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Dear Ayena,

Consultation on DCC Price Control: Regulatory Year 2022/23

Thank you for the opportunity to respond to the consultation on the DCC Price Control: Regulatory Year 2022/23.

Since the start of the smart meter programme Electricity North West Limited (ENWL) has held regular bilateral meetings with the Department for Energy Security and Net Zero (DESNZ) and its predecessors to support progress with the rollout, thereby helping our ