situation after concerns were raised about the financial stability of the existing provider (a significant subcontractor in the Government's supply chain). DCC was under direct instruction from Ofgem and the Government to prioritise service continuity, and all decisions made in the procurement process were influenced by that instruction. In suggesting that these External Costs were not incurred economically and efficiently, Ofgem has not properly taken into account:

- a) Its own Guidance, in particular (i) the necessary trade-off made between cost and timeliness to ensure service continuity (which was achieved, but with only weeks to spare) (ii) that the impending financial failure of the subcontractor was entirely outside DCC's reasonable control (iii) the information available to DCC at the time, specifically the instruction that a new solution must be procured urgently to ensure service continuity, (iv) given that the relevant subcontractor had in fact not yet ceased trading at the relevant time, DCC had no

leverage with which to negotiate with its own contractor or to require that contractor to assume any part of the cost of the new solution.

b) The interests of consumers, specifically in ensuring service continuity.

- Ofgem has also proposed to disallow up to the entire cost of procurement of the Component Integrator services, which is required as part of the 4G Comms Hubs & Networks, on the basis that it was a direct award procurement. First, direct award of contracts is not a ground for excluding cost. Second, Ofgem has not suggested at any point that there was not a need for the Component Integrator service. There is in fact such a need, and Ofgem must therefore accept that there is an economic and efficient cost for that service. To the extent that Ofgem does intend to exclude any part of the External Cost, it should only be the part which it considers to be over and above an economic and efficient cost.
- Ofgem has proposed to disallow further costs on the basis of means of procurement, including [REDACTED] (see section 5.4.2 below), Project Dynamo (section 5.4.3), and a continued disallowance of new costs associated with various services that Ofgem previously disallowed in RY21/22 (section 5.4). The same point as above applies.
- Ofgem has also proposed to disallow the entirety of further costs where Ofgem must surely accept that the associated services contain some value, including the Executive Leadership Programme (see section 5.3.2 below) and Customer Engagement Portal (section 5.4.5). The same point as above applies.
- Ofgem has proposed to disallow 50% of the salary costs of the Service Delivery function working on the various Network Evolution-related programmes (see section 5.1.4 below) purely because we exceeded the forecast provided more than a year earlier. This is not sufficient justification that costs were not economic and efficient.

In respect of all of these proposed disallowances, and similar disallowances throughout the Consultation, DCC considers that Ofgem is at significant risk of making a decision that is contrary to the Licence, outside its powers, and/or open to formal challenge. DCC trusts that Ofgem will consider this Response in full and endeavour to exercise its powers in a manner that is consistent with the Licence, its own Guidance, and its principal objective.

4. External Costs

Summary

- **SMETS1 Supply Chain (Civet) - Context:** Ofgem acknowledges in its consultation document that the situation required an emergency intervention to ensure business continuity and that DCC's options were constrained. We are therefore extremely disappointed to note that Ofgem is proposing to disallow a significant portion of DCC costs which suggests it has not assessed performance based on the circumstances at the time – which as mentioned in previous sections is in contravention of its own principles. Ultimately, the decisions taken by DCC resulted in a robust solution delivered on time, that has functioned effectively and protected customers from significant disruption to their energy supply. Further this was in line with the explicit direction provided at the time by Ofgem, DESNZ and the Cabinet Office.
- **SMETS1 Supply Chain (Civet) – Disallowance error:** In addition, DCC is disappointed by the inaccuracy of Ofgem's calculations which have resulted in £1.4m of proposed disallowed costs (related to overlap of services) that were never actually incurred.
- **SMETS1 Service Stabilisation:** DCC was compelled by government to use a design for SMETS1 that we did not support due to operational performance concerns, and as acknowledged by Ofgem, it has proven to be technically extremely complex. The costs of running the service are largely consequential to decisions made several years ago. We fundamentally disagree with Ofgem's proposals, and we believe our approach has been in the best customers' interest (including from a cost efficiency perspective).
- **4G Comms Hubs & Networks – Component Integrator:** We disagree with Ofgem's minded-to position to disallow these costs. When it was apparent that the requirements of our vendors were not compatible with the business case we had submitted to BEIS (now DESNZ) and for which we received a non-objection, we worked at pace to provide a robust and cost-effective alternative with a supplier who could meet the requirements in the timescales involved. Delay would have had a significant negative impact on consumers.

4.1. SMETS1: Supply chain

Question 1: What are your views on our proposal to disallow £4.159m in incurred External Costs and £12.406m in forecast External Costs associated with DCC's procurement of an interim solution for the SMETS1 supply chain?

This section 4.1 of our Consultation Response addresses Question 1 and responds to paragraphs 3.52 to 3.63 of the Consultation.

Question 1 relates to DCC's procurement and running of a new, interim solution for hosting the DCO, which is critical to continuity of the SMETS1 service. This aspect of the SMETS1 service was previously provided by UKCloud, a subcontractor of DCC's primary contractor, Capgemini. UKCloud encountered financial difficulty and ultimately entered into compulsory liquidation during RY22/23.

The project to procure the new solution was known as Civet. As summarised at Table 3.8 of the Consultation, Ofgem proposes to disallow the following sums from the Civet cost:

- Alleged overlap of services costs - £1.716m in RY22/23 and £0.858 in RY23/24.
- Build costs - £2.443m in RY22/23.
- Future running costs - £4.471m in RY24/25 and £4.471m in RY25/26.
- Service uplift and management costs - £0.731m in RY23/24, £0.937m in RY24/25, and £0.937 in RY25/26.

In the following paragraphs, DCC will summarise the need for the new solution, the time-sensitive decisions that were made in procuring that solution, and why the associated costs were incurred economically, efficiently, and as a matter of necessity in all the circumstances. DCC will then address each of the 4 proposed disallowances individually and in detail.

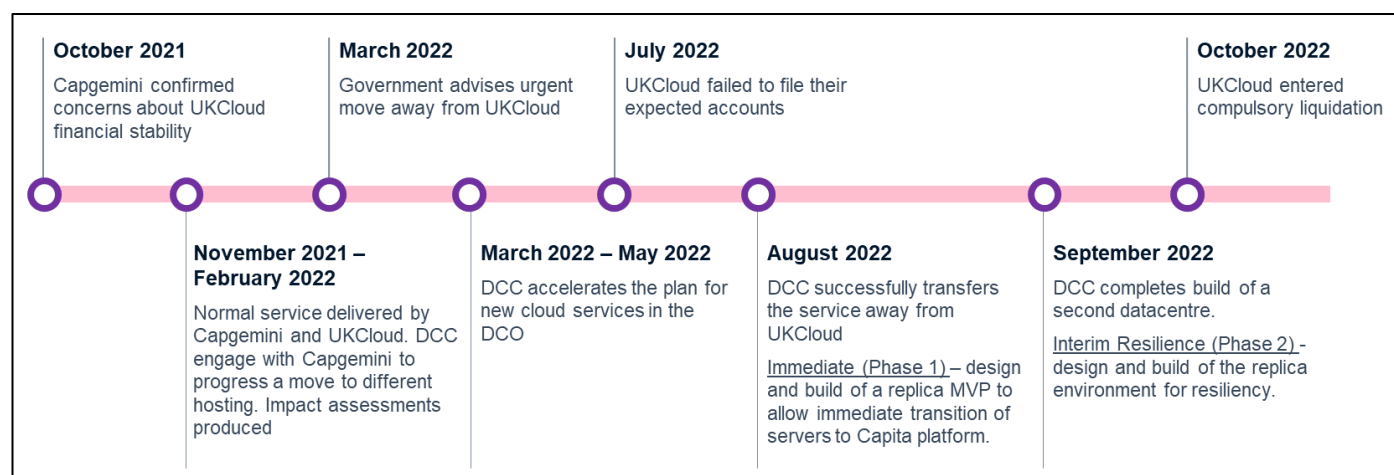
Factual Background

As set out in DCC's original price control submission, and subsequent communications on this matter, from April 2022, DCC managed the urgent move away from one of the sub-contractors within the DCO ecosystem (UKCloud, a subcontractor of Capgemini) due to its impending insolvency.

The building and running of an alternative hosting service resulted from an emergency situation and was therefore unpredictable by nature. It was not due to any fault of DCC, and it was essential for the continuity of core services that a solution was found quickly. DCC responded rapidly and was directed to do "whatever it took" in several engagements with DESNZ, the Cabinet Office, and Ofgem. DCC notes that Ofgem has recognised the urgency of the situation at paragraph 3.58 of the Consultation.

Below is a timeline of the key factual events, starting from the time when Capgemini confirmed concerns in respect of UKCloud's financial stability that were first raised earlier in the year, then the Government's direction to urgently move away from UKCloud as a service provider, and finally the successful implementation of an alternative solution shortly before UKCloud's compulsory liquidation.

Timeline of the main events



Procurement of the new solution

Under the described conditions, and being considerate of the direction from government and Ofgem, DCC made a direct award to the only service provider (Capita) who was able to accommodate a 'lift and shift' solution, as required, within the time constraints imposed. This was successfully delivered, and the service continued without disruption. Delivering a successful solution with no service interruption under these conditions was a major accomplishment. The potential impact on consumers of a service disruption would have been significant, and DCC operated at all times to prioritise the reduction of the risk of service disruption.

The original contract with Capgemini had been in place since RY2018/19. At the time, DCC took legal advice as to its options in light of the UKCloud concerns, over which privilege is not waived. Strictly speaking, failure of a subcontractor such as UKCloud would have been Capgemini's responsibility to resolve, including any associated liabilities. However, UKCloud had not in fact failed at the time of the Government and Ofgem's direction. As such, DCC only had three options:

1. Hold Capgemini to their original contract, which would have required Capgemini to address the eventual failure of UKCloud, but by which time would have had serious repercussions for the

continuity of service provided to customers. DCC had been expressly directed by Ofgem that service continuity must be maintained.

2. [REDACTED].
3. Adopt a practical approach of negotiating with Capgemini in order to agree a solution that avoided loss of service continuity and did not put DCC at risk of receiving a legal claim for significant financial damages.

We were negotiating a contract extension with Capgemini at the time concerns about UKCloud's financial stability were confirmed (October 2021) and had no alternative commercially but to adopt option 3, agreeing that the new contract explicitly removed Capgemini's liabilities for UKCloud. However, that was conditional upon adopting Capgemini's proposed solution on Amazon Web Services (AWS). A full business case was produced that demonstrated the benefits of moving to this AWS solution. However, a Government-imposed constraint that 'build and migration' had to occur before the October tariff change removed this option. As a result, DCC was required to negotiate a solution [REDACTED].

Costs economically and efficiently incurred

In respect of the implementation of the above course of action, Capgemini were paid to cover (i) on-demand support, (ii) procurement of third-party licences for a private cloud provided by Capita, (iii) support to Capita in their build of a second data centre, and (iv) service transition and infrastructure decommissioning. Build costs were paid to Capita to cover set-up, labour, test and run costs for the new data centre.

Incurring these costs was an essential part of ensuring the smooth and timely transition away from UKCloud to the new solution. However, as explained above, Capgemini's existing contract did not require them to provide any of these services.

DCC does not believe that a different procurement approach would have had any impact on the outcome as we would still have been negotiating a final contract against the backdrop of UKCloud's insolvency and this commercial reality would have always been reflected in the deal struck. A full procurement exercise would also have risked making public the fact UKCloud were encountering solvency issues, something DESNZ had sought to avoid. Seeking to criticise DCC with the benefit of hindsight overlooks the need to consider the facts and circumstances that were known to DCC at the time. The 'perfect storm' of events that led to this issue could not reasonably have been predicted or mitigated.

The disallowances that Ofgem proposes are costs that were necessarily incurred, and which inevitably arose from the actions that DCC was required to take:

- Build costs – In summary, it goes without saying that in building a replacement solution it was necessary to incur build costs. It is extremely difficult to understand Ofgem's approach. [REDACTED]. It is not understood what is meant by Ofgem's suggestion that these costs "should have been included in the build costs of the incoming service provider". The costs were necessarily incurred by the appropriate parties to deliver each service, and needed to be recovered by the companies that incurred those costs. A further explanation of each relevant cost is provided at Section 4.1.2 below.
- Future running costs – In summary, we have clearly set out the timelines of the existing contractual arrangements and the probable timelines of a new procurement exercise. DCC will be undertaking a procurement process for a permanent replacement solution as requested by Ofgem. However, as explained in paragraph 4.1.3 below, the option of having a completely competitively procured

solution in place before the end of the existing contracts would be impractical and would offer no value for money to customers. For the reasons explained, an extension of the existing interim solution, and the forecast costs, to allow sufficient time for a full procurement is the most economic and efficient solution. Further, it is not open to Ofgem to disallow the entirety of a cost because it considers a different solution may be more economic and efficient (or because it wishes a procurement process to be carried out). It may only disallow that part of the cost not economically and efficiently incurred.

- Service uplift and management costs – In summary, the disallowance that Ofgem suggests is a sum that Capgemini is entitled to under its contract. The obligation to make these payments was economically and efficiently incurred for the reasons set out in Section 4.1.4 below. Failure to pay such sum to Capgemini would be a breach of contract.
- Alleged overlap of service costs – In summary, Ofgem has misunderstood the position. As a fact, there was no cost overlap from October 2022. See evidence below. As to the remaining element, the costs were economically and efficiently incurred for the reasons set out in Section 4.1.1 below.

The proposed disallowance of legitimate costs incurred during this project, that were unavoidable due to the timing and contractual constraints imposed, sets a very difficult precedent and materially increases risks for future such activities. This will make it impossible to deliver an equivalent outcome should a similar situation arise in future. In turn, it may have serious consequences for system stability and security.

Key points of evidence

- Overlap of services – The Capgemini billing sheets (excerpt below) show no charges after October 2022 (for services delivered in September 2022) therefore showing no overlapping costs after that point. In total, £1.43m of proposed disallowed cost was not incurred and so cannot be disallowed. The remaining costs, which were economically and efficiently incurred, are set out in Section 4.1.1 below.
- Build costs - No additional evidence needed. Please see explanation for costs above and at Section 4.1.2 below.
- Future running costs – No additional evidence needed. See explanation above and at Section 4.1.3 below.
- Service uplift - No additional evidence needed. See explanation above and at Section 4.1.4 below.

Customer support

The significant negative consequences of not being able to secure the continuity of this core service are well understood by our Customers. As such, they have been supportive of our successful efforts to find an urgent alternative solution in difficult circumstances. It should be noted that DCC Customers were happy to express their support for our successful efforts at the Ofgem Customer Stakeholder Engagement Event on 8 December 2023.

4.1.1. SMETS1 Supply Chain (Civet): Overlap of services

Ofgem has proposed to disallow £1.716m of costs it claims were incurred through the dual running of the previous and new Service Providers. However, of this, £1.43m was not actually incurred and cannot be disallowed by the terms in the Licence that permit only actual costs to be disallowed from the Allowed Revenue calculation.

Currently Ofgem is proposing to disallow costs that it believes have been incurred in RY22/23 from October 2022 until March 2023. However, DCC made their final payment to Capgemini in October 2022, relating to services provided to the end of September. There, were no payments to Capgemini on this matter after that date. Therefore, the balance of the costs (5 months) for RY22/23 (£1.4m) cannot be disallowed as they were not incurred. Further, the forecast costs in RY23/24 (£0.9m) that Ofgem has

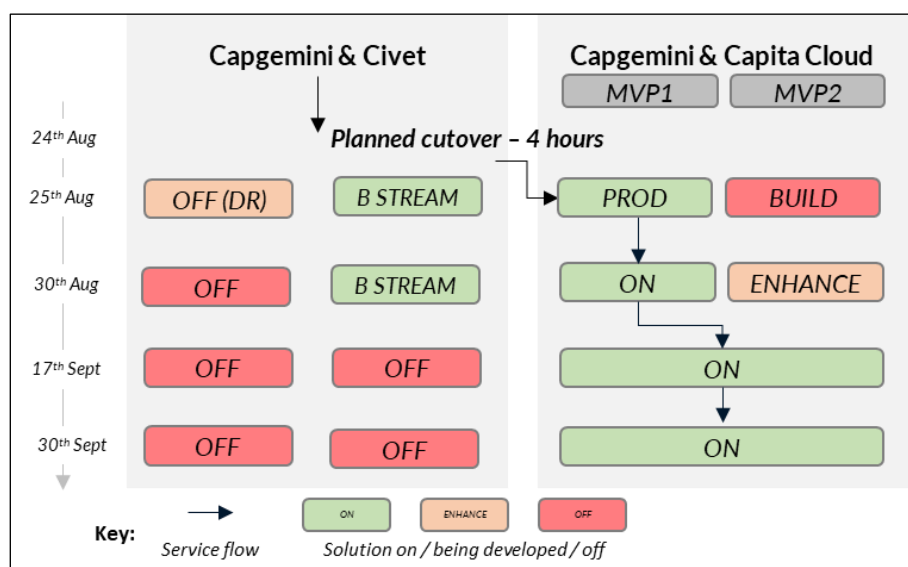
incorrectly identified, and is minded-to disallow, should be removed from the final decision, as no costs have been paid to Capgemini since October 2022.

DCC have clear evidence that while the previous contract was in place until July 2023 (as Ofgem correctly state), no costs were incurred after the end of October 2022, as it was a volume-based contract, and no chargeable activity was undertaken. We have provided the Capgemini billing sheets to show that this £1.43m of cost was not incurred and so cannot be disallowed. We provide a summary below. It should be noted that the months in the table relate to the date that the services were delivered. Capgemini typically sent invoices in the month following the delivery of services, so the final UKCloud costs for September service were invoiced in October.

Capgemini DCO invoices summary – August 2022 – December 2022

Service delivery month	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22
Pricing Unit					
DCO Enduring - Fixed	£830,179	£830,179	£830,179	£830,179	£830,179
DCO Enduring - AppDynamics Licensing etc	.	£20,006	.	£39,754	£54,915
DCO Enduring – Variable (including UKCloud)	£244,401	£235,742	.	.	.
Total Capgemini DCO invoice value	£1,074,580	£1,085,927	£830,179	£869,933	£885,094

After removing the £1.43m of costs not incurred from the proposed disallowance, this leaves £0.29m for dual running costs actually incurred. The overlap of service where duplicate charges were incurred was the 37 days between 24 August 2022, when production services were first running on the Capita single site, and 30 September 2022, when the cutover of non-production environments was completed. The diagram below provides an overview of events during this overlap period. It shows the initial planned cutover (24 August), the necessary harvesting of hardware security modules (HSMs) (started 30 August, completed 30 September), and the commissioning of MVP2 on 17 September.



It is reasonable, and indeed essential, to have a short overlap of services provision. There is a risk of service disruption during any handover of service provision. To have no overlap would require a seamless instantaneous fault-free switch over, with no room for error or delay. Given the impact to consumers of any service disruption, it would be reckless of DCC to not mitigate this risk. A five-week overlap is actually very short for a project of this scale and complexity – indeed, a customer at Ofgem’s Stakeholder Event stated that three months would have been expected. As such this £0.29m of dual running costs reflects excellent value for consumers in mitigating the risk of service disruption.

4.1.2. SMETS1 Supply Chain (Civet): Build costs

Ofgem is concerned about the level of the build costs for the replacement solution to UKCloud. Specifically, the costs associated with PR7399 (£1.233m) and PR7411 (£1.210m) paid to Capgemini. We are disappointed that Ofgem is proposing that these costs, and others associated with Civet, are to be disallowed. Despite the clear requests to DCC for action from the Cabinet Office, Ofgem and DESNZ, the fact that Ofgem is proposing to disallow costs, clearly does not take into account all relevant facts and circumstances at the time (which is contrary to Ofgem’s guidelines and DCC’s Licence).

The speed of response and set-up (build) of the new cloud solution, was unprecedented, with the initial datacentre being built in only 63 days. This was intended to be stood up as an MVP only. At all times DCC was responding to the shifting dynamics of the risk, and potential scale of impact, of a service failure. As the new solution was being built and tested, it also became apparent that the situation relating to UKCloud was worsening. As the situation worsened, so the risk and the potential scale of impact increased. Related to this, the Cabinet Office had made it very clear that there were essential services that would be disrupted should there be a service interruption, and it was imperative that this did not happen.

To ensure there was no service interruption, the design and subsequent build activity moved from a single data centre to dual data centres – which is the standard environmental configuration for all SMETS1 live services. In accordance with standard DCC Business Continuity and Disaster Recovery (“BCDR”) obligations on its service providers, and DCC’s own licence obligations, one of these data centres would provide the primary service with the other providing disaster recovery functionality if the primary data centre failed. This also removed the dependency on UKCloud for fail over support, which was both sensible and required.

The Smart Energy Code (SEC) sets out the requirements for DCC’s BCDR procedures (section 5.2).¹ This sets out the mitigation measures that DCC “shall implement”. These include the provision of a primary and a secondary data centre, to allow DCC to fail over to the secondary data centre in the event of the loss of the primary data centre.

PR7399 and PR7411 relate to the costs of delivering the two data centre solution. Had we not opted for this, we would have been in breach of the SEC. If there was a failure of the service at cut over, the entire SMETS1 network would have failed, prepayment top ups would not have been possible and government would not have been able to process the Energy Bill Support scheme payments in October 2022, potentially putting the safety of hundreds of thousands of customers at risk.

It is not unusual for DCC to use Project Requests (PR) to cover the initial design, build and test activities, with contract change then being used to apply the associated impacts on the run part of the service, as set out in the contract / agreement. The Deed and Restatement change on the Capgemini contract was the contract change route to apply the changes to the DCO run service resulting from these two PRs.

PR7399 covered the procurement of required licenses (or support cost from third party for software/hardware) to enable the project to deliver this private cloud emergency interim capability, and the greater resilience and service security it provided. The licences enabled disaster recovery (DR) services for emergency interim capability for Testing in different environments during the Build & Test, Standby,

¹ <https://smartenergycodecompany.co.uk/the-smart-energy-code-2/>

and Live Services phases. These licences were essential, even just for testing, let alone operation of the solution.

Given the changing risk and impact dynamic, there was insufficient time available to engage the market and seek alternative credible bids. DCC sought to secure value for money through its effective contract management. The initial purchase order set out a safety-first fall-back position. The nature of the transfer between Capita and UKCloud created periods over duplication and redundancy. DCC and partners were committed to not overspending and would strive to bring the PR in below the full price. In the end, the work (and accompanying licences) was achieved with less than half of the initial budget.

PR7411 covered the costs of the essential additional equipment and services for second data centre for DCO and Commissioning Party (CP) in Farnborough, geographically separated from the initial DCO based at Corsham (primary data centre). In order to meet the time constraint imposed by DESNZ, this needed to be operational by 18 September 2022. The primary requirement was to uplift the Farnborough data centre to have the same capability as that in Corsham.

Given the changing risk and impact dynamic, there was insufficient time available to engage the market and to seek alternative credible bids. DCC sought to secure value for money through its effective contract management.

PR7411 covers the time and material use of resources to carry out a range of tasks as set out above. The initial scope was clarified, following a process of engagement between DCC and the supplier. Further engagement continued across the period from June 2022 to September 2022, with DCC challenges and queries being responded to by the suppliers. This ensured that the initial scope was as tight as possible, and the further changes in the statement of works were confirmed as necessary and not excessive, thereby reducing the unnecessary costs and improving the value for money to customers.

Both PR7399 and PR7411 should be considered as part of the main build cost, which has been allowed. Like the main build costs, they are a sensible response to changing events that prevented potential loss of service that would have created great disruption and cost to Customers and Consumers.

4.1.3. SMETS1 Supply Chain (Civet): Future running costs RY24/25 onwards

Through the programme of work set out above, the decision was made to move the hosting services from UKCloud across to Capita under the emergency clause of the Applications, Network and Security Operations (ANSO) contract.

This revised service has been live since October 2022, with newly conformed contracts being put in place with both Capgemini and Capita. However, due to the complexity of the service split, contracts were not concluded until August 2023. It was therefore impractical to kick off a new procurement exercise whilst we were still finalising the restated agreements with both Capita and Capgemini as the baseline was still in flux (e.g. ways of working and systems that any new provider would be transitioning away from). The ANSO contract continues to provide the service wrapper around the hosting provided by Capita.

Our focus now needs to turn to securing these services for the future, in line with the broader SMETS1 strategy. The table below illustrates current contractual positions across the DCO ecosystem:

Contract & Purpose	Supplier	Expiry date	Extension rights
Applications and Hosting contract: Provides hosting for the DCO and CP applications	Capita	31 Mar 2024	Options up to end date 31 Oct 2027 (directly negotiated by DCC)
Applications, Network and Security Operations (ANSO): Hosting service wrapper	Capgemini	31 Oct 2024	3 x 12-month extension options – max end date 31 Oct 2027

DCO Application support: Support for the bespoke DCO application, CP application, Interoperability Checker (IC) and Representative Test Environment (RTE)	Critical Software (CSW)	31 Oct 2024	None
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DCC is seeking to put in place an enduring DCO solution which will be procured competitively based on refreshed business needs developed in consultation with customers. A full competitive tender and programme of work to handle the service transition could take until the end of 2026, but current contracts only provide operational service until 2024.

Competitively procuring the two-year extensions is not a practical option, as the procurement itself would take 18 months before design, build and test could commence. Competitive procurement for a service for a limited duration would not create any value for end consumers and it would be more sensible to focus on the competitive procurement of the enduring solution.

Doing nothing is not an option as it would mean the contracts run until the end of their respective Initial Terms and move into exit position with no strategy to replace the DCO Service, thus rendering SMETS1 inoperable. This would be an unacceptable risk as it does not allow any business continuity, and the SMETS1 service would become inoperable, and would offer no value for money but significant customer and consumer detriment would be incurred.

To run a full procurement (with the RFP covering all three contracts planned to be launched in January 2024), DCC will need to extend the existing contractual arrangements on a like-for-like basis until the end of 2026.

Ofgem accept DCC's decision to enter into this emergency contract on an interim basis but expects DCC "to run a complete competitive procurement for an enduring solution at the earliest possible opportunity." Ofgem then state it is "minded-to exclude from DCC's Allowed Revenue all of forecast enduring (run) costs following the contract end date in April 2024." In so stating, Ofgem appear to be of the view that a full competitive procurement could be satisfactorily completed, and a new service implemented, by April 2024.

This is not the case and is impractical and unreasonable. April 2024 is not, in DCC's view "the earliest possible" date for a new competitively procured service to be operational.

It is worth noting that any such disallowance as described above would require us to consider further options in order to be able to safeguard continuity of service, given that we would effectively be unable to pay one of our service providers for their provision of services.

We also note that in its information request under LC29 of 10 November, Ofgem asks for "an explanation for why DCC did not put in place plans to competitively procure the enduring solution immediately and allow for sufficient time for that solution to be implemented ahead of contract expiry of the interim solution."

As noted above, due to the complexity of the service split, the Capgemini and Capita contracts were not concluded until August 2023. It was therefore impractical to kick off a new procurement exercise whilst the baseline was in flux. The Licence, specifically, does not require DCC to run competitive procurement processes where it is impractical to do so.

In summary, we believe that the forecast costs for the interim solution into RY24/25 and RY25/26 should be allowed because the option of having a completely competitively procured solution in place before then is impractical and would offer no value for money to customers. Therefore, an extension of the existing interim solution, and the forecast costs, to allow time for a full procurement is the most economic option.

In any event, for the reasons set out above, Ofgem does not have the power to disallow the entirety of this cost purely because it wishes a procurement process to proceed in the future. Ofgem may only disallow a

cost not economically and efficiently incurred. It may not disallow the entirety of a necessary cost simply because it does not agree with an element of it.

4.1.4. SMETS1 Supply Chain (Civet): Service uplift and management

Rebuilding the DCO service at extremely short notice required DCC to make pragmatic decisions to avoid significant disruption to the SMETS1 service. The solution required two data centres – one for primary operation and another for disaster recovery in the event the primary solution failed. Both of these Capita-owned data centres were ideally suited to a rapid “lift and shift” of the Civet solution but could not replicate some features of the prior service in the time available, which created additional challenges and costs:

- **Service Uplift and Management**
 - Given the situation, DCC made the decision that Capgemini should perform the Managing Agent role, directly managing Capita to ensure continued high performance. The Managing Agent charges are included in the Service Uplift charge and includes the full-time resource costs of two FTEs.
- **The loss of Control Plane software**
 - Removal of the Control Plane from Capgemini impacts its ability to perform day to day operations of the cloud estate and increases effort by approximately 10% across the Capgemini teams.
 - Operational tasks (such as snapshots, power up/down/reset and configuration changes) now all need engagement with Capita to complete, imposing additional resource time and associated costs.
 - Actions taking more time and needing more coordination between both organisations to understand requests, carry out necessary investigations and action appropriately.
 - Reduced incident investigation tool, resulting in additional time and effort to identify and remedy incidents.
 - Service Integration (SI) now requires a bridge to Capita.
- **Functional differences arising from the new service versus the old fully-integrated UK Cloud solution**
 - Changed service and technical model which initially resulted in increased incidents and operational issues.
 - Different Core Change Hours - Capita utilises a shared platform where the majority of work is out of hours, thereby increasing out of hours support provided by Capgemini.

The combined effect of the above was that incremental service uplift and management charges were £92,100 in July and August 2023 and £78,100 in subsequent months. These charges are set out in the table below.

Average Monthly Charges (£ k):	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24
Service Uplift	70.9	70.9	56.9	56.9	56.9	56.9	56.9	56.9	56.9
Agency Management	21.2	21.2	21.2	21.2	21.2	21.2	21.2	21.2	21.2
Total CAN Incremental Charges***	92.1	92.1	78.1	78.1	78.1	78.1	78.1	78.1	78.1

DCC challenged these charges extensively and negotiated hard with Capgemini to ensure a downward glidepath of the Service Uplift charge reducing over time, as can be seen above. The original proposed charges (inclusive of April 2023 indexation) were quoted as £80k per month, which we negotiated down to £70.9k, a saving of over 11%.

Ofgem is proposing to disallow these costs but has not offered an explanation or any evidence that DCC could have delivered the service more efficiently. Ofgem seem to be suggesting that because other areas of costs (e.g. running costs) have risen, then costs relating to service management should not also increase. This is an illogical position and not an evidence or fact-based view. The reality is that these activities (and therefore costs) are essential, and DCC negotiated hard to achieve favourable rates with the supplier.

In its Price Control Processes and Procedures guidance, Ofgem commits to assessing DCC's performance based on the circumstances at the time and not with perfect hindsight. We would remind Ofgem that the decisions we took resulted in a robust solution that has functioned effectively and protected customers from significant disruption to their energy supply. We had no options other than to pursue the replacement system via Capita, with the various challenges that entailed.

4.2. SMETS1: Service stabilisation

Question 2: What are your views on our proposed cost disallowance of up to £2.675m in relation to SMETS1 service stabilisation in RY22/23?

This section 4.2 of our Consultation Response addresses Question 2 and responds to paragraphs 3.64 to 3.72 of the Consultation.

Question 2 relates to DCC's cost of stabilising the SMETS1 FOC Service, which involved maintenance, bug-fixes and the like in respect of the FOC Service. Similar costs have previously been incurred by DCC in stabilising the IOC and MOC Services (Initial and Middle Operating Cohort respectively).

At paragraphs 3.71 and 3.72 of the Consultation, Ofgem proposes to disallow £2.675m from the total cost of stabilisation. Ofgem has since confirmed in correspondence that the breakdown of its proposed disallowance is as follows:

- Project Request (PR) Costs of £0.736m from services provided by [REDACTED].
- Maintenance Release Costs of £0.263m from services provided by [REDACTED] and £0.326m from services provided by CGI.
- Alleged "unjustified" costs of £0.348m from [REDACTED], £0.776m from [REDACTED], and £0.083m from CGI.

In the following paragraphs, DCC will summarise the relevant factual background as to the need for service stabilisation, and why the associated costs were incurred economically, efficiently, and as a matter of necessity in all the circumstances. DCC will then address each of the 3 proposed disallowances individually and in detail.

At the outset, DCC should express its concern that Ofgem proposes to disallow these costs on the basis that it would have preferred an alternative solution to avoid these costs and/or which would have allowed certain further costs to have been recovered from the suppliers. However, the alternative solution would have been around four times more expensive than the solution adopted. In this respect:

- Ofgem has not followed its own Guidance in looking to the counterfactual. In particular, it has not fully appreciated the extent of increased costs that would have been incurred with its preferred counterfactual solution.
- Ofgem has also misdirected itself as to its powers by disallowing the entirety of a cost for an activity rather than an element that it says is not economic and efficient (although here the alternative would have been more expensive).

Factual Background

Following delivery of SMETS1 FOC Service, DCC has been working to complete the remaining activities with regards to work off, tech refresh, enduring requirements, and ultimately the end-of-life service for SMETS1. In parallel, DCC has been migrating FOC Installations in British Gas and Npower SMSOs, but in doing so, have encountered unforeseen challenges in the migration process. Given the size, complexity, and challenge in resolving these issues, DCC developed, and has been delivering, a FOC Stabilisation plan.

We have reminded Ofgem on several occasions that government insisted on the SMETS1 service being designed to include DCO functionality. We advised against this design and proposed the build of a new head-end but were unable to secure government approval. Had DCC's preferred design been adopted, the SMETS1 migration issues would have been significantly fewer and less costly to resolve, not least because the DCO would not have been required.

Costs economically and efficiently incurred

In crucial areas, the design of the SMETS1 solution has largely left DCC to face significant challenges over which it has limited control, and it would be unreasonable for this not to be taken into account in Ofgem's decision.

Ofgem has proposed to disallow a number of costs incurred in stabilising the FOC cohort. For complex projects such as this, maintenance release and bug-fixes are common. Of the 77 changes in FOC, DCC successfully challenged 69 as being defects. These were subsequently paid by the supplier at fault. However, in seven instances, there were also consequential costs incurred by other suppliers as a result of the fix. DCC's contracts do not provide for the pass through of these consequential costs. That is normal industry practice. The reason is that requiring suppliers (or contractors) to take liability for such consequential costs would significantly increase their risk, which they would pass back to DCC through increased costs for providing the service. Duplicated across the whole supplier base, such cost increases would be material to DCC. In turn, DCC would then need to recover those higher costs through its External Costs from consumers. It is therefore more economic for this risk to be retained by DCC and to incur the relatively small costs of fixes as they occur. We would expect that point to be uncontroversial.

Ofgem's proposed disallowance of fix costs would suggest that testing should be carried out in a pre-productive environment (i.e. before the system is migrated) to avoid the need for fixes. However, a decision was taken not to build a pre-productive environment for testing migrations as the cost of doing so was prohibitively expensive (and far higher than the cost actually incurred in addressing faults as they arise) and would still not be guaranteed to identify all the faults. This decision has been borne out in that the two faults leading to PRs being needed (discussed further below) would not have been identified until migrations were scaled up in the live environment. The costs incurred across the PRs and maintenance releases were therefore significantly lower than the counterfactual.

The disallowances that Ofgem proposes are costs that were necessarily incurred, and which ultimately reduced DCC's overall spend. In summary:

- PR costs – The counterfactuals to Ofgem's proposed disallowances would both have resulted in DCC incurring a significantly greater cost, which DCC would recover as part of the Price Control and which would not represent value for money to consumers. That is the opposite of what DCC is required to achieve under the Licence, as further explained at Section 4.2.1 below.
- Maintenance release costs – As with PR costs, Ofgem does not appear to have accounted for the increased costs of the counterfactual. As explained at Section 4.2.2 below, defects and defect resolution are a standard and necessary part of any software release process, and the level of defects experienced was below industry average.
- Alleged “unjustified” costs – As explained at Section 4.2.3 below, of the £1.246m that Ofgem proposes to disallow for FOC Stabilisation costs, circa £532k does not in fact relate to FOC

Stabilisation. In respect of the balance, Ofgem proposes to disallow costs that DCC validly and necessarily incurred on grounds that it is not empowered to do so.

The proposed disallowance of these legitimate costs, incurred as part of the typical process of addressing defects in new software, would require DCC to adopt a counterfactual that materially increases the cost of future service provision and have negative consequences for delivering value for money.

Key points of evidence

- PR Costs – No additional evidence needed. Please see explanation for costs above and at Section 4.2.1 below.
- Maintenance release costs - No additional evidence needed. Please see explanation for costs above and at Section 4.2.2 below.
- Alleged “unjustified” costs – An explanation as to which of the proposed disallowed costs do and do not relate to FOC stabilisation has been provided at Section 4.2.3 below, along with further justification in relation of all costs incurred.

4.2.1. PR Costs

Ofgem has proposed to disallow costs associated with PR7553 and PR7505 of £0.085m and £0.685m respectively.

PR7553

On 25 October 2022 a production incident resulted in a number of migrations failing due to a DCO error during the rotation of ESME authentication or encryption keys, after the rotation of the master key. The fix for this error was made by the DCO at zero cost to customers. However, as with all DCC's contracts, where an issue is found in other parts of the ecosystem that affects other service providers, it will impose consequential costs on those suppliers. The cost of PR7553 relates to [REDACTED] making the necessary changes in the S1SP retry strategy so that such failures of the migration key rotation job could be re-executed successfully.

For the reasons set out above, DCC's external service provider contracts do not make our service providers liable for consequential costs incurred by other service providers in responding to issue fixes. Ofgem's proposal to disallow consequential costs is not justified, as the cost was incurred economically and efficiently.

Further, Ofgem's proposed approach has the potential to create significant cost increases. The logical result of Ofgem's proposed disallowance would be for DCC to renegotiate each of its supply contracts to make each supplier liable for any consequential costs resulting from defaults. In turn, the cost of each relevant contract will increase. That increase across the board will be significantly greater than the consequential loss sum recovered by DCC from defaulters through the additional right, which would be the opposite of what DCC is required to achieve under the Licence.

PR7505

As set out in the submission, PR7505 relates to the design change costs of remedying a rollback failure. In testing, the failure mode was analysed as being at very low volumes, but in upscaling it was found to be significantly more prevalent. This meant we had to instruct Trilliant to make design changes to make the “Installation Rollback” migration process in the S1SP system more robust.

Ofgem's position appears to be that the cost could (or should) have been avoided by bringing up performance of its suppliers, which, if intended to avoid any issues in the services provided, would require testing in a pre-production environment. As with all of DCC's cohorts, FOC does not have a pre-production environment. The reasons for this are:

1. **Economy and efficiency:** DXC produced a strawman quote for a pre-production environment for FOC and costed it at £4m for implementation, plus support service, plus other SPs (DCO/DSP) support development/implementation.
2. **Pre-Production cannot be representative:** even if real meters were used, an extremely large cohort of meters would be needed to recreate the situation we encountered with FOC as it scaled in production. It is unlikely we would have recreated a similar situation in a pre-production environment to what actually happened in live operation. As a result, a pre-production environment may not have identified the issue. An alternative to real meters would have been to use emulators, but again our assessment was that these failures would not have been picked up using an emulator-based pre-production environment.

In the case of FOC we believe the decision not to have a pre-production environment is robust given its cost and limitations. DCC's decision enabled Go Lives (MVP, R2.1, R2.2), and has proved to be cost efficient against the cost of a pre-production environment for FOC (£4m), plus the previously avoided costs for IOC and MOC. Ofgem does not appear to have accounted for the costs of the counterfactual analysis in its proposed disallowance.

4.2.2. Maintenance Release Costs

Ofgem has proposed to disallow the costs of four maintenance releases: May 2022, June 2022, August 2022 and November 2022 at a total cost of £0.7m. We believe Ofgem has proposed to disallow these costs as it views them as being consequential costs arising from defects for which DCC or its external service providers should be held liable. As set out above, DCC's contracts do not make our service providers liable for consequential costs of this nature, and Ofgem should avoid establishing a precedent that they should, given the impact would be more expensive contracts and higher costs to customers.

As discussed above, defects and defect resolution are a standard part of any software release process. Similarly, the use of maintenance releases (regular or ad-hoc) is routine; indeed, in some environments it is not uncommon for very frequent (e.g. weekly or more often) releases. DCC opted for regular monthly FOC-related maintenance releases, to capture all defect fixes completed in that month, and to push them out.

The average cost of a maintenance release in the FOC cohort was £140k with 11 releases in RY22/23 summing to £1.5m, providing a £2.5m Positive Business Case against the indicative cost of building a pre-production environment (when compared with the £4m cost of a pre-production environment). The benefits would be larger when taking into consideration the avoided costs from delaying Go-Live and the avoided additional support costs from DCC's service providers if a pre-production environment had been used.

Ofgem should also be aware that the Trilliant defects which have resulted in maintenance release costs are not materially different to the industry average. Software Engineering Standards identify between 1-70 defects per 1,000 lines of code is the industry average in test. Given scaling defects were time delayed, the 73 found against the c.1.7m lines of the Trilliant S1SP Code is below industry average. It is not the case that the FOC cohort has experienced significantly different costs of defects and defect fixes. In addition, we have also ensured that customers are protected from costs being passed through unnecessarily by challenging the root cause of defects such that 69 of the 77 changes (89.6%) made to FOC were successfully challenged as defects by DCC and resolved at the service provider's cost.

4.2.3. "Unjustified" costs

Ofgem identified a number of transactions that it is minded to disallow unless DCC provides additional information on their economy and efficiency.

These costs can be grouped into two categories.

- First, costs incorrectly coded which do not relate to FOC Stabilisation.
- Second, costs related to FOC Stabilisation.

Costs incorrectly associated with FOC Stabilisation

The first group are costs were incorrectly coded as being a direct part of FOC Stabilisation and are not in fact FOC Stabilisation costs at all. These are pure coding errors in the underlying SAP system and should be allowed, as Ofgem's grounds for disallowance of FOC Stabilisation costs do not apply to them.

The following costs (£522,958) are those not related to the FOC Stabilisation activities in RY22/23.

Entry	Provider	Cost	Description
PR7375	████	£ 47,822	This was not related to FOC stabilisation. It was a targeted uplift for opt-in, opt-out (OIOO). Script deployment, not a maintenance release. This is part of a mandated programme and as such, the work is mandated by government.
PR7523	████	£34,726	This was not related to FOC stabilisation, instead it is BAU operations change for capacity and traffic management. It reduces attempts to connect to a device from 4 to 2 to increase available network capacity.
Devices	████	£21,240	This does not relate to FOC Stabilisation. This relates to the purchase, in April 2022, of 143 additional devices needed for testing, as DCC's stocks were running low. Devices included E470, G470, G370, NP2 CHF, and IHDs. They were purchased through a variation to the NCP0054 contract with Npower (now novated to Eon).
CR4669	████	£15,800	<p>This was not related to FOC stabilisation, instead it is BAU operations change for network traffic management.</p> <p>The nightly push data from the Comms Hub includes incomplete daily (cumulative) reads data. This data is persisted in the database and deleted by a daily script. DCC decided not to use the daily reads data contained in the nightly push to respond to SRV 4.6.1, therefore, the data serves no useful purpose in the database and processing of the data takes away resources that might otherwise be used for other purposes.</p> <p>Requirement was for █████ to implement a change to stop the Comms Hub from pushing daily reads data in the nightly push</p>
CR4819	████	£ 219,870	<p>This work relates to the expediting of key changes under the FOC Programme and is not linked to Defect or Maintenance Release costs.</p> <p>Specifically, it concerns the enduring process for rotating CHF keys before they expire. This is the rotation of the Push and Operate Certificates 5 years after migration to allow the Devices to continue to operate. It must be done or the entire estate will be lost. This is just a time delayed piece of work that wasn't contracted initially and is specific to FOC.</p> <p>The costs here are from in January 2023, covering the costs of the Full Impact Assessment work by █████.</p>
PR7139	████	£ 63,500	This is a delayed invoice related to a maintenance release in December 2021, therefore out of RY22/23.

Following on from the deployment of FOC Uplift 2.2 in October 2021, it was expected that there would be a number of defects which will require fixing shortly after go-live in order to remove any Operational impact and align with the expectations of key stakeholders. These were delivered as part of the December 2021 MR.

At the time, DCC committed to industry and BEIS (now DESNZ) to deliver a number of defects/changes in the next available release. The timing of the items in this PR is agreed with relevant Service Providers as December 2021.

PR7246		£120,000	This was not related to FOC stabilisation and was incorrectly coded as such. It is a CH&N cost.
Total costs	£ 522,958		

Costs correctly associated with FOC Stabilisation

The second category is costs correctly associated with FOC Stabilisation.

DCC does not understand the reasoning that Ofgem gives in the Consultation. Ofgem says “over 90% were incurred by two service providers whose poor performance contributed to the identifiable Unaccepted Costs discussed above and which was observed by the independent auditor in their report”. However, the correct test for Ofgem to apply is whether the costs were not economically and efficiently incurred by DCC. There is no suggestion that DCC was not required, by contract, to pay these costs to the relevant suppliers. The costs were incurred in the usual course of business. The consequences of the disallowance would be to refuse to pay DCC for costs it validly and necessarily incurred with service providers. Ofgem is not empowered to disallow such costs.

The following costs (£746,492) are related to FOC Stabilisation activities in RY22/23 and have been economically and efficiently incurred.

Entry	Provider	Cost	Description
PR7336		£ 22,917	This PR is to cover the testing of Incident fix 824150 in UIT-A. was responsible for building on top of the current (at the time) production baseline (March MR). This was uplifted to UIT-A by before testing was completed ahead of deployment to production and test exit. uplifted this release to UIT-A.
PR7372		£ 683,375	platform upgrade required to reduce costs of extended maintenance. This is standard BAU activity, upgrading to prevent going out of support. As deemed critical national infrastructure, it is obviously essential that all support is kept fully up to date.
CR496		£ 14,900	Investigative analysis was required regarding some server problems that were experienced. This change was to provide DCC with costs, together with likely associated benefits, of two possible solutions being proposed, so that DCC could select the best one.

PR7517	██████	£ 25,300	DCC and ██████ worked together to fix a top up vends issue with SRV2.2. Functional testing was unable to assign responsibility for the fix.
Total costs		£ 746,492	

4.3. 4G Comms Hubs & Networks: Procurement of new Fundamental Service Capability

Question 3: What are your views on our proposal for a disallowance up to the amount of External Costs incurred on a directly awarded contract in the 4G CHs & Networks programme?

This section 4.3 of our Consultation Response addresses Consultation Question 3 and responds to paragraphs 3.73 to 3.83 of the Consultation.

Question 3 relates to the cost of one of the contracts procured by DCC as part of the programme to replace existing 2G and 3G Comms Hubs and associated infrastructure with new 4G equivalents. The contract concerned the Component Integrator service. Ofgem is proposing to disallow up to the entirety of the £2.9m cost incurred in RY22/23 on that contract on the basis that it was a direct award procured.

In the following paragraphs, DCC will summarise the relevant factual background as to why the contract was procured as a direct award basis and explain what additional information has been provided to Ofgem to justify that the associated costs were incurred economically and efficiently. In addition, DCC will address the fact that Ofgem is not empowered to disallow costs on the basis that it suggests.

Factual Background

We explained in our price control submission that DCC proposed to BEIS (as was), in the CH&N Outline Business Case (“OBC”), that DCC would perform the role of Component Integrator. The scope of this service would be to provide management and assurance services to the various componentry used by the programme to ensure compatibility. We were open about this proposed approach with stakeholders throughout the development of the business case.

When BEIS issued its non-objection to the OBC in December 2020,¹ it made clear that it was not objecting to DCC performing the role of Component Integrator. As such, we continued to move forwards with procuring the remaining contracts for CH&N.

We anticipated that DCC’s role would have been limited to providing management and assurance services to the various componentry to ensure compatibility. However, as we went through the process of negotiating the remaining contracts, our service providers requested that DCC should provide testing services – specifically Early Integration Testing – in order to avoid duplicate testing which would lead to higher costs as vendors performed individual tests. DCC’s licence prohibits us from performing testing activities ourselves on any part of the system that constitutes Fundamental Service Capability. The business case shared with BEIS had anticipated that DCC’s role would have been to provide management and assurance services, not to conduct the testing itself. As such, the new requirement of the service provider meant that DCC could no longer perform the role and had to procure it externally, with only limited time to do so.

Procurement of Component Integrator

When it was apparent that the requirements of potential suppliers were not compatible with our preferred model for component integration, we worked at pace to provide a robust and value for money alternative.

¹ This will be provided to Ofgem as an accompanying document to this response.

This resulted in us awarding the contract to a trusted service provider with experience of component integration activities in the SMETS2 service.

Further information provided

At paragraphs 3.81 and 3.82 of the Consultation, Ofgem states that the evidence submitted by DCC does not provide sufficient justification for the cost and value for money of the contract, and notes having requested further information from DCC.

In response to that request, DCC has provided:

- A detailed paper on the features of the components of the CH&N procurements.
- The Full Business Case for CH&N, including the Economic Case which sets out the full costs and benefits of the programme, and for which DESNZ issued its non-objection.
- The Award Recommendation Report setting out the process we adopted and why we awarded the contract.
- The complete schedules 7.1 and 7.3 setting out the payments and value for money provisions in the contracts.
- The abridged financial model.

Costs economically and efficiently incurred

Ofgem must accept that procuring multiple high value contracts is not straightforward and challenges will emerge. Based on the costs we have incurred, and the rate cards applied, the service we procured offers strong value for money at a blended average day rate of [REDACTED] benchmarked to [REDACTED] for a comparable contract such as Enduring Change of Supplier (ECoS). If Ofgem disagrees with our position, the Guidance entitles Ofgem to carry out its own benchmarking exercise. We understand that no such exercise has been undertaken. As such, the evidence available demonstrates that the costs have been economically and efficiently incurred.

In any event, it cannot be the case that all of the costs of the Component Integrator contract are uneconomic and inefficient – there is a market price for such a service, and we strongly believe that such costs are in line with those we negotiated with [REDACTED]. If Ofgem disallow all the costs incurred, that is akin to Ofgem saying that there is no value in providing Component Integration, which is at odds with the Licence and Ofgem's own Guidance.

4.4. Forecast costs (FSPs)

Question 4: What are your views on our proposal to disallow £44.054m in forecast FSP External Costs?

This section 4.4 of our Consultation Response addresses Consultation Question 4 and responds to paragraphs 3.94 to 3.106 of the Consultation.

Question 4 concerns DCC's forecasts of certain of its External Costs for the Regulatory Years 23/24, 24/25, and 25/26.

As detailed in Table 3.9 of the Consultation, Ofgem has proposed to disallow forecast costs in respect of User Integration Testing, SMETS2, ECoS, Network Evolution, and SECMP0007. The proposed disallowance figures total £44.054m.

Ofgem proposes to disallow forecast costs in their entirety, in circumstances where Ofgem acknowledges that at least part of the cost is justified, or where it considers that DCC has failed to establish in its own evidence that the forecast was economic and efficient. These are not reasons why Ofgem may disallow costs, forecast or otherwise, and overlook Ofgem's positive obligation to assess the economy and efficiency of DCC's costs.

User Integration Testing

Ofgem states at paragraph 3.10 of the Consultation that it would expect to see more comprehensive justification for these forecast costs. The forecasted DSP costs relating to extending the provision of the UIT-B environment has been approved through prior year Price Control arrangements and as such form part of the approved baseline forecasts for User Integration Testing. Therefore, we disagree with Ofgem's position that DCC has not sought to justify these costs as they have already been allowed in previous Price Control submissions based on the justification provided then. In any event, alleged insufficient justification by DCC is not a reason for which Ofgem is permitted to disallow cost.

DCC acknowledges a level of uncertainty regarding the User Integration Testing CR relating to Service Provider Onboarding activity, as this has been replanned in line with the overarching Test Automation Framework activity currently underway. However, it would be sensible for Ofgem to reconsider its position. Ofgem must accept that some cost will be incurred, and DCC would be happy to discuss this issue further with Ofgem in order to identify a realistic forecast that creates reasonable expectations for stakeholders and reduces regulatory burden.

ECoS Change Requests

We also acknowledge a level of uncertainty around the value of ECoS CR that is being challenged. This CR related to the activity required from the DSP to transition their service to operational capability. The final value of the CR was significantly less than originally forecast, but we would again suggest that Ofgem and DCC work together to identify a realistic forecast for the reasons outlined above.

SMETS2 Project Requests and Change Requests

Ofgem has stated that the forecasted costs for the SMETS2 PR exceeds the justified amount in our written submission. However, we do not believe that this is the case as Ofgem is comparing DCC's forecast for RY23/24 to the actual cost incurred in RY22/23. The correct basis for comparison, to deem whether this forecast should be allowed, is the price quoted for PR7272 v2.0 in Table 15 of our submission, which is close to £1m higher than our submitted forecast.

As requested, we have provided the final Full Impact Assessment for CR4634 so anticipate that the related forecast will be accepted. In any event, if Ofgem considers that any cost (forecast or otherwise) exceeds that which is justified as being economic and efficient, it should only disallow the part that it considers to be economic and efficient, not the entire cost.

Network Evolution DSP and DSMS programmes

Regarding both the forecasts for the Network Evolution DSP and DSMS programmes, DCC acknowledges that there was a level of uncertainty around both the phasing and value of these. In addition, significant replanning exercises have been undertaken for both programmes which has involved resetting the procurement and delivery approach for DSMS as well as rephrasing the activity and cost forecasts required to deliver the DSP Re-Procurement programme.

Considering this, DCC is prepared to accept that the submitted forecasts do not currently meet Ofgem's certainty threshold, however we know that some costs will be incurred in this area and, as such, will be included in the next Price Control submission.

SECMP0007

Ofgem has also commented on a perceived lack of scrutiny by Industry of the cost of SECMP0007 but have disregarded our response and the evidence submitted in relation to clarification question #144. We would also point out that revised total costs for this change is still within the original budget envelope of £28m-£30m.

Due to the complexity of the change and the staggered delivery approach it has been difficult to distinctly ascertain the costs directly relating to SECMP0007 in the associated CRs and PRs for each release. However, we have now completed that exercise and below is a table showing the latest position of the total costs:

Supplier	CR/PR Ref	Status	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26	Total
████	CR1408	Committed - Financed	-	0.769	1.973	2.447	2.362	-	7.550
████	CR4374	Committed - Financed	-	-	0.087	1.043	1.043	-	2.173
████	CR4412	Committed - Financed	-	-	0.604	0.587	0.576	-	1.767
████	CR4452	Committed - Financed	-	-	0.308	0.182	0.182	-	0.672
████	CR4452	Committed - To be Financed	-	-	-	1.665	-	-	1.665
████	CR1408	Committed - Financed	0.004	0.103	0.162	0.162	0.150	0.006	0.588
████	CR4117	Committed - Financed	-	-	0.822	1.726	1.841	-	4.389
████	CR4117 / CR4452	Committed - Financed	-	-	-	0.251	0.377	-	0.629
████	CR4412	Committed - Financed	-	-	0.042	0.254	0.254	-	0.550
████	CR4452	Committed - Financed	-	-	-	0.128	0.192	-	0.320
████	CR4587	Committed - Financed	-	-	-	0.055	0.082	-	0.137
████	PR7404	Committed - Financed	-	-	-	0.187	0.281	-	0.468
████	CR4117	Committed - To be Financed	-	-	-	0.275	-	-	0.275
████	CR1408	Committed - Financed	0.003	0.084	0.133	0.132	0.122	0.005	0.480
████	CR4117	Committed - Financed	-	-	0.673	1.412	1.506	-	3.591
████	CR4117 / CR4452	Committed - Financed	-	-	-	0.206	0.309	-	0.514

■■■	CR4412	Committed - Financed	-	-	0.035	0.208	0.208	-	0.450
■■■	CR4452	Committed - Financed	-	-	-	0.105	0.157	-	0.262
■■■	CR4587	Committed - Financed	-	-	-	0.045	0.067	-	0.112
■■■	PR7404	Committed - Financed	-	-	-	-	-	-	-
■■■	CR4117	Committed - To be Financed	-	-	-	0.275	-	-	0.275
■■■	CR1408	Committed	0.266	0.447	-	-	-	-	0.713
■■■	CR4412	Committed	-	0.033	1.078	-	-	-	1.111
■■■	CR1408	Committed	-	0.026	-	-	-	-	0.026
■■■	CR4412	Committed	-	0.012	0.021	-	-	-	0.033
■■■	PR7070	Committed	-	0.017	-	-	-	-	0.017
TOTAL			0.272	1.492	5.937	11.344	9.709	0.012	28.765

4.4.1. Other views on External Costs

Question 5: Do you have any other views on External Costs?

Our additional views on External Costs are covered in sections 4.1 - 4.4.

5. Internal Costs

Summary

- **Recurrent process issues in assessing the costs disallowance:**
 - More than 50% of the proposed disallowance for internal costs (£6.1m) relate to items where Ofgem is proposing to disallow all the costs of a particular contract (instead of disallowing the differential between the actual amount incurred by DCC and the amount deemed to be economic and efficient by Ofgem). As mentioned in Section 3 and Annex 2, this is not compliant with the Licence, which only permits Ofgem to disallow costs which have not been economically and efficiently incurred. It is also inconsistent with Ofgem's own guidelines and not good practice. For example, Ofgem proposes to disallow all costs associated with the Business Accuracy Programme for RY22/23 and RY23/24.
 - Ofgem has adopted inappropriate counterfactuals, or in some cases, no counterfactual whatsoever. For example, the Business Case Centre of Excellence was created to satisfy Condition 16.6 of the Licence and following the conclusion of an independent lessons learned review. DCC concluded that prior to recruiting the necessary skills internally, an interim outsourced solution was necessary to respond to DESNZ requests and in line with the volume of activity required to ensure service stability. This was procured competitively in November 2022. Despite this, Ofgem has proposed a disallowance of £1.2m (c80%) on the grounds that this activity could have been planned or resourced in a more economic and efficient manner, with no accompanying evidence to support this conclusion.
- **Support to DCC Core Programme:** We are disappointed to note that, for the first time, Ofgem is proposing to disallow costs related to managing some of our core programmes – including CH&N and DSP (£1.3m), and we have provided further evidence in section 5 below to support these costs. Ofgem has also proposed to disallow a significant portion of the legal cost to support the CH&N Programme (£0.6m), which was a very modest and reasonable cost incurred for a total programme that itself cost in excess of £2bn over many years – and again without providing any detail behind its counterfactual.
- **Direct Award Procurements:** Ofgem proposes to disallow £1.2m of direct award procurements which DCC undertook for certain urgent activities to ensure efficiency, deliver value for money for our customers, and reduce the risk of widespread failure of the network. As outlined in Section 3, not only do we strongly disagree with Ofgem's interpretation of DCC's Licence Condition 16 around procurement, but we also believe that our approach is compliant with best practice, including those adopted by the Government – hence delivering best value for our customers.

5.1. Payroll Costs

Question 6: What are your views on our proposals to disallow a 50% proportion of the RY22/23 resource costs associated to Corporate Management, Design and Assurance, Security cost centres and the Network Evolution programme?

This section 5.1 of our Consultation Response addresses Consultation Question 6 and responds to paragraphs 4.44 to 4.68 of the Consultation.

Question 6 relates to Ofgem's proposed disallowance of £1.71m of DCC resource costs associated with the following DCC Cost Centres:

- Corporate Management.
- Design and Assurance.
- Security.
- The Network Evolution programme.

In the following paragraphs, DCC will address the proposed disallowance in each of these four Cost Centres in turn, explaining the nature of the resource costs incurred, how that resource supported DCC in its provision of the Mandatory Business required by the Licence, and why it was economic and efficient to incur those costs in the circumstances. In summary:

- Corporate Management – Ofgem proposes to disallow these costs on the assumed basis that they related to innovation work. However, Ofgem has misdirected itself as to a matter of fact. As explained at Section 5.1.1 below, the relevant costs were not related to innovation work, and so the sole proposed basis of disallowance is flawed. In any event, it was economic and efficient to incur these costs in order for DCC to comply with Condition 17 of the Licence.
- Design and Assurance – Ofgem again proposes to disallow these costs on the assumed basis that they related to innovation work, and (as explained at Section 5.1.2 below) that is mistaken.
- Security – No justification has been offered by Ofgem for why it considers that these costs were not economically and efficiently incurred. Disallowing costs necessarily incurred in association with the security of Critical National Infrastructure is not in accordance with the Licence. It is also contrary to Ofgem’s principal objective concerning the interests of existing and future customers.
- The Network Evolution programme – Ofgem proposes to disallow these costs on the basis that they vary from the amount previously forecast, which is not a reason why Ofgem may disallow cost. In any event, there has been an increase in activity relative to RY21/22, which justifies the increase in incurred cost. Ofgem has not suggested that any of these costs were not economically and efficiently incurred. As such, DCC Ofgem should reverse its proposal to disallow these costs.

DCC also notes at the outset that, contrary to the wording of Question 6, Ofgem has not proposed to disallow 50% of each of these costs. Rather, it has proposed to disallow the entirety of the relevant Corporate Management and Security costs, and 50% of the relevant Design and Assurance and Network Evolution programme costs.

5.1.1. Corporate Management – Customer Experience sub-team

A new Partnerships Director role was created, within the Customer Experience sub-team, in order to service a rise in the number of external queries from organisations seeking to understand the smart-metering network and on-board as DCC Other Users in their own right. As is detailed the table below, there is a heavy load of queries to DCC from other users - with a 292% increase in the use of the DCC network by other users over the last year. These activities incurred a cost of £0.09m in RY22/23.

In paragraph 4.49 Ofgem propose to disallow the entirety of this cost on the assumption that the work in this area is “associated with DCC’s support of innovation activity”. That assumption is wrong. The vast majority of activity undertaken in this area related to fielding external queries and driving improvements to the DCC’s ‘Other User’ on-boarding process (which has not been substantially updated or reviewed since DCC was established).

These activities fall under Condition 17 of the Licence, which requires DCC to offer terms for the provision of services to SEC parties, REC parties and “otherwise”¹. Regardless of whether the requestor accepts those terms, DCC must assess the request and its impacts – this inevitably creates costs through engagement and other activities. The number of external queries from industry has risen over the reporting year, reflecting increasing interest from the wider market in leveraging smart metering data, as well as a rise in the number of organisations seeking to on-board as DCC Other Users.

The table below breaks down the activity undertaken by the Partnerships team in the last year.

¹ Otherwise is not defined but covers non-SEC and REC parties’ requests

#	Category	Quantity/Metric	Commentary/Evidence
1.	Number of inbound queries	97 enquiries via DCC website 14 enquiries via other routes	Direct contact to DCC from companies and organisations seeking to understand potential use of the smart metering network in supporting customer propositions, including: <ul style="list-style-type: none"> The role of Consumer Access Devices (CADs) in supporting Home Energy Management Services (HEMs). The use of consumption data in supporting carbon reporting regulations (e.g. TCFD, SECR) The use of data (consumption, system level) in supporting assessments of thermal efficiency, network planning, identifying fuel poverty. Use of the smart metering network in supporting load control (e.g. SAPC, HCALCs functionality).
2.	Number of on-boarders	4 organisations actively on boarding as Other Users live discussions with 8 other organisations	Active on-boarders include: AMT Sybex (utilities software provider), Heatio (Home Energy Management platform business), Core Climate (Carbon reporting business), HomeLink (Home Energy Management)
3.	Number of off-boarders	1 off-boarder	E.ON – migrating to a new platform – E.ON next
4.	Rise in use of DCC network by other users	Other User Service Request Variant (SRV) volumes have risen by 292% on a 12-month rolling basis	<div>April 21 to 22 – 12 month rolling total of OU SRV volumes</div> <div>93,283,253</div> <div>April 22 to 23 – 12 month rolling total of OU SRV volumes</div> <div>365,568,451</div> <div>% increase</div> <div>292</div>

These costs were necessarily incurred by DCC in order to comply with its obligations at Condition 17 of the Licence. It was economic and efficient to incur these costs in order to manage increasing interest in the growing smart metering network that DCC delivers. Furthermore, Ofgem has not suggested in its Consultation that these costs were not incurred economically and efficiently. Given that the only grounds for disallowance offered by Ofgem were based on a mistaken assumption of fact, DCC considers that Ofgem should reconsider and reverse its proposal to disallow these costs.

In addition, it goes without saying that, notwithstanding Condition 17 of the Licence, if Ofgem were to suggest that DCC should not be incurring a cost to provide this service, it would have a substantial negative impact on achieving Ofgem's principal objective.

5.1.2. Design and Assurance – Technology Innovation sub-team

As we set out in the Design and Assurance section of our Price Control submission, and in response to CQ181, the Technology Innovation team was restructured to better support the demands of the SEC sub-groups, and in particular SEC Ops in its role of supporting modification proposals. To allow this to happen we made a small structural change to the team, moving over three roles from the Engineering team into the Technology Innovation team. On 23 November 2023 we showed Ofgem information to prove this, but to reiterate, the roles are:

- 08.3117.03.03 - E2E Architect

- 08.401.02.05 - E2E Architect
- 08.468.03.03 - Technical Lead

These are all permanent members of staff who have been with DCC for several years. Ofgem will be able to verify this from the permanent staff benchmarking files by looking up the role IDs. The main activities of the above roles have been in delivering SEC Mods and related change under the SEC, most notably:

- SECMP0176A – Customer Analytics Reporting
- SECMP0178 - Removing DSP validation against the Smart Metering Inventory (SMI) join status for SR8.8.x
- SECMP0202 - Enduring Solution for SMETS1 and SMETS2+ PPMIDs
- SECMP0207 - Allowing Registered Supplier Agents to Maintain Meter Firmware
- SECMP0211 - Aligning the SMI with the CPL
- SECMP0217 - Obtaining Timestamps to allow Target Response Time Measurements
- SECMP0223 – WAN Coverage Reporting
- DP169 - Managing SEC Obligations and the Consumer's Right to refuse a Smart Meter
- DP184 - Increase Smart Capability of SMETS2 Twin Element ESME to support Solar and Storage use cases DP226 - Incorporation of Category 3 IRPs into the SEC - Batch 10
- DP187 - Incorporation of Target Round Trip Times and Target Success Rates into the SEC
- DP232 - ACB Certificates on Install & Commission
- DP235 - Enhanced Meter Data Access for Other Users
- DP241 – Interoperability Checker Update
- DP242 - Change to Operational Metrics to Measure on Success

In each of the above cases, the three colleagues listed above have either raised the SEC Mod on behalf of DCC or are the DCC Subject Matter Expert for a modification raised by other parties.

To reiterate, the team itself is not engaged in any form of Permitted Business. It is therefore incorrect to assume 50% of the costs were spent on innovation, and there should be no disallowance on this area of payroll.

Ofgem also expressed concerns that the costs of the team were forecast to increase from RY22/23 to RY23/24 and RY24/25. This is not because of any further increases in the size of the team, but because in RY23/24 and RY24/25 the costs are for six staff for the full year, whereas in RY22/23 two of the team moved mid-year, meaning only a part of their salaries are included – as per the table below.

Role	RY22/23 £m	RY23/24 £m	RY24/25 £m
A	0.157	0.174	0.174
B	0.185	0.194	0.194
C	0.120	0.121	0.121
D	0.106	0.107	0.107
E	0.045	0.138	0.138
F	0.047	0.143	0.143

5.1.3. Security – CISO sub-team

Ofgem has proposed to disallow the entire variance of £178k against baseline in the Chief Information Security Office (CISO). DCC has previously explained that this variance arose due to the appointment of a new CISO, and the need for handover from the previous, interim CISO.

A highly technical Exco level role such as CISO requires an appropriate handover period to ensure the continuing security resilience of DCC's system. Historically, DCC has had significant issues with turnover of the CISO role and DCC's interim CISO was employed to work closely with the incoming permanent role to support him during his probation period. The handover period between CISOs was six months, which DCC considers was appropriate. The costs in this period relate solely to salary.

As set out in Section 3, Ofgem is not entitled to disallow a cost merely because it varies from a forecast. The relevant test is whether the cost was not economically and efficiently incurred. No explanation has been offered by Ofgem for why it considers the handover period does not justify the variance value, or more importantly, why it does not consider it to be economic and efficient. Security is a critical aspect of DCC managing the deemed Critical National Infrastructure and we must take a risk averse position in such matters.

In addition, seeking to disallow costs associated with a necessary activity in ensuring the ongoing security of that deemed Critical National Infrastructure is contrary to Ofgem's principal objective of safeguarding the interests of existing and future customers.

5.1.4. Network Evolution Programme – Service Delivery sub-team

Ofgem proposes to disallow 50% of the variance between the actual incurred payroll costs of DCC's Service Delivery sub-team for RY22/23 and the amount forecast in its RY21/22 Price Control submission.

As set out in Section 3, Ofgem is not entitled to disallow a cost merely because it varies from a forecast. The relevant test is whether the cost was not economically and efficiently incurred.

At no point does Ofgem suggest that any of the activities carried out by the Service Delivery sub-team were not required. Rather, at paragraph 4.67 of the Consultation, Ofgem compares the forecasted activities and costs against the actual activities and costs to suggest that, as the activities largely mirror each other, the increase in cost is not justified. That is not an appropriate comparison. The Network Evolution programme was in the very early scoping stages during RY21/22. Forecasts at this early stage in a programme lifecycle are immature and less accurate than during later stages, due to the high levels of uncertainty regarding the programme delivery approach and technical solution. This uncertainty is recognised in Ofgem's Processes and Procedures document¹ and indeed, all forecasted payroll costs for the programme were disallowed by Ofgem in the RY21/22 Price Control, with the justification being that the forecast costs did not meet Ofgem's certainty threshold.

Ofgem also state at paragraph 4.67 that they have not received satisfactory explanation of how the increased costs in RY22/23 relate to an increase in activity relative to RY21/22. As DCC have explained to Ofgem, the increase in incurred payroll costs is largely due to the transition of the CH&N programme to the post contract award delivery stage, which is more resource intensive and required the establishment of a delivery team. In comparison, last year's activities were mainly focussed on early scoping, planning and procurement, which require less resource. Additionally, the high level of complexity of the DSP solution required a greater level of Business Analysis support to ensure we captured every business requirement in full to minimise the costs of future change.

For all these reasons, there has in fact been an increase in activity relative to RY21/22, which justifies the increase in incurred cost. Ofgem has not suggested that any of these costs were not economically and

¹ <https://www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022>

efficiently incurred. It has only sought to disallow the costs on the basis of an inappropriate comparison to a forecast that fails to account for the necessary increase in Licenced activity. As such, DCC considers that Ofgem should reconsider and reverse its proposal to disallow these costs.

DCC reiterates that Ofgem is not entitled to disallow a cost merely because it varies from a forecast. The relevant test is whether the cost was not economically and efficiently incurred.

5.2. Benchmarking

Question 7: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

This section 5.2 of our Consultation Response addresses Consultation Question 7 and responds to paragraphs 4.10 to 4.43 of the Consultation. Question 7 relates to DCC's salary benchmarking for recruitment of permanent and contractor staff.

DCC's Price Control Benchmarking Report sets out an effective methodology for ensuring our remuneration levels are economic and efficient, and we welcome Ofgem's decision to allow the vast majority of DCC's internal cost resource spend. In particular, we are pleased to see that Ofgem has recognised DCC's work to ensure that permanent staff costs are economic and has, again, not proposed a disallowance in this area. We note that Ofgem would like DCC to do further work to assess our permanent staff bonus package. In RY20/21 we benchmarked our bonuses and other benefits against a range of companies and confirmed that our remuneration offerings were in line with the wider market.

However, we are disappointed that Ofgem is proposing to disallow £0.402m of contractor resource costs. Ofgem propose to disallow these costs on the basis that they fall materially above reasonable market rates, but also acknowledge (i) at paragraph 4.37, that hiring up to the median benchmark is the economic and efficient approach (ii) at paragraph 4.38, that it is necessary to hire contractors above the benchmark in certain situations. The vast majority of contractors hired in RY22/23 were below the benchmarked rate; with the overall net position showing a negative variance (i.e. a saving) of £5.5m when compared to the median benchmark. That figure demonstrates that, across the period of RY22/23, DCC has complied with the economic and efficient position of hiring up to (and in fact, significantly below) the benchmark. Proposing to disallow any incurred costs for individuals above the benchmark ignores the fact that DCC's significant efforts in hiring below the benchmark are what allow it to hire above market rates in certain instances where it is beneficial to do so.

5.3. Continuation of RY21/22 activity

Question 8: What are your views on our proposal to disallow the continued costs that are linked to the activities that we disallowed in RY21/22 – these include additional costs associated with the Executive training programme, innovation and growth as well as a continuation of the RY21/22 non-competitive procurements?

This section 5.3 of our Consultation Response addresses Question 8 and responds to paragraphs 4.69 to 4.77 of the Consultation. Question 8 relates to the proposed disallowance of various “non-resource” costs, including:

- £0.144m which Ofgem has incorrectly identified as innovation and growth costs but in fact relates to the continuation of DCC's simulated testing environment, the costs of which Ofgem has previously approved in RY20/21 and RY21/22, as explained at Section 5.3.1 below.
- The entire £0.132m spend relating to the Executive Leadership Programme, which is a training and development service for DCC's key IT leaders and staff. Ofgem proposes to disallow the entire cost on the basis that, in Ofgem's view, DCC did not provide sufficient evidence that the service represented value for money compared to the equivalent service previously provided by Capita. As further explained at Section 5.3.2 below, that is not a valid basis for disallowing the entirety of a cost, particularly as it is implicit in Ofgem's reasoning that it recognises the need for, and some value

for money in, the training service generally. If Ofgem considers that the current service does not represent value for money as against the previous Capita service, then it should only disallow the portion of the incurred cost that it considers not to have been economically and efficiently incurred.

- Finally, £0.49m of costs relating to contracts that were procured on a non-competitive basis in RY21/22, further details of which are at Section 5.4 below. As explained at Section 3 and Annex 2 of this Response, non-competitive procurement is not a reason permitted by the Licence for Ofgem to disallow costs. Ofgem may only disallow costs that have not been incurred economically and efficiently. Ofgem does not seek to challenge the need for DCC to incur these costs, and so must accept that there is an economic and efficient cost associated with the relevant services. If Ofgem disagrees with DCC's position that these costs were economically and efficiently incurred, Ofgem should disallow the portion of cost that it considers not to have been incurred economically and efficiently, not the entire cost of the service.

5.3.1. Innovation and Growth

In paragraph 4.75 of the Consultation, Ofgem proposes to disallow £0.148m in respect of what it deems "innovation and growth specific activities". However, this is an incorrect interpretation of these costs, which in fact relate to improved testing tools ("**DCC Boxed**") for DCC's customers.

DCC Boxed provides industry with a test environment, which simulates to a great extent the full SMETS2 end-to-end system, including the ZigBee HAN and its connected devices. DCC users only have the formal UIT environment to perform this type of testing, so the tool provides an alternative to industry and is a service designed to ultimately reduce testing charges for DCC customers.

DCC Boxed was introduced under SEC Mod 179 and implemented in the Feb 2022 SEC Release following Change Board approval on 26 Jan 2022 and is not "Permitted Business". Ofgem has allowed expenditure on this for the last two years. Disallowing expenditure previously allowed without any change to those activities would be inconsistent and unreasonable. Ofgem has made no suggestion that the cost was not economically and efficiently incurred.

5.3.2. Executive Leadership Programme

The Executive Leadership Programme ("**ELP**") is a subscription service which provides DCC with highly valuable training and development resource for our key IT leaders and their staff. Ofgem has proposed a disallowance of £0.132m, representing the entirety of the incurred cost for this programme in RY22/23, on the grounds that "DCC did not provide sufficient evidence that this service was delivering value for money compared to this service previously being offered by Capita".

The proposed disallowance of the entire ELP is not only contrary to the terms of the Licence, but also seriously restricts DCC's ability and autonomy to assess and deliver on the training and development needs of our leadership and wider staff. In terms of providing value for money, the ELP offers high value training and development resources for our key IT leaders and their staff including free access to conferences, online journals, reports and analysis. DCC have previously shared with Ofgem evidence to show that the ELP is well utilised by staff, a breakdown of the activities and training in scope of the ELP, and a comparison with the cost of the previous Capita contract. As this is a subscription service at a fixed price, DCC are unable to negotiate a lower cost with the supplier, however we are happy to work with Ofgem to understand what further evidence it considers is needed to demonstrate value for money as against the cost of the previous Capita service.

Nevertheless, even if Ofgem were to regard the ELP as being inefficient or uneconomical compared to similar training programmes, that does not permit Ofgem to disallow the entirety of the cost of the programme. Ofgem appears to recognise the benefit in having such a programme in place. It may only disallow the cost that it considers not to have been incurred economically and efficiently.

If it is Ofgem's opinion that this type of training and development programme is not suitable or should not be utilised by DCC staff, then Ofgem should state the basis for that assessment. However, any suggestion

that DCC should not invest in the training and development of its staff would undoubtedly stifle DCC's ability to support Ofgem in delivering on its principal objective.

5.4. RY21/22 Non-competitive procurements

5.4.1. OPR Review

The costs associated with this activity were driven by Ofgem requiring DCC to work with one of the SEC Sub-Committees, the Operations Group ("OPSG")¹ and customers to identify appropriate measures for inclusion in the future OPR system performance incentive scheme. It also requested significant information on SRV8.11.

In March 2022 Ofgem confirmed, at extremely short notice, that the existing OPR regime would be interim, and that further work would be required of DCC in RY22/23. Ofgem stipulated that 6-monthly reports would need to be submitted, with the first due in September 2022, to track DCC's progress. Ofgem also made it clear that extensive progress would need to be made by DCC by this date. DCC urgently needed to agree a plan with OPSG to ensure all parties were aligned on a reasonable approach and plan. As a result, it would not have been practicable to engage in a competitive procurement – see Licence Condition 16.9.

The role of agreeing, leading, and delivering that plan required flexibility to meet the needs and availability of the internal and external stakeholders involved. To ensure the right level of engagement was obtained, the role had to be filled with the necessary level of seniority to successfully liaise with and influence senior stakeholders, while at the same time effectively leading an internal cross-functional team that was already time-limited. At that time, DCC did not have the resource available internally to support this activity, which also required a high level of subject matter expertise and experience.

██████████ were able to support DCC at short notice, at a discount to its standard rates of 13%, or 27% when considering indexation, and had the capacity to support on a part-time basis. ██████████ are a well-respected organisation who have previously supported DCC with senior resource on delivering earlier phases of the OPR project. They have an in-depth understanding of the complexities associated with the OPR. They also have extensive knowledge of the performance measures that exist within DCC's Service Provider contracts, as well as the system limitations. In parallel they have upskilled internal DCC resources to ensure the knowledge base surrounding OPR and the Systems Performance measures is strengthened. This has enabled DCC to become self-sufficient in this area, removing a reliance and dependency on external resource.

For all these reasons, DCC considers that it was both economic and efficient to appoint ██████████ directly. Ofgem has offered no explanation as to why it considers that the costs were not economically and efficiently incurred, beyond the fact that they were not procured competitively. In that regard, DCC notes that (i) there is no evidence to suggest that procuring on a competitive basis would have offered a more economic and efficient outcome than that achieved by DCC (ii) in any event, as explained at Section 3 and Annex 2, non-competitive procurement is not a reason permitted in the Licence for Ofgem to disallow costs (iii) at no point in the Consultation does Ofgem challenge the need for DCC to incur a cost as part of the OPR review.

If Ofgem disagrees with DCC that this cost was economically and efficiently incurred, it should disallow the cost it considers was not economically and efficiently incurred. Not the entire cost of the activity.

5.4.2. NEP – ██████████

This year DCC has continued to use our framework agreement with ██████████ (agreed in January 2020) to call off support at discounted rates. Ofgem has proposed to disallow the entire expenditure incurred in

¹ The purpose of the OPSG is to deal with operational matters relating to the services provided under the SEC, including DCC Services, and to enable close co-operation between the DCC and DCC Users.

RY22/23 that was called off against this framework contract. However, this agreement was procured in accordance with government procurement best practice and delivered good value for money.

Using frameworks to govern the terms of call-off contracts is a well-known and widely used method of procurement in both the public and private sectors. For example, it is the approach Crown Commercial Service use under Management Consultancy Framework 3. Also, the rates agreed with [REDACTED] as part of the framework agreement are significantly lower than [REDACTED] standard rates and significantly lower than market rates for comparable services. It is therefore disappointing that Ofgem feel the need to disallow costs based on the notion that procurement through call-off contracts is not economic and efficient.

Last year DCC provided Ofgem with benchmark evidence that compared the day rates payable to [REDACTED] under the framework agreement with the average day rates of all the companies on DCC's Business and Management Consultancy Services framework (which itself was competitively procured). This showed that, on average, the rates agreed with [REDACTED] were almost 40% lower than comparable market rates. Clearly this offers good value for money, as required by Licence Condition 16.11, and has reduced costs for customers.

Although not determinative of whether a cost has been economically and efficiently incurred, in circumstances where any competitive tender would be highly unlikely to deliver rates at 40% below market, DCC has complied with Licence Condition 16.9. In simple terms, it would not have been "proportionate" to have incurred the significant additional time and cost of carrying out a separate procurement exercise for each call-off when it was highly unlikely to have resulted in a positive benefit to competitively procure a contract. Had we done so, as Ofgem is incentivising us to do, it would have resulted in either [REDACTED] winning the contract but with the additional costs of procurement, or an alternative more expensive supplier than [REDACTED] winning the bid (in the event [REDACTED] did not tender). In both of those scenarios, a procurement process would impose more costs on customers. DCC's preferred approach was economic and efficient when compared to the counterfactual.

In any event (i) as explained at Section 3 and Annex 2, non-competitive procurement is not a reason permitted in the Licence for Ofgem to disallow costs (ii) at no point in the Consultation does Ofgem challenge the need for the services provided by [REDACTED]. If Ofgem disagrees with DCC that this cost was economically and efficiently incurred, it should disallow the cost it considers was not economically and efficiently incurred. Not the entire cost of the activity.

5.4.3. Project Dynamo

Throughout the year, DCC continued its efforts to mitigate the risk to the Smart Metering rollout Programme that was identified in the North Region. The CSP.N Scaling and Optimisation project was established to ensure that the Smart Metering network has the capacity to support the full scheduled roll-out in the North Region, identifying and addressing the gaps between the original contracted design and the current and known future requirements which have evolved materially over time. At its heart is the need to protect system continuity and security for the benefit of consumers.

The immediate risk to the Smart Metering rollout in the CSP.N Region meant that DCC needed to act quickly to ensure continuity of service and security of the network. Due to the complexity of the smart metering technical ecosystem and the unique nature of the long-wave radio system, specific expertise and knowledge was required to be able to provide a clearly articulated recommendation report to DESNZ in a short period of time. Failure to do so would have led to a heavily constrained system and message overload, meaning it was paramount that the work was undertaken to explain to our key stakeholders – DESNZ, Arqiva and DCC Customers – the risk and to assess the issue accurately and efficiently.

DCC moved decisively in its classification, analysis and mitigation through the deployment of Project Dynamo. Ofgem has proposed to disallow the expenditure incurred on Project Dynamo in RY22/23, as a continuation of the disallowed costs incurred under the pre-existing contract with [REDACTED] in RY21/22.

Again, it is understood that Ofgem's concern is that the solution identified by DCC was not procured through a competitive process. First, DCC believe that the project did satisfy all criteria within DCC's

Procurement Policy and Procedure to justify the non-competitive procurement as an “exceptional circumstance” and as such believe that this disallowance is unjustified.

The premise of exceptional circumstances is “Where DCC have established that the capacity and/or capability to provide the goods or services as required currently only exists with one provider and there is no possibility of it [sic] that changing within the required timescale “. Given that DESNZ, Arqiva and the DCC board were unconvinced by the Problem Statement at the time, [REDACTED] unique position in its ability to produce the deliverable within time, its level of expertise of DCC systems and the Arqiva Network Components (SENSUS), and the trust they had established already with these key stakeholders meant that it was the only provider capable and positioned to provide the services in the necessary timescale.

In addition, given that [REDACTED] had already commenced and were delivering these services in RY21/22, it would not have been proportionate to competitively procure them in RY22/23, and would have added costs and delay.

In any event (i) as explained at Section 3 and Annex 2, non-competitive procurement is not a reason permitted in the Licence for Ofgem to disallow costs (ii) at no point in the Consultation does Ofgem challenge the need for the services provided by [REDACTED]. If Ofgem disagrees with DCC that this cost was economically and efficiently incurred, it should disallow only that portion, not the entire cost of the activity.

5.4.4. Order Management System

As Ofgem will recall from prior submissions, there was a compelling case to augment the existing three Order Management Systems (OMS) into one, to deliver savings and service improvement. However, as 2G/3G sunsetting was brought forward, DCC had to redesign its approach and build the OMS requirements for a 4G environment. The expenditure in RY22/23 is a small amount of legacy spend from this period. We would like to remind Ofgem that it must assess DCC’s economy and efficiency based on the facts at the time and not with the benefit of hindsight. The facts at the time were that there were significant savings available from consolidating the OMS systems, and we pursued those to deliver benefits for our customers.

5.4.5. Customer Engagement Portal

In last year’s submission, we made provision in our forecast for [REDACTED] licences for the Customer Engagement Portal of £0.195m in RY22/23 and RY23/24. Ofgem reduced the forecast to zero in its decision on the RY21/22 Price Control, meaning there was no baseline for the portal. As we have an ongoing obligation to maintain a portal for our customers to access documentation and respond to consultations etc, we have incurred £0.162m in RY22/23. [REDACTED] licences are not negotiable.

Although we recognise that Ofgem disallowed all expenditure associated with the Customer Engagement Portal last year because of concerns that the project did not achieve its stated benefits, Ofgem continues to take an approach that is inconsistent with the Licence and its principal obligation.

As there is no development work in RY22/23 associated with the portal, and the costs are simply maintenance costs to keep the portal open in response to customer demands, the expenditure is economic and efficient.

In addition, in any event (i) as explained at Section 3 and Annex 2, non-competitive procurement is not a reason permitted in the Licence for Ofgem to disallow costs, and (ii) at no point in the Consultation does Ofgem challenge the need for the services. If Ofgem disagrees with DCC that this cost was economically and efficiently incurred, it should disallow only that portion and not the entire cost of the activity.

5.4.6. Living Pillars

The Living Pillars Project set out to examine the use of DCC’s smart metering infrastructure for remote monitoring and measurement of domestic energy consumption, and its application to determine the thermal efficiency of a smart meter equipped property.

Ofgem propose to continue to disallow DCC expenditure related to Living Pillars in RY22/23, including expenditure around its Proof of Concept, on the premise of it not falling under DCC's Mandatory Business. However, Licence Condition 5.10(b) provides that, as part of our Second Enduring General Objective, DCC is required to carry on the Mandatory Business in a manner that is most likely to facilitate:

“such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation.”

The Living Pillars Project directly contributes to DCC's achieving of its Second Enduring General Objective, and the associated cost should not be disallowed.

5.5. Planning, Scoping and Resourcing of projects

Question 9: What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not have been resourced in the most economic and efficient way?

This section 5.4 of our Consultation Response addresses Question 9 and responds to paragraphs 4.78 to 4.96 of the Consultation.

Question 9 relates to Ofgem's proposed disallowance of costs where it says that DCC did not resource the associated services in the most economic and efficient way. In particular:

- At paragraph 4.93, Ofgem proposes to disallow £3.335m in RY22/23 and £0.312m in RY23/24. While not stated in the Consultation document, the disallowances relate to (i) Integrated Activity Planning (ii) Business Case Centre of Excellence (iii) Project Sky (iv) Project Diamond (v) Operations Demand Planning (vi) Customer Engagement Performance Network (vii) HMT Business Case Development (viii) Price Control Support (ix) Architectural Resource (x) Financial Modeller (xi) Network Evolution Legal Support.
- At paragraph 4.95, Ofgem proposes to disallow £0.049m in respect of OMS and £0.162m in respect of CEP for RY22/23.

As to the £3.335m, Ofgem proposes to disallow a proportion of the total costs on the basis that (i) unsatisfactory evidence was received regarding resourcing decisions (ii) it does not consider that the associated activities were resourced in the most economic and efficient way. However, Ofgem does not state how much cost it proposes to disallow in respect of any activity, nor on what grounds it has concluded that the activity was not resourced in the most economic and efficient way. This makes it difficult for DCC or other stakeholders to respond to Ofgem's proposal in a meaningful way. Absent an explanation and engagement on the sums proposed to be disallowed, Ofgem's decision has the appearance of arbitrariness.

DCC is concerned that Ofgem retrospectively adjudicating on whether an activity should have been outsourced, severely limits DCC's autonomy to plan the best resourcing approach based on the facts at the time. This type of regulatory micromanagement could have serious unintended consequences, such as incentivising the over recruitment of permanent staff resulting in long-term inefficiencies.

DCC is also concerned by Ofgem's use of inappropriate counterfactuals to determine to what extent a procurement exercise was economic and efficient. This has made it extremely difficult for DCC to understand how Ofgem arrived at its figures. Despite DCC requesting the underlying spreadsheets used to calculate these counterfactuals Ofgem has not provided them. Without knowing the exact mix and value of day rates, hours, internal resource etc. that Ofgem has used in their calculation of the “economic and efficient” counterfactual, it is difficult for DCC to assess if this is a fair comparison.

However, it is clear that in some respects Ofgem's counterfactuals significantly underestimate the costs of using permanent staff. For example, the counterfactuals do not include non-base staff costs such as pension, bonus, national insurance and other benefits, nor does it include any recruitment costs.

In the following paragraphs, DCC will explain why its resourcing of each of the proposed disallowance items was in fact economic and efficient. In summary:

- As to Integrated Activity Planning, DCC employed an external supplier on a short-term basis to support an urgent function while DCC was recruiting its new in-house team. DCC benchmarked the external resourcing to ensure economy and efficient, and Ofgem has offered no alternative benchmarking to suggest otherwise, all as explained at Section 5.4.1.
- As to the Business Case Centre of Excellence, as external lessons-learned review showed that DCC did not have the internal capability necessary to produce HMT Green book style business cases. DCC chose to recruit, train and develop a new internal CoE team to address this shortfall, but in the interim, outsourced this function to address the need for short-term business case support. A competitive procurement exercise was conducted, as explained at Section 5.4.2.
- As to Project Sky, as explained at Section 5.4.3, Ofgem has proposed to disallow costs of externally resourcing an auditing exercise in circumstances where would it be economic and efficient for DCC to internally retain such resource. The 'data processing' element of the disallowance is made on a mistaken factual premise that DCC has an in-house capability. Further, as Ofgem has not produced a counterfactual that demonstrates that the 'people' element could have been incurred more economically and efficiently, the only evidence is that the cost was economically and efficiently incurred. Further, Ofgem seems to have proposed to disallow the entire cost, which it has no power to do.
- As to Project Diamond, this proposed disallowance relates to an exercise to improve economy and efficiency within DCC. Ofgem has not produced a counterfactual that demonstrates that the cost could have been incurred more economically and efficiently, yet proposes to disallow 43% of the cost without apparent justification (which is outside its powers), as explained at Section 5.4.4.
- As to Operations Demand Planning, first, this proposed disallowance also relates to an exercise to improve economy and efficiency within DCC. Ofgem's counterfactual omits significant costs factors, including the cost of recruitment and redundancies, pensions, bonuses, national insurance, and the inefficiency of employing permanent staff for a short-term project (who would ultimately become underutilised), such that the true cost of Ofgem's counterfactual would in fact not be economic and efficient, as explained at Section 5.4.5.
- As to the Customer Engagement Performance Framework, while the Customer Engagement team has grown in recent years, the increase did not include the relevant capability necessary to undertake the framework development activity internally. Given the short-term nature of the project, it would not have been economic or efficient to recruit, onboard, train and develop a new internal resource. As such DCC followed a competitive process to appoint a supplier to undertake this work, as explained at Section 5.4.6.
- As to HMT Business Case Development, DCC did not previously have the internal capability to produce HMT business cases, and so outsourced the activity while its internal resource was developed. The contract was competitively procured through DCC's consultancy services framework, which was itself competitively procured to ensure economy and efficiency, as explained at Section 5.4.7.
- As to Price Control Support, despite the growing requirements for Price Control reporting and having never previously disallowed expenditure on delivering the Price Control reporting, Ofgem has now proposed a disallowance without providing the underlying calculations or assumptions, meaning DCC cannot assess and (if appropriate) challenge the Ofgem's counterfactual position, as explained at Section 5.4.8.
- As to Architectural Resource for CTO, due to significant competing requirements for resource, DCC procured support from [REDACTED] to build the SIS Catalogue and to urgently replace a resource who left DCC at short notice. DCC's benchmarking shows that the day rates procured are extremely competitive. We therefore believe that DCC chose the best value for money option, and that these external procurements were economic and efficient, as explained at Section 5.4.9.

- As to Financial Modeller, DCC externally procured a financial modeller to meet an urgent need following the unexpected departure of DCC's Economic Modelling team leader. A competitive procurement exercise was not practicable in the circumstances, as explained at Section 5.4.10.
- Finally, as to Network Evolution Legal Support, our benchmarking shows that permanent staff would have been more expensive than the outsourcing option. We adopted a competitive procurement to ensure that costs were economic and efficient, and Ofgem has not produced a counterfactual that demonstrates that the cost could have been incurred more economically and efficiently, as explained at Section 5.5.11.

5.5.1. Integrated Activity Planning

In the Internal Costs section of the Price Control submission DCC provided Ofgem with a detailed narrative explaining the need for this activity planning work, the clear differences between this work and other change management activity (e.g. BAP) and the steps DCC took to maximise value for money.

Before the introduction of this project, there was no internal Enterprise Planning capability within DCC. As DCC continued to mature and transform as an organisation, there was a clear and urgent need to introduce an overall Enterprise Planning capability. Without it, there was a real and escalating risk of coordination problems and prioritisation conflicts occurring across a wider range of external, operational and maintenance activities.

DCC appointed an Enterprise Planning Director and, given the urgency, employed an external supplier to support the Director in providing this function in the short-term. In parallel, DCC undertook the recruitment and development of its new in-house team, who are now in place, with the work having transitioned as an enduring function.

For the short-term external support, DCC decided that a single source procurement with [REDACTED], a supplier on DCC's competitively appointed Consultancy Framework, was the preferred approach to ensure the urgent provision of the necessary capability and capacity. DCC was able to secure discounted rates from [REDACTED], which were on average 15% lower than the rates agreed in the Consultancy Framework. We conducted a benchmarking assessment to compare these discounted day rates against competitors offering a similar service, which showed that [REDACTED] were in line with market rates. We are therefore satisfied that the resourcing and the costs incurred were economic and efficient, and would invite Ofgem to reconsider its assessment.

We are not aware of:

- Any alternative, or parallel, benchmarking exercise carried out by Ofgem. It is therefore difficult to understand the basis that Ofgem could properly conclude that the above benchmarking exercise does not demonstrate that the costs were economically and efficiently incurred.
- Alternatively, if Ofgem is saying that roles/services should not be provided (at all), it is not understood which (if any) roles or services Ofgem is suggesting are superfluous in delivering DCC's services under the Licence. It is difficult for DCC to respond to this element of the Consultation, as it is not clear which parts of the Enterprise Planning capability Ofgem says (i) should have been procured more economically and efficiently or (ii) should have been dispensed with in their entirety.

With regards to Ofgem's comments about the potential overlap in scope between this activity and the Business Accuracy Programme ("BAP") (paragraph 4.111 of the Consultation Document) DCC reiterates that, while it is complimentary, this activity is separate and distinct from other internal change programmes. This project is focussed on planning for, and controlling the initiation and delivery of, changes with a focus on the activities required. By comparison, BAP is focussed on improving the quality of our data, systems and processes. The Integrated Activity Planning project's remit does not include financial governance or approvals, which is provided through the DCC Lock process and was developed as part of BAP. These are therefore two separate and distinct workstreams.

5.5.2. Business Case Centre of Excellence

The Business Case Centre of Excellence (“**CoE**”) was created to satisfy the amendment to Condition 16.6 of the Licence, which requires DCC to complete HMT Green Book style business cases for relevant procurements with a value above £10m. It is disappointing that Ofgem have proposed a disallowance of circa 80% on the costs of the CoE on the grounds that this activity could have been planned or resourced in a more economic and efficient manner. This reasoning is difficult to understand in circumstances where DCC have provided Ofgem with an extensive narrative and accompanying evidence to demonstrate the evolution of the CoE, including how it was planned and scoped to ensure that it (i) was resourced using the most appropriate method and (ii) delivered good value for money.

Before setting up the CoE, DCC considered the findings of the 4G Comms Hub and Network business case lessons-learned review completed by Turner and Townsend. This review showed that DCC did not have the internal capability necessary to produce HMT Green book style business cases. In the context that this was a requirement not previously fulfilled by DCC, the outcome of the Turner and Townsend review was rational. As such, it was not possible at that point in time to use internal resource to staff a CoE. In considering how to deliver the resource, DCC therefore conducted an extensive options evaluation process, working through options ranging from complete outsourcing of the CoE to complete internal resourcing over a period of time, to carefully consider how the CoE was best resourced and delivered to ensure it was effective while also being economic and efficient.

While, for the long-term, a fully insourced model was chosen as the preferred option, given the time it would take to recruit, onboard, train and develop a new internal CoE team to produce business cases to the required standard, and the ongoing need for short-term business case support, an interim outsourced solution was necessary. As such, a competitive procurement exercise was conducted in November 2022 to procure external CoE support in the interim period, in order to continue producing HMT standard business cases while the internal team was recruited and trained – this is set out in detail in the Corporate Management Cost Centre of the Price Control submission.

The evidence we have provided to Ofgem clearly justifies both the need for the CoE support and that DCC has ensured it was resourced in the most economic and efficient way, which is demonstrated through the planning, scoping and options assessment work we conducted. We would therefore invite Ofgem to reconsider its assessment.

5.5.3. Project Sky

[illegible]

Ofgem's criticism of DCC in respect of these cost items regards their resourcing, and particularly where DCC has resourced matters externally rather than using permanent staff and contractors to deliver the work. However, a significant proportion of expenditure in Phase 2 of this cost item was software and data processing costs – i.e. technology and not people costs. Disallowing the costs of processing 251GB of data, and the analytical tools that made that processing possible, cannot be justified on grounds that DCC should have used internal resource. No such internal resource exists. As a result, the element of the disallowance relating to the processing of data and analytical tools seems to have been made on a mistaken factual premise, which means it cannot stand.

By the same token, DCC does not retain a team of internal forensic auditors who could have been assigned to work on Project Sky, nor would it be economic and efficient to do so. We therefore believe that any disallowance in this area would be based on an inappropriate counterfactual – recruiting an in-house team to deliver this work would have led to a longer-term structural increase in cost that would have been in no way economic or efficient. The only viable counterfactual would be to benchmark the costs with other similar consultancy firms, which we did when we engaged [REDACTED] in the procurement process, which concluded that [REDACTED] offered the best value for money option.

In summary:

- First, the element of the disallowance relating to data processing and analytical tools costs is made on a mistaken factual premise that DCC has an in-house capability. It does not.
- Second, as Ofgem has not produced a counterfactual that demonstrates that the 'people' element of the cost could have been incurred more economically and efficiently through other consultancies, the only evidence is that the cost was economically and efficiently incurred.

Third, Ofgem seems to have proposed to disallow the entire cost of this service. As set out at Section 3 and Annex 2, it has no power to do so. If Ofgem is to make a disallowance it must identify the delta between the economic and efficient cost and the cost incurred by DCC.

5.5.4. Project Diamond

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[illegible][illegible]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

pipeline, and the synergies that we were satisfied would be achieved through reduced onboarding time and effort.

The objective of the work was in two core areas:

- Create a roadmap to identify the portfolio of activity across DCC, with an estimate of the associated service requirements. This will be used as an input into the resource model, discussed below.
- Develop a resource model tool to analyse future resource levels and associated costs to serve. Once finalised, the model, knowledge, and management of it will be transferred to DCC.

We are concerned that Ofgem is effectively incentivising DCC to be inefficient by disallowing expenditure specifically designed to reduce our costs and better prioritise our activities. Ofgem is also incentivising us to bolster our permanent team through focussing its disallowances on external support, which would result in further inefficiencies from underutilised staff. Also, Ofgem's own counterfactual benchmarking exercise contains factual mistakes that result in a significant understatement of the costs associated with the counterfactual benchmark. In assuming a benchmark against internal provision, Ofgem has not taken account of non-base salary add-on costs such as:

- Pension.
- Bonus.
- National Insurance.
- Other benefits such as Life Insurance.

Ofgem has also failed to account for recruitment costs and redundancy costs.

Ofgem's approach assumes that recruiting additional internal headcount would be the economic and efficient approach, with which DCC disagrees. An appropriate counterfactual would be for Ofgem to benchmark the cost against another supplier, which we do not believe Ofgem has done.

In summary:

- First, this proposed disallowance relates to an exercise to improve economy and efficiency within DCC, by better prioritising activities and managing resourcing.
- Second, Ofgem's counterfactual omits significant costs factors, including the cost of recruitment and redundancies, pensions, bonuses, national insurance, and the inefficiency of employing permanent staff for a short-term project (who would ultimately become underutilised). The true cost of Ofgem's counterfactual would not be economic and efficient.
- Third, the approach benefited from [REDACTED] in-depth knowledge of DCC's operations, allowing them to understand and deliver value much more quickly than other contractors could have.

5.5.6. Customer Engagement Performance Framework

While DCC has made significant progress in improving customer engagement across the board, this is an area where both Ofgem and industry are keen that DCC continue to focus and drive further improvement. The Customer Engagement Performance Framework (CEPF) is an important element of this work as it enables DCC to identify, track and quantify the improvements being made in customer engagement. This is enabling DCC to better assure consistency of performance and focus our efforts in areas which drive greatest value for our customers.

While the Customer Engagement team has grown in recent years to support the high volume of engagement across our programmes, the increase in delivery and planning roles did not include the relevant skills and capability necessary to undertake the framework development activity internally. Given the short-term nature of the project it would not have been efficient to recruit, onboard, train and develop a new internal resource as this would have been more costly in the long-term. As such DCC followed a competitive

process to appoint [REDACTED] to undertake this work. This is explained in detail in the Corporate Management Cost Centre chapter of the Price Control submission.

5.5.7. HMT Business Case Development

During the year there were two major programmes that were subject to Condition 16.6 (A-C) and, as such, required HMT Green Book style business cases: 4G CH&N and the DSP. As previously mentioned in section 5.5.2 of this Response, DCC did not internally possess the specialist skills necessary to produce business cases of the required standard. Despite multiple recruitment exercises, efforts to secure permanent or contractor staff with the right skillset were unsuccessful.

While DCC has since created the CoE to centralise the training and development of business case support, at the time there was no alternative option but to outsource this activity for the above programmes. The challenging timelines and urgency to produce these business cases also added to the decision to outsource.

As set out extensively in the Internal Costs chapter of the Price Control submission, the original contract to acquire business case support was competitively procured in RY21/22 through DCC's consultancy services framework. This framework was itself competitively procured to help secure ongoing value for money and reduce the cost and time overheads required to secure consultancy support. In line with DCC's longer-term strategy, provision of business case support is now managed through the CoE.

5.5.8. Price Control Support

It is disappointing that Ofgem has chosen to disallow expenditure associated with delivering the Price Control information required by the Licence. Each year the information requirements increase – for example, expansion of the Supplementary Schedules to include information on all External Services, not just those over £150k – and, as a result, so do the resource burdens on DCC. In the case of the expansions in the Supplementary Schedules, Ofgem provided no notice that this would be a requirement, making it impossible for DCC to plan for its delivery.

Ofgem's unprecedented disallowances in RY21/22 necessitated additional work in the consultation phase in RY22/23, with DCC using its existing, competitively tendered contract with [REDACTED] to bring in additional resource. We have previously discussed that DCC only maintains a small permanent Price Control team of around 3 people as it would not be economic and efficient to retain a larger team for the full year.

Ofgem has not previously disallowed expenditure on delivering the Price Control reporting requirements. Ofgem's current proposal is inconsistent with all prior consultations. Regulatory predictability is an important aspect of regulatory decision-making.

Although we understand Ofgem has proposed a partial disallowance of the total expenditure:

- We have not seen the underlying calculations. As such we have not been permitted an opportunity to comment on whether there are any arithmetical errors.
- We do not know if there are specific assumptions underlying the proposed disallowance, as such we have not been given the opportunity assess and (if appropriate) to challenge the assumptions for Ofgem's counterfactual position.

In considering any counterfactual it would be important to take into account:

- That for limited tasks which require "peak" capacity, such as the Price Control, it is not possible to rely fully on permanent staff and contractors.
- The contractor market contains a limited number of Price Control experts found in specific consultancies.

As a broader point, it will also be important that Ofgem's calculations concerning any counterfactual take into account the changes that Ofgem has made to the Price Control process, including: (i) new Guidance

being implemented for the first time this year (ii) the enhanced level of scrutiny that Ofgem has very recently afforded DCC.

5.5.9. Architectural Resource – CTO

In RY22/23, DCC commenced procurement of the Systems Integration Service (“SIS”). This was a significant procurement that needed a large amount of technical input to ensure the requirements were properly specified, allowing for a robust contract award.

RY22/23 was an extremely challenging year for DCC, with substantial procurement activity on the CH&N programme, replacing the Civet infrastructure, and ongoing work to progress disaggregating the DSP to provide a better performing and improved value for money service. Given these competing requirements for resource, DCC procured support from [REDACTED] in the form of (i) a Systems Integration Lead to build the SIS Catalogue needed to allow the SIS procurement to proceed (ii) Engineering Support Service to urgently replace a PMO resource who left DCC at short notice, so as not to impact CTO’s support for different programmes within CTO.

Our benchmarking assessment of [REDACTED] shows that their day rates are extremely competitive and in line with our contractor benchmarks, as per the table below. We have compared the discounted day rates we were able to procure from [REDACTED] with the equivalent Systems Integration Lead and Engineering Support Service (PMO Analyst) rates in the contractor benchmarking model, which Ofgem is in possession of, to confirm that we achieved significant value for money over a contractor alternative. We therefore believe that DCC chose the best value for money option, and that these external procurements were economic and efficient. We consider that Ofgem should reverse its proposed disallowance in the circumstances.

	[REDACTED] Day Rate (£)	50P10 Benchmark Day Rate (London) (£)
Systems Integration Lead	[REDACTED]	[REDACTED]
Engineering Support Service	[REDACTED]	[REDACTED]

5.5.10. Financial Modeller

Due to the unexpected departure of DCC’s Economic Modelling team leader, there was an urgent need to procure a financial modeller to meet the CH&N Final Business Case (FBC) deadline and to provide an opportunity for a handover of the complex financial modelling, while the incumbent was still in post. Given these constraints, a competitive procurement exercise was not practicable.

The specialised nature of the role, which requires a suitably qualified modeller, constrained DCC’s ability to backfill the position internally. [REDACTED] was able to offer a fully qualified financial modeller, with the required expertise in business case development, who was available to start immediately and at a reasonable rate. This external procurement ensured that we were able to deliver an effective CH&N FBC, to the required timeline, in an economic and efficient manner.

5.5.11. Network Evolution Legal Support

We have described the requirement for external legal support for the 4G CH&N Programme in the last three years’ Price Control submissions. The Final Business Case, which received DESNZ’s non-objection on 5 September 2022, values the contracts at more than £2bn over their lifetime.

It is incorrect to view CH&N as a single project. There was both an aggregated (“Lot 1”) and disaggregated (“Lot 2”) solution, and that Lot 2 was further divided into four projects (Comms Hub, WAN, Device Manager and System Integration). Suppliers on the latter consisted of [REDACTED], requiring

separate negotiations with each. It is therefore an extremely large and multi-dimensional procurement, which DCC's legal team (with a peak of five staff), was not set up to deliver without extensive external support. This was known and fully costed in the FBC to which DESNZ issued its non-objection.

Ofgem has developed a counter-factual to calculate the proposed disallowance. We do not consider that this counter-factual is reasonable for the following reasons:

- If DCC were to resource such needs internally, that would entail maintaining a team permanently on foot with a range of skills (IT/outsourcing, procurement etc.) at considerable ongoing cost and with that team having peaks and troughs of utilisation. At its peak, there were 9 external lawyers working almost full-time across 6 workstreams in RY22/23 (5 separate agreements and a procurement workstream).
- As permanent resources cannot be flexed up and down given the nature of their contracts, the costs over the year of recruiting at least 9 additional permanent lawyers, at a cost of at least £100k per team member, plus recruitment fees of at least 20% would drive an equivalent annual cost of at least £1.1m in the first year and an annual run cost of at least £0.9m thereafter. Including a sensitivity to account for insurance, bonus, pension contributions and other benefits, it is entirely plausible that each additional member of permanent staff would cost £150k per annum. This would increase the first-year cost of such a team to £1.6m and the subsequent annual run cost to £1.35m. Quite plainly, a fully internally resourced legal team would have been more expensive than the option we chose (<£1.3m).
- The CH&N programme was of sufficient size and complexity that several of the suppliers also used external counsel to lead their negotiation teams. This is unusual in this market as suppliers will typically try to resource projects internally to the extent possible and further underlines the need for DCC to seek external support.
- One of the key things that DCC rightly sought from external advisers was value add by way of knowledge of current market terms; this is only available from specialists who are negotiating transactions in the relevant space on a regular basis, which DCC's permanent team does not do.

The novel and complex features of the procurement necessitated the involvement of senior external firm personnel. These features included:

- The DCC Licence provisions relevant to procurement (which were the subject of modification during CH&N).
- Unusually extensive conflict of interest issues for DCC personnel and consequent advice.
- In relation to Lot 2, negotiating a contractual framework that allowed for effective co-operation between different suppliers and implementing a "polluter pays" liability structure.

As we set out in the Price Control submission, and in the responses to the clarification questions and the Cost Visit, DCC ran a competitive tender process at the outset of the procurement with external law firms. The successful bidder, based on quality and price, was [REDACTED]. After the Cost Visit, we provided additional evidence to show that the average fees we paid to [REDACTED] were below five competitors we benchmarked.¹ The majority of the personnel we used were regionally based, enabling a reduction in cost compared to using City-based individuals.

In summary:

- Our benchmarking analysis shows that permanent staff would have been more expensive than the outsourcing option we chose to adopt.

- Our competitive procurement of the work shows that utilising other legal firms for the same services would have also been more expensive.
- There is no sufficient market for independent contractor-type legal services.
- Ofgem has not produced a counterfactual that demonstrates that the cost could have been incurred more economically and efficiently.

We believe these costs were incurred economically and efficiently and do not believe there are grounds to disallow the expenditure. Furthermore, persisting with a disallowance would be inconsistent with Ofgem's decisions in each of the prior two years, in which costs of this nature were allowed.

5.6. Business Accuracy Programme

Question 10: What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?

This section 5.5 of our Consultation Response addresses Question 10 and responds to paragraphs 4.97 to 4.113 of the Consultation.

The Business Accuracy Programme (BAP) is part of the wider business transformation programme and supports DCC's transition as it grows in size, scale, and complexity. The BAP was established to deliver improvements in DCC's internal processes across key business areas, including Finance, Commercial and Portfolio. The programme has so far delivered outputs across four main themes:

- **Process and Governance** – Establishing efficient, repeatable processes and governance structures that provide control and assurance over activities and portfolios.
- **Systems and Data** - Creating a data architecture that provides the business with timely, reliable, and aligned datasets for governance, reporting and forecasting.
- **Reporting** – Building a reporting framework and culture of accountability and transparency, enabling internal and external parties to understand expected and actual performance.
- **People** – Promoting a more sustainable, process-driven culture at DCC.

We are confident that the BAP has already delivered, and will continue to deliver, tangible benefits to the way the business operates and functions, as well as the way it collects and reports data. The programme has already delivered a business planning and performance management framework (the Lock process) which will improve our ability to deliver business outcomes in an economic and efficient manner, understand and track our cost base, and more accurately predict resource requirements.

Ofgem proposes to disallow all costs associated with the BAP for Regulatory Years 22/23 and 23/24. Given that Ofgem has also stated in the Consultation Document that DCC's forecasting and general internal reporting of data needs to improve, it is difficult for DCC to understand why Ofgem is proposing to disallow all costs relating to the very programme that was designed to improve these internal processes.

In paragraph 4.109 of the Consultation Document, Ofgem state that *"there remains insufficient evidence of a robust cost benefit analysis in place that precisely sets out when and how such savings will be realised, including a methodology for monitoring, and tracking them"*. However:

- DCC has provided Ofgem with such evidence in the form of the original business case, which contained a thorough cost-benefit analysis (CBA), as well as the BAP Closure Report, which contained an updated CBA with actual costs and a detailed benefits realisation plan. The CBA has monetised both direct and indirect (enabled) benefits and estimates the programme will deliver a benefit-cost-ratio of 1.8. This means there is an estimated £1.80 of benefits for every £1 of costs.
- The benefits realisation plan we provided to Ofgem contains a comprehensive approach for monitoring and tracking the direct benefits of the programme. The plan identifies the metrics which will be tracked and the internal processes that will be used and links them with specific benefits that need to be measured. While the indirect benefits and enabled cost-efficiencies cannot be

directly measured and completely attributed to BAP, the benefits realisation plan details how the Cost Benchmarking Project will be used to provide a baseline against which future cost-efficiencies can be measured.

Given the benefits that DCC has and continues to evidence as arising from the BAP, DCC considers that the cost spent in developing the programme was economically and efficiently incurred and should not be disallowed. While we note Ofgem's concern, at paragraph 4.110, about customer engagement in respect of the BAP, that is not a reason for which Ofgem is entitled to disallow costs. As set out in Section 3, the sole basis for disallowing costs is that Ofgem determines that a cost was not economically and efficiently incurred.

We also note Ofgem's further concern, at paragraph 4.111, regarding potential overlap between the scope of the BAP and "*several other workstreams*". Ofgem does not state specifically which workstreams it is referring to, save those "*including activities on cost benchmarking and the integrated activity planning*". Regarding Integrated Activity Planning, DCC reiterates the final paragraph of section 5.5.1 of this Response, which explains the distinction between Integrated Activity Planning and the BAP.

In summary:

- First, this proposed disallowance relates to an exercise to improve economy and efficiency within DCC by improving DCC's internal processes.
- Second, Ofgem is proposing to disallow a cost that, amongst other things, will directly address the criticism that Ofgem has levied against DCC in respect of its forecasting and internal reporting.
- Third, Ofgem's proposal to disallow this cost on the basis of a lack of cost-benefit analysis overlooks the Business Case and the BAP Closure Report, which demonstrates a benefit-cost-ratio of 1.8. DCC considers that the contents of those documents are sufficient to demonstrate the economy and efficiency of DCC's investment in the BAP.
- Fourth, Ofgem has not provided any alternative assessment that suggests that the Business Case and the BAP Closure Report are incorrect. As a result, the only evidence before Ofgem is that the costs were economically and efficiently incurred.

5.7. Direct Award Procurements

Question 11: What are your views on our proposal to disallow costs associated with the RY22/23 non-competitive procurements for which we have not received satisfactory justification or evidence?

This section 5.6 of our Consultation Response addresses Question 11 and responds to paragraphs 4.114 to 4.132 of the Consultation.

Question 11 relates to DCC's procurement of certain services on a non-competitive basis. Ofgem proposes to disallow a total of £1.240m for RY22/23 on grounds that DCC purportedly did not provide satisfactory justification that a direct (i.e. non-competitive) award was the most economic and efficient option.

The circumstances in which DCC are permitted to procure services without resort to a competitive procurement process have been explained in detail at paragraphs 7.13 to 7.23 of Annex 2 to this Response. DCC continues to be concerned by Ofgem's approach to disallowances in relation to non-competitive procurements ("**NCP**"). Over the course of the last year, DCC has obtained external legal advice (privilege in which is not waived) and had extensive engagement with Ofgem to explain why their interpretation of Condition 16 is flawed, particularly with regard to the circumstances in which DCC must procure competitively. In summary, the following points are of relevance:

- First, for the reasons set out in Annex 2, Ofgem has misdirected itself as to the circumstances in which competitive procurement of services must take place.

- Second, the outcome of Ofgem's misdirection is that it considers that DCC should undertake a competitive procurement exercise even where it is impracticable or disproportionate for DCC to do so. That interpretation of the Licence is:
 - Inconsistent with the express words of the Licence.
 - At direct odds to Ofgem's principal objective, as it only serves to increase costs for consumers without any tangible benefit.
 - Seeks to require DCC to carry out a task that is impracticable and/or disproportionate, which is at odds with the efficient and economic deployment of costs.
- Third, in any event, as set out in Annex 2, Ofgem is not entitled to disallow costs purely because they were not incurred through a competitive process. The sole basis upon which Ofgem may disallow a cost is that it was not economically and efficiently incurred. That is an express requirement of the Licence.

Despite DCC's extensive engagement with Ofgem on this issue, Ofgem has chosen to disregard 100% of costs in cases where it does not support the use of NCPs (e.g. Network Evolution DSP and Smart Routing Gateway High Levels Designs). As explained at Section 3 of this Response:

- That is not in accordance with Ofgem's powers. Ofgem can only disallow costs which have not been economically and efficiently incurred. If any of these costs had been incurred in non-compliance with the procurement provisions of the Licence (which they were not), that would not be a reason entitling Ofgem to disallow the associated cost.

If Ofgem considers that an alternative means of procurement would have resulted in DCC achieving a more economic and efficient costs, then it should assess and disallow the uneconomic and inefficient cost, not the entire incurred cost.

In order to aid Ofgem in this regard, we have conducted further analysis to benchmark the specific direct award costs that Ofgem proposes to disallow against a plausible range of counterfactuals. The following table summarises the direct award costs in question and compares them to two viable counterfactuals:

1. The average rate for the same grade consultants in Lot 4 of DCC's framework, which itself was competitively procured. Lot 4 consists of seven providers of 'Testing' consultancy services and is therefore a reasonable comparator for the direct award activities in question.
2. The average rate for the same grade consultants across a range of suppliers from previous, but comparable, DCC competitive procurement exercises or another framework Lot.

Activity	Expenditure (£m)	Counterfactual Range	Difference to Counterfactual Range	Comments
Operational Performance Dashboard	£0.187	£0.126 - £0.169	10% to 33%	
Smart Routing Gateway HLD	£0.196	£0.127 - £0.129	34% to 35%	
Network Evolution HLD	£0.713	£0.461 - £0.470	34% to 35%	

SMETS1 Technical Assurance	£0.144	£0.098 - £0.197	-37% ¹ to 32%	
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In the subsequent Sections 5.7.1 to 5.7.4, DCC has explained why it directly procured each of the above services, and why it was appropriate to do so in the circumstances. If, despite those explanations, Ofgem still considers that NCP was not the most economic and efficient solution, then rather than disallow the entire cost of the services necessarily procured, Ofgem should compare the relevant costs to the counterfactual and make its assessment as to economy and efficiency accordingly.

5.7.1. Operational Performance Dashboard

There was a need within DCC for an accessible and easy to use operational dashboard, which could be utilised on the move and across different devices and platforms. The DCC website was designed, delivered and is currently maintained by [REDACTED]. DCC felt that there was a strong case to utilise the same service provider for the dashboard, in order to exploit the efficiencies of delivering the two together and attain any subsequent cost savings.

DCC have provided Ofgem with an explanation of the factors, and potential cost-savings, that led to the decision to direct award this activity. This includes enabling reutilisation of the website infrastructure for hosting the dashboard, thereby avoiding the costs of building new environments. [REDACTED] also had experience with developing and deploying DCC's style and assets, which would avoid the familiarisation time and costs associated with onboarding a new supplier. Finally, [REDACTED] had a good record of maintaining DCC's website and had already developed a demo version of a dashboard. This reduced the failure risk, and costs, associated with selecting an unproven supplier to develop a new and untested product.

As a result of the foregoing:

- In the context of the existing synergies and overlaps, it was not proportionate to separately tender and competitively procure this activity.
- Seeking to do so would likely have resulted in an increase in cost due to an inability to reutilise the website infrastructure for hosting the dashboard, thereby increasing the costs of building new environments.
- Any higher hourly rate (as shown above) was compensated, and set off, by the benefits of using an existing provider.

5.7.2. Smart Routing Gateway High Level Design

The Smart Routing Gateway is a service that enables DSP traffic to switch between the existing legacy DSP and a new DSP. A High-Level Design (HLD) was initially conducted to assess the feasibility of moving the SRG service into DSP procurement service. It was concluded that a full transition of Smart Routing Gateway into the DSP procurement service would not be as beneficial as using a Hybrid and Dual-Running approach at first. This approach refers to running 'as-is' DSP and 'to-be' DSP in parallel.

There is, however, a need to route the current traffic between these two services in an intelligent way. This includes routing of southbound messages (i.e., service requests from end users), northbound messages (i.e., service responses and alerts), and DSP-only messages.

¹ Compared to the average rates for comparable roles in Lot 1 of the framework, the costs incurred were significantly lower in this NCP. We believe Lot 1 represents a closer match to the work conducted in this project, which was management and business consulting, compared to Lot 4 which is geared more towards technical testing consulting.

Note that, for routing messages via the final Smart Routing Gateway service, no or minimal changes need to be done by end users or systems. The Smart Routing Gateway solution will meet the current service request processing requirements.

The DSP contract renewal process has started, and one of the core elements to allow this multi-million-pound procurement to achieve value for money is to show that the Smart Metering System can move traffic from the existing legacy platform to a new platform that could be procured as part of the process.

Moving all the DSP traffic in one “Big Bang” migration is seen to be too risky by all parties involved in the Smart Metering System, and without being able to gradually migrate traffic from the existing platform to the new platform, CGI would know that DCC would be unable to change platforms and be in a monopoly provider position.

Therefore, DCC commenced work on developing a capability that would enable traffic to gradually be moved over from one platform to another, and this capability became the Smart Routing Gateway.

The main requirement of the Smart Routing Gateway is to seamlessly move traffic as migration of DSP progresses to the new platform in a safe, controllable, reliable way, to enable a new contract to commence without impacting system availability or reliability. The HLD provided enough information for the SRG to be put into the lotting instruction (officially it is Statement of Work 6 of Lot 1 of the DSP Request for Proposal) and will enable bidders to scope and cost its delivery as accurately as possible, ensuring that a full competitive process can take place. This approach ensures that there are minimal costs of subsequent change due to poorly specified requirements.

5.7.3. Network Evolution High Level Design

DCC's CTO required a third-party DSP Transformation Design Partner to support the current delivery team with digital design capabilities needed for a high-level design of the new DSP platform. Under this arrangement, the selected external partner is accountable and responsible for the creation and design of artefacts needed for the new SMIP, the internal DCC team is responsible for their assurance, and the Cross Functional Design Authority (CFDA), for their approval.

As part of the work conducted for SSP0155 – DSP Design Partner, DCC selected [REDACTED] to deliver this initial phase of work. This included the initial High-Level Design of the Smart Routing Gateway.

Digital design is a relatively new skill with the market dominated by large advisory firms that can deliver high level advice (e.g., [REDACTED]). There is a market for more detailed early design partners who can deliver digital transformation (e.g., [REDACTED]). However, these suppliers tend to be aligned to specific technologies and are less able to advise or support on the elaboration of the design from a strategic perspective or build a high-level and software design specifications. These types of suppliers do not have the skills to anticipate and refine high level strategies at the level needed for DCC's Data System Platform. [REDACTED] was chosen as the delivery partner given its global reach, industry expertise, and insight on latest technology and global standards. [REDACTED] also shows best practice in its quantitative and qualitative methods through its list of awards and suite of engineering tools.

Putting to one side the issue of competitively procuring the activity, the work had to be undertaken to design the next DSP – it will not be the same as the current incarnation and all the interactions and dependencies need to be comprehensively considered and designed. It cannot therefore be the case that 100% of the costs are inefficient and uneconomic.

5.7.4. SMETS1 Technical Assurance

The SMETS1 Technical Assurance procurement was a wide-ranging assessment of Continuity of Service risks in the context of the following:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The deliverables of the work included:

- Detailed 45-page Report endorsed by the DCC ExCo members accountable for each component.
- Written response addressing all 32 questions raised by the SEC OPSG and other stakeholders via bilateral discussions in relation to both Continuity of Service and future transition plans (attached).
- Production and presentation of supporting documents for the DCC Board, SEC Panel, OPSG, the Continuity of Service Steering Committee, and the DCC Audit and Risk Committee.
- Review and Collation of a library of 41 artefacts to underpin/evidence the assessment and conclusions in detailed Report.

In the circumstances, it was not practicable or proportionate to carry out a competitive procurement process. In any event, the above benchmarking shows that the cost was within the benchmarks – and therefore economic and efficient.

5.8. Shared Service Charge

Question 12: What are your views on our proposals on the Shared Service Charge?

This section 5.8 of our Consultation Response addresses Consultation Question 12 and responds to paragraphs 4.33 to 4.146 of the Consultation.

Question 12 relates to the Shared Service Charge (“SSC”) which DCC pays to its parent company for support services, including HR, payroll, IT and the like. The SSC formed part of DCC’s bid at Licence award

and is permitted by Ofgem without justification in respect of DCC's Baseline Activities. However, Ofgem has historically rejected SSC for New Scope Activities (those not envisaged at the time of Licence award) and Additional Baseline Activities (those envisaged but not costed at Licence award) unless DCC has provided justification for payment.

We note that Ofgem is proposing to disallow the SSC on a number of General Ledger (GL) codes for Additional Baseline activities. Although we acknowledge that DCC changed the basis of its application to include these GL codes, that is not a reason under the Licence for Ofgem to disallow costs, and we believe that payment of SSC in relation to these activities is clearly compatible with the original LABP provisions given all Internal Costs are eligible for SSC.

5.9. Forecast costs (Resource)

Question 13: What are your views on our proposal to disallow forecast resource cost variances in RY23/24 and RY24/25; and disallow all baseline forecast costs for RY24/25 onwards?

This section 5.9 of our Consultation Response addresses Question 13 and responds to paragraphs 4.147 to 4.172 of the Consultation. Question 13 relates to Ofgem's proposed disallowance of DCC's forecast resource costs in RY23/24 and RY24/25.

Ofgem proposes to disallow:

- Either £18.228m or £19.654m in respect of variances against the Price Control baseline in RY23/24. There is a discrepancy between the figures in paragraph 4.164 and Table 4.9 of the Consultation.
- £24.416m in respect of variances against baseline in RY24/25.
- £89.613m in respect of all variation in DCC's baseline forecasts from RY25/26 onwards.

The reason offered by Ofgem for disallowing these forecast costs is that DCC has not sufficiently justified them. DCC is satisfied that the evidence we have submitted to Ofgem, as part of our Price Control Submission, justifies our forecast resource costs for RY23/24 and RY24/25. We are disappointed that Ofgem has deemed some of these forecast costs to have not been sufficiently justified. We would ask that Ofgem reconsiders its position, especially given the evidence submitted 5.1.2 and 5.1.3 relating to the Technology Innovation and CISO sub-teams respectively.

Ofgem must accept that there will always be a level of inherent uncertainty regarding future resource costs and in some cases, such as in our programme teams, the degree of uncertainty will be higher due to the evolving nature of the programme itself.

Furthermore, if Ofgem disallows either the entirety or the variance of a forecast cost, and in the following Regulator Year seeks to criticise DCC for failing to comply with what will inevitably be an unrealistic forecast, then Ofgem runs the risk of significantly misdirecting itself in its Price Control procedure.

6. Performance Incentives

Summary

- **System Performance** – We welcome Ofgem's recognition that DCC has met all system performance targets in RY22/23.
- **Contract Management** – We disagree with Ofgem's proposal to downgrade the scores provided by the independent auditor. Ofgem has not explained which scores it proposes to reduce or to what extent, which has the appearance of arbitrariness. Moreover, Ofgem's justification lacks transparency and is seemingly influenced by its misconceptions as to DCC's procurement obligations. Ofgem should explain which specific aspects of DCC's procurement approach justify a reduction in the independent auditor's assessment. Ofgem's proposal runs contrary to the very purpose of appointing an independent auditor and does not account for the significant improvements made by DCC compared to RY21/22. Ofgem should either provide proper justification for its proposal in order that DCC may consult with Ofgem further or otherwise abide by the auditor's assessment.
- **Customer Engagement** - We are pleased that Ofgem and SEC parties have recognised our improvements in this area.
- **Project Performance (SMETS1)** - We agree with Ofgem's proposal to accept DCC's assessment of the overall performance achieved. However, we disagree with its proposal to not distribute the margin adjustment over 3 years as requested. A phased approach would align with the period of the BMPPAS itself and more fairly distribute the impact of the margin reduction to customers and DCC. We have made a compelling case to distribute the adjustment over three years and would invite further discussion with Ofgem as to our proposal.

6.1. Operational Performance Regime

The Operational Performance Regime (OPR) is designed to incentivise DCC to run a high-quality service for its customers by placing Baseline Margin at risk. In RY22/23 £7.618m was placed at risk against the OPR. The OPR incentivises DCC based on the reliability of DCC systems, customer engagement and contract management. There are currently five active performance measures under which DCC is financially incentivised:

- System: service availability.
- System: install and commission.
- System: prepayment (interim response times).
- Customer engagement.
- Contract management.

The three system measures carry an equal weighting of 23.3% each reflecting the importance of the operational performance of the DCC, and the customer engagement and contract management measures carry a weighting of 15% each. A portion of DCC's margin is put at risk against each of these measures.

DCC is aware that Ofgem intends to issue a consultation on changes to the OPR Guidance. We hope to continue the collaborative working approach between DCC and Ofgem to ensure the OPR is fit for purpose and achieves the right outcomes for industry.

6.1.1. System Performance

Question 14: What are your views on our proposed position on DCC's System Performance?

This section 6.1.1 of our Consultation Response addresses Question 14 and responds to paragraphs 5.9 to 5.48 of the Consultation. Question 14 relates to the three system measures of the OPR.

We reported system performance of 100% for RY22/23. A key topic this year was the inclusion of the SRV8.11 metric which remains outside of DCC's full control. This position has been supported by customers and we removed this from our reporting to show a fair assessment of performance.

We welcome Ofgem's recognition that DCC has met all system performance targets and is therefore minded-to award DCC the full margin associated with system performance for RY22/23. This demonstrates the benefits of clearly measurable targets as they can help to drive performance improvement.

We also welcome Ofgem's minded-to position to zero weight SRV8.11 in RY22/23. This has been DCC's longstanding position, and we have submitted material evidence to justify this change to the OPR. We still support the consideration of a measure based on a definition of 'success' rather than target response times and will support the progression of a SEC modification to bring this into the code.

6.1.2. Contract Management

Question 15: What are your views on our proposed position on DCC's Contract Management?

This section 6.1.2 of our Consultation Response addresses Question 15 and responds to paragraphs 5.49 to 5.72 of the Consultation. Question 15 relates to the Contract Management measure of the OPR.

Ofgem appointed an independent auditor, using the National Audit Office (NAO) Framework, to assess DCC's Contract Management performance. The independent auditor determined a performance score of 1.95 out of 3 (i.e. 65%). Ofgem proposes to reduce the auditor's score to 1.71 out of 3 (i.e. 57%), equating to a reduction of £0.489m from DCC's margin. Ofgem cites DCC's procurement approach and the performance of its 2nd Tier Suppliers as justification for its proposal.

Ofgem's proposed reduction

At Table 5.4 of the Consultation, Ofgem sets out its individual scores against seven metrics of the Contract Management audit. Ofgem then states at paragraph 5.69 in respect of the auditor's scores that *"in some instances it was necessary to reduce the scores given DCC's approach in managing its supplier performance and ensuring competition"*. However, Ofgem has not explained which scores it has reduced and why, or stated the score originally awarded by the auditor. This makes it difficult for DCC or other stakeholders to respond to Ofgem's proposal in a meaningful way. Absent an explanation of the nature and scale of Ofgem's individual reductions, Ofgem's decision appears arbitrary. DCC would welcome specific clarification as to which sections of the auditor's findings Ofgem proposes to reduce, and to what extent.

Ofgem's justification for reducing the score, provided by an independent auditor following a six-week audit process against agreed criteria, is extremely high level and seemingly influenced by information which DCC has not been privy to. This not only lacks transparency but introduces a significant element of apparent arbitrariness (or at the very least, of subjectivity) into the evaluation, potentially undermining the integrity of the entire assessment, and running contrary to the very purpose of appointing an independent auditor.

Ofgem's approach is seemingly also influenced by its misconceptions as to DCC's procurement obligations, which have already been explained in Section 3 and Annex 2 of this Response. If DCC is being penalised for not carrying out procurement processes where it was impractical or disproportionate to do so, it would be an irrational result (if the aim was to further the interests of existing and future consumers). Ofgem should explain which specific aspects of DCC's procurement approach are considered to justify a reduction in the independent auditor's assessment.

The auditor's assessment

In paragraph 5.69 of the Consultation, Ofgem say that:

"Whilst we the consider majority [sic] of the scores awarded by the auditor to be an accurate reflection of DCC's performance, on the basis of wider assessment, we consider in some instances it was necessary to reduce the scores given DCC's approach in managing its supplier performance and ensuring

competition. We note that many of the findings of the audit are similar to those of the RY21/22 audit such that DCC has clearly failed in some areas to act on the findings of last year, justifying our reduction.”

The auditor’s report for RY21/22 proposed a score of 1.33 out of 2 (i.e. 67%) which Ofgem accepted. For RY22/23, the independent auditor proposed a score of 1.95 out of 3 (i.e. 65%) which Ofgem is minded to reduce to 1.71 out of 3 (i.e. 57%). We have concerns that both the auditor’s and Ofgem’s proposed reduced score are not reflective of the discussion that took place when the auditor talked DCC through the draft report in July 2023. The auditor advised that, though there is still work to be done, there had been an improvement in performance versus last year. That is reflected within the report’s Executive Summary and contradicts the award of an aggregate lower score for RY22/23 compared to RY21/22.

Examples of improvements made in response to last year’s feedback, and acknowledged in this year’s audit, include developing a suite of contract management tools and a Contract Management Handbook, restructuring of the Commercial Directorate team, and developing a Supplier Lifecycle Programme. These and other significant improvements made in RY22/23 were a direct result of the previous year’s audit findings but have seemingly not been reflected in the auditor’s final scoring of DCC’s performance. DCC rely on the findings of the auditor to drive improvements to our Contract Management but have always maintained concerns over the suitability of the NAO framework. DCC would be happy to work with Ofgem to develop this incentive so that the independent audit remains a useful and trusted assessment of performance. In the meantime, Ofgem should recognise the key improvements made by DCC in RY22/23 and at least honour the assessment of the independent auditor.

6.1.3. Customer Engagement

Question 16: What are your views on our proposed position on DCC’s Customer Engagement?

This section 6.1.3 of our Consultation Response addresses Question 16 and responds to paragraphs 5.73 to 5.101 of the Consultation. Question 16 relates to the Customer Engagement measure of the OPR.

DCC’s performance is assessed in respect of timing and frequency of engagement, quality of information provided by DCC, and accountability of customer views. DCC and the SEC Panel make submissions as to DCC’s performance against set criteria.

DCC reported a performance score of 2.25 out of 3 (i.e. 75%) for RY22/23, which was an improvement against last year’s award of 1.42 out of 3 (i.e. 47%). This self-assessment reflected the many initiatives we had undertaken to enhance the ways in which we engaged with our customers in RY22/23. The SEC Administrator and Secretariat (“SECAS”) proposed a score of 2 out of 3 (i.e. 67%). We understand that Ofgem’s minded-to position is to award a score of 2 out of 3 (i.e. 67%).

We are pleased that Ofgem and SEC parties have recognised our improvements in this area, and we look forward to working with Ofgem and SECAS to further improve ways of working between DCC, our customers and our key stakeholders. We understand that Ofgem intends to consult on changes to the OPR Guidance which will impact the Customer Engagement aspect of the OPR. We are keen to take a collaborative approach to develop a set of measures that are challenging, measurable, and achievable.

6.1.4. Project Performance: SMETS1

Question 17: What are your views on our proposed position on the assessment of the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS)?

This section 6.1.4 of our Consultation Response addresses Question 17 and responds to paragraphs 5.102 to 5.111 of the Consultation.

Question 17 relates to the Baseline Margin Project Performance Scheme (“BMPPAS”) created by the Secretary of State (“SoS”) for SMETS1. The SoS may create a BMPPAS defining a project and an incentive regime which (i) places DCC’s Project Baseline Margin (“BM”) at risk and (ii) requires DCC to make a submission at completion of the BMPPAS as to its performance against the regime.

The SMETS1 BMPPAS placed 50% of DCC's relevant BM at risk depending on the rate of enrolment of SMETS1 Smart Metering Systems, and the remaining 50% depending on the proportion of SMETS1 Smart Metering Systems enrolled by the end of the scheme. In RY22/23, this scheme closed and DCC reported having achieved 39% against the scheme (equating to a 61% reduction in BM).

Given the materiality of the value associated with the SMETS1 BMPPAS, we proposed a 3-year phasing to the BM reduction. This has the impact of reducing DCC's BM by £2.7m each year for the next 3 years, rather than Ofgem's proposed £6.955m in RY22/23 and £1.224m in RY23/24. This phased approach would align with the period of the BMPPAS itself and more fairly distribute the financial impact on customers and DCC.

Ofgem's minded-to position is to accept DCC's assessment of its overall performance but not distribute the BM adjustment over 3 years as requested. We have made a compelling case for distribution of the BM adjustment and would invite further discussion with Ofgem in this regard.

7. Baseline Margin Adjustment and External Contract Gainshare

Summary

- **BMA** – Ofgem has proposed to disallow a wide range of business-as-usual costs such as building rent and other accommodation costs, and a significant proportion of expenditure on External Services, with no explanation, and without any evidence of having assessed whether they are economic and efficient. We again reiterate that the application process is extremely onerous and is no longer fit for purpose given the fundamental changes in DCC structure and operating model since the Licence was awarded.
- **ECGS** - We note and accept Ofgem's position.

7.1. Baseline Margin Adjustment

Question 18: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

This section 7.1 of our Consultation Response addresses Question 18 and responds to paragraphs 6.1 to 6.48 of the Consultation. Question 18 relates to the Baseline Margin Adjustment ("BMA") mechanism which allows DCC to apply for a Relevant Adjustment to the Baseline Margin values stipulated in the Licence.

As Ofgem notes at paragraph 6.2 of the Consultation, the BMA mechanism is intended to ensure that DCC is compensated for material changes in its Mandatory Business – including the volume, characteristics, risks and timescales of these activities. Ofgem acknowledges, at paragraph 6.27, that DCC has met the conditions for a Relevant Adjustment but suggests that DCC has not provided sufficient evidence to support the full amount applied for.

Ofgem's proposed disallowances

Ofgem's BMA reductions are set out in the table below.

Cost area	Proposed reduction (£m)			
	22/23	23/24	24/25	Total
BM Activities Rejected	1.518	0.373	0.475	2.366
Drivers/Grounds Rejected	0.352	0.455	0.545	1.352
Payroll - Internal costs disallowances	0.314	3.616	4.329	8.258
Contractor Benchmarking - Internal costs Disallowances	0.043	0.000	0.000	0.043
Non-PR Internal Costs Disallowances	1.505	0.043	0.000	1.548
Total	3.732	4.486	5.349	13.567

A significant amount of the rejected BMA in RY22/23 is accounted for by Ofgem's Internal Cost disallowances. We challenge these disallowances in Section 5 of this Response and do not repeat our arguments here. However, there are significant reductions of individual activities as well as a rejection of a Driver/Ground with which we disagree:

- **BM Activities Rejected** – Ofgem has extensively rejected applications across a wide range of Accommodation, External Services, IT services and Office Sundry. In the vast majority of cases, Ofgem has not provided any specific rationale for rejecting them. All of the activities are legitimate

business activities where the costs have exceeded Ofgem's artificially low Price Control baseline. Similarly, given Ofgem has not disallowed any of the costs associated with these activities, Ofgem's proposal to disallow the margin on those costs is incomprehensible.

- **Drivers/Grounds Rejected** – we are disappointed that Ofgem has rejected the increase in Customer Service Expectations ground. It is indisputable that DCC's customer base is more complex than envisaged in the LABP, and for which DCC was originally funded. Rejecting costs associated with accommodating the demands of the more numerous and complex customer base is akin to asking DCC to run the service at cost. This is not the basis on which the LABP was tendered.

Ofgem has also proposed to disallow the vast majority of forecast costs on the basis that DCC can reapply in future years. While we acknowledge this is the case, we do not understand why Ofgem cannot award margin for stable costs such as Accommodation.

BMA application process

As in previous years, we would again reiterate that the BMA application process is extremely onerous, with DCC expected to justify all expenditure relative to Ofgem's baseline. This baseline is usually significantly below our business plan forecast, meaning DCC must justify ongoing spend on hundreds of members of staff and dozens of procurements.

Following Ofgem's rejection of BMA applications in previous years due to "missed windows" and further clarification of the rules in the RY21/22 Price Control process, DCC is now incentivised to apply for extremely small amounts of expenditure to avoid them being ineligible in future years because of the application process.

As DCC's activities are now dramatically different to those assumed at Licence award, the application process is no longer fit for purpose, and imposes a significant regulatory burden on DCC. It also exposes DCC to significant financial risk as the quanta of Ofgem's BMA awards are unpredictable.

The process followed by Ofgem is structurally biased against DCC as there seems to be a paradox between Ofgem disallowing a relatively small quantum of costs (with the exception of a fundamental and unpredictable change in approach in RY21/22 and RY22.23), but implicitly making a much larger amount ineligible for BMA on grounds of economy and efficiency. This provides confusing signals to DCC and undermines the original intent of the licence application, the premise of which was that efficient costs would be eligible for margin.

7.2. External Contract Gainshare

Question 19: What are your views on our assessment of DCC's application to adjust its ECGS?

This section 7.2 of our Consultation Response addresses Question 19 and responds to paragraphs 6.49 to 6.58 of the Consultation.

We note and accept Ofgem's position on the award of gainshare, including adjusting the amount to reflect the impact of the VMO2 price support.

8. Switching Programme

Summary

- **Costs** - We believe it would be sensible for Ofgem to revisit its proposed forecast cost disallowances to promote stakeholder certainty and reduce regulatory burden.
- **Switching Incentives** - We welcome Ofgem's recognition that the final delivery milestone for this programme was achieved in full and its decision to allow additional switching margin through the DDR and DRM.

8.1. Switching Costs

Question 20: What are your views on our proposed position on DCC's costs associated with Switching?

This section 8.1 of our Consultation Response addresses Question 20 and responds to paragraphs 7.1 to 7.9 of the Consultation. Question 20 concerns DCC's costs in respect of the Switching Programme, intended to improve consumers' experience of switching between energy suppliers.

We are pleased to note that Ofgem is not proposing to disallow any of DCC's costs incurred in RY22/23. However, consistent with what we have said at Section 5.9] above, we are concerned that Ofgem proposes to disallow the entirety of the forecast costs associated with the Switching Programme for RY23/24, RY24/25, and RY25/26. While there may have been uncertainty during the Design, Build and Test ("**DBT**") phase that justified such exclusions, now that the programme has transitioned into live operations, it would be sensible for Ofgem to revisit its position. DCC would be happy to discuss this further with Ofgem in order to account for the fact that some cost will be incurred, in order to (i) ensure that a realistic forecast is in place, which creates reasonable expectations for stakeholders, and (ii) reduces regulatory burden on DCC in justifying its expenditure in future Price Control submissions.

8.2. Switching Incentives

Question 21: What are your views on our assessment of Delivery Milestone 5 of the Switching Programme?

This section 8.2 of our Consultation Response addresses Question 21 and responds to paragraphs 7.10 to 7.15 of the Consultation. Question 21 concerns the incentivised aspect of the Switching Programme.

During the DBT phase of the switching programme, £2.7m of margin was placed at risk against five delivery milestones – the final milestone (DM5) fell due in RY22/23 and was achieved in full and on time.

Since the programme closed in RY22/23, we have reported on our full programme performance, in which we reported a loss against DM1 only (which occurred in RY19/20) of £0.58m. This is reflective of the positive success we have seen on the Switching Programme overall. That loss was partially offset by DCC's further work on address matching through the Discretionary Data Reward ("**DDR**") and customer engagement through the Discretionary Reward Mechanism ("**DRM**"). We successfully demonstrated our outperformance in these areas, which resulted in additional margin of £0.20m.

We welcome Ofgem's recognition that the final delivery milestone for this programme was achieved in full and its decision to award additional switching margin through the DDR and DRM. This was a good example of how upside incentives can further promote the achievement of good outcomes for our customers. We would be interested in exploring this further and designing similar mechanisms in the future.

9. Proposals to amend future Baseline Margin and Shared Service Charge

9.1. BMA and Shared Service Charge

Question 22: Do you agree with our proposal to apply a margin somewhere in the range of 7-9% when calculating BM adjustments from 01 April 2024 onwards? Do you have a specific figure that you think should be applied?

Question 23: Do you agree with our proposal to adjust the Shared Services Charge (SSC) from 9.5% to 4.5% from 01 April 2024 onwards?

Question 24: Do you agree with our proposal that any services provided to DCC by Capita, whether through a services contract or through the SSC arrangements, should not be eligible to earn any additional BM through the adjustment process from 01 April 2024 onwards?

This section 9.1 of our Consultation Response addresses Questions 22, 23, and 24 and responds to paragraphs 8.1 to 8.47 of the Consultation. Questions 22, 23, and 24 concern Ofgem's proposed:

- Reduction in BMA applicable to costs incurred from 1 April 2024 onwards.
- Reduction in SSC applicable to costs incurred from 1 April 2024 onwards.
- Disapplication of BMA to services provided by DCC's parent company, Capita.

We are disappointed that Ofgem has chosen to propose fundamental changes to both the Baseline Margin Adjustment mechanism and the Shared Service Charge rate in its Consultation document. We have expressed concerns before that Ofgem is delivering fundamental policy change without the opportunity for DCC (as licensee) to challenge such changes (if appropriate) via an appeal to the Competition and Markets Authority.

Responses to the specifics of Question 22, 23 and 24 will be provided in a separate document by DCC's shareholder.

Annex 1 – Consultation Questions

External Costs

Consultation question	DCC Response
1 What are your views on our proposal to disallow £4.159m in incurred External Costs and £12.406m in forecast External Costs associated with DCC's procurement of an interim solution for the SMETS1 supply chain?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence. Due to a lack of contextual understanding and an unwillingness to recognise the costs as economic and efficient, and in one significant area an error made in Ofgem's calculations.</p> <p>Our detailed response is set out in section 4.1 of this document.</p>
2 What are your views on our proposed cost disallowance of up to £2.675m in relation to SMETS1 service stabilisation in RY22/23?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence, on a number of grounds including the risk of setting a potentially very costly precedent.</p> <p>Our detailed response is set out in section 4.2 of this document.</p>
3 What are your views on our proposal for a disallowance up to the amount of External Costs incurred on a directly awarded contract in the 4G CHs & Networks programme?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence. Procuring multiple high value contracts is extremely challenging and when it was apparent that the requirements of our vendors were not compatible with our preferred model, we worked at pace to provide a robust and value for money alternative.</p> <p>Our detailed response is set out in section 4.3 of this document.</p>
4 What are your views on our proposal to disallow £44.054m in forecast FSP External Costs?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence. There will always be a level of inherent uncertainty regarding future resource costs, and the degree of uncertainty will be higher due to the evolving nature of the FSP programme itself.</p> <p>Our detailed response is set out in section 4.4 of this document.</p>
5 Do you have any other views on External Costs?	<p>Our detailed response is set out in section 4.5 and the Executive Summary of this document.</p>

Internal Costs

Consultation question	DCC Response
6 What are your views on our proposals on disallow a 50% proportion of the RY22/23 resource costs associated to Corporate Management, Design and Assurance, Security cost centres and the Network Evolution programme?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence.</p> <p>Our detailed response is set out in section 5.1 of this document.</p>
7 What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence.</p> <p>Our detailed response is set out in section 5.2 of this document.</p>

8	What are your views on our proposal to disallow the continued costs that are linked to the activities that we disallowed in RY21/22 – these include additional costs associated with the Executive training programme, innovation and growth as well as a continuation of the RY21/22 non-competitive procurements?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence as they limit DCC's autonomy and limit our ability to provide an effective service for our customers.</p> <p>Our detailed response is set out in section 5.3 and section 5.4 of this document.</p>
9	What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not have been resourced in the most economic and efficient way?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence as outsourcing activity was well planned, justified and ensured to be economic and efficient.</p> <p>Our detailed response is set out in section 5.5 of this document.</p>
10	What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence as we consider that BAP has already delivered, and will continue to deliver, tangible benefits to the way the business operates and functions.</p> <p>Our detailed response is set out in section 5.6 of this document.</p>
11	What are your views on our proposal to disallow costs associated with the RY22/23 non-competitive procurements for which we have not received satisfactory justification or evidence?	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence. For certain urgent activities to ensure efficiency, these procurements were given to suppliers on our framework agreement to ensure costs were economic and efficient.</p> <p>Our detailed response is set out in section 5.7 of this document.</p>
12	What are your views on our proposals on the Shared Service Charge?	<p>We note and accept Ofgem's proposals regarding ineligibility of certain costs.</p> <p>Our detailed response is set out in section 5.8 of this document.</p>
13	What are your views on our proposal to disallow forecast cost variances in RY22/23 and RY23/24; and all baseline forecast costs for RY24/25	<p>We do not agree that these proposed disallowances are reasonable or consistent with the Licence.</p> <p>Our detailed response is set out in section 5.9 of this document.</p>

Performance Incentives

Consultation question		DCC Response
14	What are your views on our proposed position on DCC's System Performance?	<p>We welcome Ofgem's recognition that DCC has met all system performance targets in RY22/23.</p> <p>Our detailed response is set out in section 6.1.1 of this document.</p>
15	What are your views on our proposed position on DCC's Contract Management?	<p>We disagree with Ofgem's proposal to reduce the scores awarded by the Independent Auditor.</p> <p>Our detailed response is set out in section 6.1.2 of this document.</p>
16	What are your views on our proposed position on DCC's Customer Engagement?	<p>We are pleased that Ofgem and SEC parties have recognised our improvements in this area</p> <p>Our detailed response is set out in section 6.1.3 of this document.</p>

17	What are your views on our proposed position on the assessment of the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS)?	<p>We accept Ofgem's position to accept the overall performance achieved but disagree with its position to not distribute the margin adjustment.</p> <p>Our detailed response is set out in section 6.1.4 of this document.</p>
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Baseline Margin Adjustment and External Contract Gainshare

Consultation question	DCC Response
18	<p>What are your views on our assessment of DCC's application to adjust its Baseline Margin?</p> <p>Ofgem has inappropriately disallowed a number of business-as-usual activities. We again reiterate that the application process is extremely onerous and is no longer fit for purpose.</p> <p>Our detailed response is set out in section 7.1 of this document.</p>
19	<p>What are your views on our assessment of DCC's application to adjust its ECGS?</p> <p>We note and accept Ofgem's position.</p> <p>Our detailed response is set out in section 7.2 of this document.</p>

Switching Programme

Consultation question	DCC Response
20	<p>What are your views on our proposed position on DCC's costs associated with Switching?</p> <p>We acknowledge Ofgem's position on costs, but we believe it would be sensible for Ofgem to revisit its position on forecasts.</p> <p>Our detailed response is set out in section 8.1 of this document.</p>
21	<p>What are your views on our assessment of Delivery Milestone 5 of the Switching Programme?</p> <p>We welcome Ofgem's minded-to position.</p> <p>Our detailed response is set out in section 8.2 of this document.</p>

Proposals to amend future Baseline Margin and Shared Service Charge

Consultation question	DCC Response
22	<p>Question 22: Do you agree with our proposal to apply a margin somewhere in the range of 7-9% when calculating BM adjustments from 01 April 2024 onwards? Do you have a specific figure that you think should be applied?</p> <p>This question will be responded to by DCC's shareholder.</p> <p>Our detailed response is set out in section 9.1 of this document.</p>
23	<p>Do you agree with our proposal to adjust the Shared Services Charge (SSC) from 9.5% to 4.5% from 01 April 2024 onwards?</p> <p>This question will be responded to by DCC's shareholder.</p> <p>Our detailed response is set out in section 9.1 of this document.</p>
24	<p>Do you agree with our proposal that any services provided to DCC by Capita, whether through a services contract or through the SSC arrangements, should not be eligible to</p> <p>This question will be responded to by DCC's shareholder.</p> <p>Our detailed response is set out in section 9.1 of this document.</p>

earn any additional BM through the
adjustment process from 01 April 2024
onwards?

Annex 2 – Licence and Legal Context

1. Introduction

1.1 In this Annex, DCC sets out its understanding of:

- The relevant terms of the Licence concerning price control.
- Ofgem's Guidance in respect of price control.
- The Authority's principal objectives, and their relevance to the Licence and the price control procedure.
- On the basis of the above, the proper approach to understanding the scheme of price control and the Authority's powers.
- The role of undertakings.

1.2 The above form the relevant context to the exercise of the Authority's powers in respect of price control, and (specifically) its powers to exclude costs from Allowed Revenue.

2. Background to the Licence

2.1 On 20 September 2013, the Secretary of State, in exercise of the powers conferred by section 7AB(2) of the Gas Act 1986 (the "**Gas Act**") and section 6(1A) of the Electricity Act 1989 (the "**Electricity Act**"), granted a licence (comprising a smart meter communication licence under the Gas Act and a smart meter communication licence under the Electricity Act) to DCC (the "**Licence**").

2.2 The Licence was expressed to have effect on and after 23 September 2013 in accordance with and subject to the Terms set out in Parts 1 and 2, the Conditions set out in Part 3, and the Schedules set out in Part 4 of the Licence.

2.3 As the owner of the Licence, DCC is responsible for providing the communications service that links gas and electricity smart meters in homes and small businesses across Great Britain with the systems of energy suppliers, network operators and energy service companies.

2.4 In this respect, amongst other things, the Licence requires that:

- The First Enduring General Objective of DCC is to carry on the Mandatory Business in the manner that is most likely to ensure the development, operation, and maintenance of an efficient, economical, co-ordinated, and secure system for the provision of Mandatory Business Services under the Smart Energy Code and where relevant the Retail Energy Code.
- The Second Enduring General Objective of DCC is to carry on the Mandatory Business in the manner that is most likely to facilitate:
 - a) effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy under the Principal Energy Legislation;
 - b) such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation; and
 - c) the reduction (by virtue of benefits arising from the provision of Value Added Services) of the charges payable for Mandatory Business Services.

3. Relevant terms of the Licence

- 3.1 The relevant parts of the Licence concerning the price control process include:
- Condition 36, which dictates how the Authority determines the amount of Allowed Revenue that DCC may recover in a Regulatory Year.
 - Condition 37 (which is stated to supplement Condition 36) permits the Authority to exclude or accept undertakings in respect of Internal Costs and External Costs which it assesses to have not been incurred economically and efficiently.

3.2 The relevant sections of these Conditions are considered in turn below.

Condition 36 (Allowed Revenue)

3.3 The purpose of Condition 36 is to establish the mechanism for determining the amount of Allowed Revenue that may be recovered by DCC through Service Charges levied in respect of its provision of Mandatory Business Services.

3.4 Paragraph 36.7 provides the calculation for assessing DCC's Allowed Revenue:

"The amount of the Licensee's Allowed Revenue in relation to Regulatory Year t is to be determined in accordance with the following formula (in this condition, the Principal Formula):

$$AR_t = EC_t + IC_t + CRSR_t + PTCT + BM_t + BMPAt + ECGSt - VASCT + Kt$$

3.5 The various parts of this calculation are defined at paragraph 36.8. The definitions of EC_t and IC_t state that, as part of its total Allowed Revenue, DCC is entitled to its actual incurred External Costs and Internal Costs, subject only to the application of Condition 37:

*" EC_t means the **actual amount** of the Licensee's External Costs, as calculated for Regulatory Year t by the Licensee, **except** to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.*

*IC_t means the **actual amount** of the Licensee's Internal Costs, as calculated for Regulatory Year t by the Licensee, **except** to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37."*

(emphasis added)

3.6 Condition 36 also states that:

- DCC, in setting "Service Charges for its Mandatory Business Services, must take all reasonable steps to secure that, in Regulatory Year t , its Revenue does not exceed a prudent estimate of its Allowed Revenue for that Regulatory Year" (paragraph 36.4).
- For the purposes of paragraph 36.4, and subject to paragraph 36.6, "a prudent estimate of Allowed Revenue is **the Licensee's** best estimate of Allowed Revenue as adjusted to ensure that (disregarding any within-year adjustments that may be permitted in circumstances prescribed by the Charging Methodology of the Licensee) the Service Charges as they apply for Regulatory Year t will not need to be amended in the course of that year except in response to a reasonably unlikely contingency" (emphasis added) (paragraph 36.5).
- The adjustment to which paragraph 36.5 refers must not be such as to result in an expectation that Regulated Revenue will significantly diverge from the Allowed Revenue in Regulatory Year t .

Condition 37 (Assessment of Mandatory Business Costs)

3.7 The purpose of Condition 37 is to enable the Authority to monitor and assess certain costs associated with the provision of Mandatory Business Services “in order to determine whether they were economically and efficiently incurred” or, where that is not the case, whether such costs may be liable:

- “to be excluded from the mechanism for determining the Licensee’s Allowed Revenue under Condition 36”; or
- to be the subject of an undertaking given by the Licensee with respect to their future management.

3.8 Paragraphs 37.3 to 37.7 contain requirements on DCC for submission of an annual report on cost performance. Paragraph 37.8 states:

“Subject to paragraph 37.9, and after considering the report that has been submitted to it under paragraph 37.3, the Authority **may**:

(a) direct that any External Costs and Centralised Registration Service External Cost or Internal Costs and Centralised Registration Service Internal Cost that it considers **were not economically and efficiently incurred** in the Relevant Regulatory Year (“the Unacceptable Costs”) are to be excluded from any future calculation of the Licensee’s Allowed Revenue under Condition 36;

(b) accept an undertaking given by the Licensee with respect to the Unacceptable Costs on terms that relate to either or both of:

- (i) the Licensee’s future management of those costs, and
- (ii) the Licensee’s future procurement of Relevant Service Capability.”

(emphasis added)

3.9 In turn, paragraph 37.9 dictates what the Authority must do in deciding whether to exclude a cost or accept an undertaking.

“In deciding whether to make a direction or to accept an undertaking under paragraph 37.8, the Authority **must**:

- (a) consult with the Licensee;
- (b) consider the extent to which the Licensee was able, or should have been able, to control or otherwise influence the occurrence of the Unacceptable Costs, taking due account of the Licensee’s role in procuring any Relevant Service Capability giving rise to those costs;
- (c) consider the likelihood that the Licensee will be able to recover any of the Unacceptable Costs through its future procurement of Relevant Service Capability; and
- (d) consider the likelihood that through appropriate future management actions the Licensee will be able to avoid, prevent, or mitigate a further occurrence of the same or any similar costs.”

(emphasis added)

3.10 In addition to what Ofgem “must” do, paragraph 37.10 provides:

“Paragraphs 37.8 and 37.9 are without prejudice to the power of the Authority to take account of any other matters that are revealed by or are capable of being derived from the Licensee’s Price Control Information under Condition 32 and that the Authority considers would be relevant to its functions under this Condition 37 of monitoring and assessing certain costs associated with the provision of Mandatory Business Services during any Regulatory Year.”

4. Ofgem guidance

4.1 In respect of guidance, Condition 37 of the Licence states at paragraphs 37.11 and 37.12:

- “The Authority may issue, and from time to time revise, guidance about the procedure it will follow and the matters it will take into account in considering whether and to what extent to exercise its power to give a direction or accept an undertaking under paragraph 37.8” (paragraph 37.11).
- “Guidance under paragraph 37.11 may, in particular, set out the principles, methods of assessment, and types of criteria that are likely to be applied by the Authority in determining whether costs have been economically and efficiently incurred” (paragraph 37.12).

4.2 On 21 July 2022, Ofgem published its updated “Guidance: DCC Price Control: Processes and Procedures” (the “**Guidance**”). However, the Guidance acknowledges:

*“This guidance document ... **is not legally binding** and DCC and other stakeholders should take their own legal advice on any questions relating to the interpretation and application of the Licence terms and conditions ... **In the event of any inconsistency between the Licence and this document, the Licence Conditions take precedence.**”*

(emphasis added)

4.3 It is apparent from the foregoing that the Guidance may provide: (i) guidance on procedure (ii) guidance as to matters the Authority “will take into account” in deciding whether to give a direction to disallow a cost or accept an undertaking (iii) guidance as to the principles, methods of assessment, and types of criteria that are likely to be applied by the Authority in determining whether costs have been economically and efficiently incurred. However, the Guidance is not legally binding and – as such – cannot alter the terms of the Licence or create additional obligations.

4.4 In this respect, at paragraph 2.24 the Guidance says: “The Licence puts the burden of proof on DCC to justify costs as economic and efficient”. These words are not found in the Licence. For the reasons set out in paragraph 7.12 below, on a proper construction and interpretation of the Licence that approach is oversimplistic and not correct. If the Authority follows the Guidance in this respect, it would be misdirecting itself as to the proper exercise to be carried out. Please see paragraph 7.13 below.

4.5 In respect of the scope of material provided by DCC that shall be considered by the Authority, the Guidance says:¹

“Economic and efficient are not defined terms in the Licence. As such, we will consider all evidence and explanation that DCC provides to justify expenditure. This includes, for example, giving consideration to any evidence and explanation of trade-offs DCC has made between cost, quality and/or timeliness of activity.”

4.6 In addition, the Guidance expressly contemplates that the Authority may look at a range of information, including:

- Performance information reported from other sources.
- Other compliance documents or reporting submitted by DCC, for example the Regulatory Accounts, any BM notice it has submitted, and DCC’s procurement strategy.
- A cost visit to ask additional questions or request supporting references and evidence

¹ Ofgem Guidance on DCC Price Control Processes and Procedures (2022), Paragraph 2.26

- Consulting with stakeholders and DCC users will be a key part of the process and further information or evidence that they give the Authority.
- Independent and market sources of information to compare cost and the DCC's evidence, including specific benchmarking of certain Internal and External Costs.
- A forensic accounting audit to provide additional assurances about the information the DCC has provided. For example, this could review internal processes, procurement or risk management.

4.7 The Guidance states that in determining whether cost has been incurred economically and efficiently, Ofgem will consider (amongst other things):

- Any evidence and explanation of trade-offs DCC has made between cost, quality and/or timeliness of activity (see paragraph 2.26).
- What was within DCC's reasonable control (see paragraph 2.39).
- DCC's procurement and procurement strategy (see paragraph 2.57.ii, 2.66 to 2.71).
- The information available to DCC at the time when costs were incurred (see paragraph 2.62).

5. Authority's principal objective

5.1 In exercising its functions under the Licence, in addition to being constrained by the terms of the Licence as to how those functions must be exercised, the Authority is subject to a statutory 'principal objective', which is to protect the interests of existing and future consumers in relation to electricity conveyed by distribution systems or transmission systems and in relation to gas conveyed through pipes.

5.2 In this context, section 3A of the Electricity Act and section 4AA of the Gas Act explain that the 'interests of existing and future consumers are their interests taken as a whole', including:

- their interests in the reduction of electricity – and gas – supply emissions of targeted greenhouse gases;
- their interests in the security of the supply of electricity and gas to them; and
- their interests in the fulfilment by the Authority, when carrying out its designated regulatory functions, of the 'designated regulatory objectives'.

5.3 Further, in carrying out its functions the Authority must have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and
- any other principles appearing to represent the best regulatory practice.

5.4 In respect of the interests of existing and future consumers, it is important to appreciate that DCC is at the forefront of providing the technical solutions for reduction of greenhouse gas emissions. Further, as DCC seeks to deliver the foregoing through the better management of demand (through smart metering), it is responsible for one of the limited number of activities that achieves the above outcome without creating issues with security of supply.

5.5 In the circumstances, ensuring that DCC's activities remain investable (by reference to the actual amounts it incurs to provide those services) is of direct relevance to the interests of existing and future customers. Although the Licence establishes a price control process and factors that the

Authority “*must*” take into account, and “*may*” determine, the Authority should exercise any residual discretion in accordance with its principal objective, with direct reference to the above.

6. Proper approach to construction and interpretation of the licence

- 6.1 The Licence confirms, at its Part 1 Section H, that its terms are to be read as if they were “*in an Act of Parliament*”. As a result, the usual rules of statutory interpretation apply when seeking to construe the terms of the Licence.
- 6.2 The rules of statutory interpretation are well-known, and we do not propose to recite them in full here. However, it is worth noting that when assessing the meaning of any part of the Licence, the starting point is the ordinary linguistic meaning of the words used. Where a Condition is grammatically capable of only one meaning, and other interpretative criteria do not raise any doubt as to that meaning, the Condition is to be given its grammatical meaning.
- 6.3 That being said, the words of the Licence should always be read in context and having regard to their purpose. Context is meant in its widest sense, to include the context of the Licence as a whole, and its legal, social, and historical context. DCC reiterates section 5 above as to the context in which it is providing its smart metering services.

7. Scheme of price control

- 7.1 Taking the above together, the scheme of the price control provisions in the Licence may be summarised as follows:
- First, DCC is entitled to be reimbursed as Allowed Revenue, amongst other things, the “*actual amount*” it has incurred in respect of External Costs and Internal Costs in respect of a Regulatory Year. That is the starting point to any analysis.
 - Second, the only exception to the foregoing is the extent to which the Authority may direct that costs are to be excluded “*acting under Part B of Condition 37*”. As a result, the extent to which the “*actual amount*” of External Costs and Internal Costs need not be reimbursed to DCC is tightly circumscribed to those (i) directed by the Authority (ii) acting under Condition 37. That is narrow and specific in scope and nature.
 - Third, in relation to the scope of Condition 37, the Authority “*may*” direct to exclude an External Cost or Internal Cost only insofar as it considers that it was “*not economically and efficiently incurred*”. There is no other power to exclude (or disallow) reimbursement of External Costs and Internal Costs to DCC.
 - Fourth, there is no definition in the Licence of what “*economically and efficiently incurred*” means. That is accepted in the Guidance. The starting point to understanding the meaning of those words should be their ordinary linguistic meaning in the context of the Licence (and its purpose) as a whole.
 - Fifth, in relation to the evidence to be taken into account in establishing whether an External Cost or Internal Cost has been “*economically and efficiently incurred*”, there is no limitation on the scope of evidence that should be considered by the Authority. In greater detail:
 - a) Condition 37 places a positive obligation on the Authority to monitor and assess costs associated with the provision of Mandatory Business Services.
 - b) That monitoring and assessment will include consideration of all evidence and explanation DCC provides to justify expenditure, including for example the price control information submitted pursuant to Condition 32, the annual report on cost performance submitted pursuant to Condition 37, and the contents of this Consultation response.

- c) However, the evidence to be taken into account will not be limited to evidence supplied by DCC. The Authority will (and should) use its own initiative in collating and considering, without limitation, relevant evidence, including the types of information described in the Guidance (see paragraph 4.6 above).
- Sixth, if an External Cost or Internal Cost is not economically and efficiently incurred there is no automatic exclusion (or disallowance) of the cost. In this respect:
 - a) Paragraph 37.8 states that the “*Authority may*” exclude a cost which is not economically and efficiently incurred. It does not say it “*must*” be excluded.
 - b) Further, paragraph 37.8 also does not require that the Authority elect between excluding an External Cost / Internal Cost and accepting an undertaking. The word “*must*” does not appear in paragraph 37.8 nor the word “*or*” between paragraph 37.8(a) and (b).
 - c) As a result, the Authority must make an independent determination as to whether an exclusion of an External Cost or Internal Cost is to be made (even if an undertaking is thought not to be appropriate).
- Seventh, in respect of exercising the above determinative power, the Authority:
 - a) Has a mandatory obligation to take into account the factors set out at paragraph 37.9 of Condition 37 which include:
 - i. the extent to which DCC was able, or should have been able, to control or otherwise influence the occurrence of the cost, taking due account of DCC’s role in procuring any Relevant Service Capability giving rise to those costs;
 - ii. the likelihood that DCC will be able to recover any of the costs through its future procurement of Relevant Service Capability; and
 - iii. the likelihood that through appropriate future management actions the Licensee will be able to avoid, prevent, or mitigate a further occurrence of the same or any similar costs.
 - b) By reference to paragraph 3.9 of the Guidance, should also take into account the impact that excluding any cost could have on the operation of DCC’s activities.
 - c) In addition, should exercise its powers in accordance with its ‘principal objective’, which would require it to exercise its powers in the ‘interests of existing and future consumers’ which ‘are their interests taken as a whole’, including (amongst other things):
 - i. their interests in the reduction of electricity – and gas – supply emissions of targeted greenhouse gases;
 - ii. the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

7.2 As a result of the foregoing, the scheme of the Licence does not allow the following:

- First, a cost to be excluded in its entirety where the Authority considers that the associated service was reasonably required, and so a cost (of some amount) was properly incurred.
- Second, a cost be to excluded because it was (in whole or part) not in accordance with an estimate or forecast (whether that be an estimate/forecast provided by DCC or amended by Ofgem).

- Third, a cost be excluded purely because DCC has failed to establish, on the burden of proof, that it was economically and efficiently incurred.
- Fourth, a cost be excluded because it was incurred in breach of procurement obligations where, after analysis, it cannot be concluded that the cost was “*not economically and efficiently incurred*”.

7.3 Further, in considering the exercise of its powers the Authority must consider existing and future consumers interests as a whole – by reference to the principal objective rather than solely by reference to short term cost implications.

7.4 Each of these are explained below.

Excluding the entirety of a cost

7.5 As to the issue of whether Ofgem is to disallow the entirety of a cost, or rather the delta between the incurred cost and that which would have been economic and efficient:

- The Licence only permits the Authority to exclude (disallow) costs “*not economically and efficiently incurred*”. On an ordinary construction of those words, it does not empower the Authority to exclude the entirety of a cost pool where a proportion of that cost was economically and efficiently incurred. The proper approach is to allow the cost that is economic and efficient and exclude the element of the cost pool that is not.
- That position is accepted and supported in the Guidance. The Guidance provides, at paragraphs 2.30, what Ofgem will do in certain situations where it is not straightforward, or Ofgem is unable, to identify “*the proportion of costs which were incurred economically or efficiently*”. That is inconsistent with any suggestion that the Authority should exclude the entire cost. The Authority should actively attempt to identify the proportion of costs that was not incurred economically and efficiently.
- Further, the above approach is consistent with the concept of proportionality required by the Authority under the Electricity Act and Gas Act.

7.6 For the reasons set out above, it would be contrary to the Licence terms, and to its statutory duties, if the Authority were permitted to disallow the proportion of costs that *had* been economically and efficiently incurred, such that DCC was effectively required to provide the service for free, purely by reason of their association with costs that *had not* been economically and efficiently incurred.

7.7 At various points of the price control process, Ofgem has suggested that it has power to exclude the entirety of DCC’s costs in a specific pool, even where DCC would inevitably incur an Internal Cost or External Cost to provide the Mandatory Business Services. If adopted, for the reasons set out above, that approach would be misguided and wrong. We understand that this is accepted by Ofgem.

Estimates and forecasts

7.8 As set out above, DCC is paid on an *ex-post* or ‘after the fact’ basis, by reference to (amongst other things) the “*actual amount*” of DCC’s External Costs and Internal Costs in the previous Regulatory Year. That is materially different to other (*ex-ante*) regulatory regimes, where the regulator sets an amount in advance that the regulated entity will receive in each year for providing a defined good or service.

7.9 Throughout the Consultation, Ofgem has repeatedly criticised DCC regarding the accuracy of its forecasting of costs. Those criticisms are not accepted and are addressed in subsequent sections

of this response. For present purposes of understanding the scope of the Authority's powers to exclude costs, DCC notes:

- The price control procedure is not governed by *ex-ante* principles whereby DCC would be paid a predetermined sum by reference to estimates or forecasts.
- The role of forecasts and estimates in assessing any disallowance of DCC's cost is a limited one. Paragraphs 37.3 to 37.6 require DCC to provide Ofgem, in each Regulatory Year, with a report that includes:
 - a) Comparisons between the actual amounts of External, Internal, and Centralised Registration Service Costs incurred, and the estimates of those costs prepared by DCC in their forecasts of expenditure.
 - b) An explanation of any material divergence between actual and forecast cost, and a statement of any material revision that DCC thinks it is appropriate or necessary to make to any financial or operational matter included in its Licence Application Business Plan as a result.
- However, there is no power in the Licence to exclude (or disallow) costs that exceed a forecast. As set out above, the power to exclude an External Cost or Internal Cost from Allowed Revenue is limited to the criterion in Condition 37 concerning whether costs were "*not economically and efficiently incurred*".
- Further, for the purposes of Condition 36 and 37 (paragraphs 37.3 to 37.6 and paragraph 36.4) the relevant forecast is DCC's forecast – not any forecast as amended or reformulated by Ofgem. Using a forecast amended or reformulated by Ofgem would (i) not be in accordance with the Licence (ii) at its most extreme, endanger shifting the entire remuneration structure of the Licence from an *ex-post* (or 'after the fact') exercise where DCC receives its amount incurred (less one exception) to an *ex-ante* regime whereby Ofgem sets an amount in advance that DCC will be paid (which is obverse to the express terms and conditions of the Licence).
- In addition, forecasts should not be used to shift DCC's day-to day or strategic decisions on costs that should be incurred to provide the Mandatory Business Services to Ofgem. The Licence requires that it is for DCC to manage the Mandatory Business Services and incur the cost in doing so. The Authority has power only to exclude associated Internal Costs and External Costs which are not economically and efficiently incurred – not purely because Ofgem would have provided the services differently or taken different decisions in incurring the associated costs.

Burden of proof

- 7.10 In the Guidance, and at various points, Ofgem has sought to stress that there is a 'burden of proof' on DCC. It goes without saying that DCC will seek to incur costs economically and efficiently, and demonstrate that it has done so.
- 7.11 However, if the Authority considers that DCC has not proven it has economically and efficiently incurred a cost, it is not entitled to rely upon a 'burden of proof' argument to make a disallowance:
- First, as set out in paragraph 3.9 above, the starting point is that DCC should be reimbursed for its External Costs and Internal Costs in any Regulatory Year. The Authority's power to exclude costs is an exception (and limited exception) to that starting point.
 - Second, the power to determine that a cost should be excluded is tightly circumscribed by Condition 37 to the Licence. It requires:

- a) A determination that a cost was not economically and efficiently incurred; and
 - b) An exercise of the Authority's powers (taking into account the mandatory factors required by the Licence and its principal objective) to declare that a cost should be excluded.
- Third, in exercising those powers, the Guidance rightly points to the fact that the Authority should consider a wide range of information (beyond that provided by DCC) (see, for example, paragraphs 2.56 and 2.57 of that document). The Authority is not entitled to seek to place a 'burden of proof' upon DCC such that it may cease proper investigation of costs.

7.12 In substance, any attempt to rely upon a burden of proof argument (i) seeks to invert the process contained in the Licence (which provides that DCC should be reimbursed the "*actual amount*" of its External Costs and Internal Costs unless excluded by the Authority) (ii) would amount to a failure of the Authority to properly exercise its rights and powers under the Licence.

DCC's procurement obligations

7.13 At various points throughout the Consultation, Ofgem seeks to criticise DCC's approach to procurement, in particular where those services have been procured on a non-competitive basis. For the reasons set out elsewhere in this document, the factual premise of those criticisms is not accepted.

7.14 It should firstly be noted that, where Ofgem is proposing to disallow "*up to the total costs*" of any procured or re-procured services,¹ or indeed proposes to disallow any costs on grounds of the means of procurement, that is not a matter for which the Licence permits the Authority to exclude (or disallow) costs. Paragraph 37.8 does not provide for automatic disbarment of costs incurred in non-conformance with the Licence. It only permits that costs may be disallowed where they are not economically and efficiently incurred. To the extent that the Authority considers that any costs were not economically and efficiently incurred by reason of their means of procurement, the Authority will need to explain and quantify the basis for that assessment.

7.15 DCC's procurement of Relevant Service Capability is governed by Licence Condition 16, which sets out various requirements (the Part A Requirements) and principles (the Part B Principles) that DCC must comply with when procuring Relevant Service Capability, whether externally or via its own internal resource. Paragraphs 16.4, 16.5, 16.6, and 16.9 dictate the circumstances in which DCC must procure services externally and on a competitive basis, and those in which DCC may procure services internally and/or on a non-competitive basis.

7.16 Paragraph 16.4 reads as follows:

"The Licensee must (subject to paragraph 16.6) procure Relevant Service Capability from External Service Providers on a competitive basis and under arrangements to be known as External Service Provider Contracts that are compliant with the principles established by Part B below ("the Part B Principles")."

7.17 As a starting point then, paragraph 16.4 provides that (subject to Condition 16.6) DCC must procure Relevant Service Capability from an external source and on a competitive basis, provided that such procurement is compliant with the Part B Principles.

7.18 Paragraph 16.5 states that:

"The duty imposed by paragraph 16.4 applies without exception to the procurement by the Licensee of such Relevant Service Capability as is specified as:

¹ Consultation paragraph 3.82

(a) *Fundamental Service Capability in Schedule 1 (which has effect as part of this condition) to this Licence; or*

(b) *Fundamental Registration Service Capability.”*

7.19 The obvious meaning of paragraph 16.5 is that the requirements of paragraph 16.4 will apply “without exception” to “Fundamental” services but, by inference, not to non-Fundamental services. That much is confirmed in paragraph 16.6, which reads:

“Relevant Service Capability that is not so specified may be provided by the Licensee from its own resources, or be procured from an Affiliate or Related Undertaking, or from elsewhere, if the Licensee, having had regard to the Part B Principles (excluding Principle 2), is satisfied that the procurement of such capability by that means:

(a) *would be the most economical and efficient option; or*

(b) *would be immaterial in terms of its value or use of resources within the overall context of the Mandatory Business of the Licensee.”*

7.20 Taken together, these three Conditions provide that:

- Fundamental services will be procured externally and on a competitive basis, provided that such procurement is compliant with the Part B Principles.
- Non-Fundamental services may be procured from within DCC’s internal resource, subject to consideration of the Part B Principles.

7.21 The significance of the Part B Principles is plainly apparent. Of particular significance in the present circumstances is Principle 2 at paragraph 16.9, which applies to all of DCC’s external procurement, and which states that:

“Principle 2 is that Relevant Service Capability must be procured competitively wherever practicable and proportionate, and with due regard for (i) the principles of equality and non-discrimination between economic operators and (ii) the employment of transparent and objective procurement processes.”

(emphasis added)

7.22 As explained above, the combined effect of paragraphs 16.4 and 16.5 is that DCC must procure Fundamental services on a competitive basis, provided that such procurement is compliant with the Part B Principles. Principle 2 requires Relevant Service Capability (which includes Fundamental services) to be procured competitively “*wherever practicable and proportionate*”. The ordinary meaning of those words is that, in circumstances where it would not be practicable and proportionate to procure competitively, DCC should consider whether any alternative means of procurement *will* be practicable and proportionate. That is a logical conclusion, as to engage in an impracticable and disproportionate procurement exercise would very likely run contrary to the principles of economy and efficiency that underpin the price control provisions.

7.23 DCC is concerned that Ofgem has made criticisms of certain non-competitive procurement without considering whether, in the circumstances, it would have been practicable and proportionate to procure competitively. The illogical inference being that, if in fact it would not have been practicable and proportionate, then DCC is effectively being criticised for failing to act with impracticality or disproportionality in carrying out its functions.

DCC’s costs and the bigger picture

- 7.24 The Licence is structured such that DCC receives the actual amount that it incurs in respect of External Costs and Internal Costs, save for costs excluded by the Authority as not “*economically and efficiently incurred*”. That approach is important, as it encourages DCC to make appropriate investments (and incur associated costs) concerning the provision of the Mandatory Business Services. If DCC was not able to recover costs envisaged by the Licence, it would have a serious and detrimental impact of the willingness of DCC (and its shareholder, or any other company in its place) to make the significant investments needed to deliver the Mandatory Business Services.
- 7.25 As is generally accepted, the Mandatory Business Services, related to smart metering, play a critical role in seeking to deliver the greenhouse emissions targets that are at the forefront of existing and future customers interests (as expressly recognised by the Authority’s principal objective).
- 7.26 Acting in customers interests requires the Authority to take into account the importance of investability (and the investors ability to finance) in delivering a critical element of the infrastructure needed for meeting greenhouse emissions targets. An attempt to seek to reduce cost below what is stipulated by the Licence would have a knock-on detrimental impact to consumers (and the planet).

8. Undertakings

- 8.1 Paragraph 37.8(b) provides the Authority with a power to accept an undertaking from DCC in respect of any Unacceptable Costs on terms that relate “*either or both*” to:
- DCC’s future management of those costs.
 - DCC’s future procurement of Relevant Service Capability.
- 8.2 The words “*either or both*” dictate that any proposed undertaking may, but need not necessarily, concern itself with the Unacceptable Costs themselves, or any possible claw-back of those costs. The power to accept an undertaking regarding only future procurement affords the Authority the ability to recognise the inherent benefit in managing ongoing conduct in the delivery of Relevant Service Capability.
- 8.3 The Licence does not favour the disallowance of cost over acceptance of an undertaking, or vice versa. Rather, as explained at paragraphs 7.1.6 and 7.1.7 above, if the Authority elects to either disallow a cost or accept an undertaking (which it is not required to do), it should decide between those options on a case-by-case basis, in consideration of the matters at paragraph 37.9 of the Licence, and by reference to its principal objective. However, in the Guidance, the Authority suggests that it “*would only expect DCC to propose an undertaking in exceptional circumstances*”. That wording implies a level of predetermination on the part of the Authority that is inconsistent with the terms of the Licence, contrary to the interests of existing and future consumers, and would amount to a failure of the Authority to properly exercise its rights and powers.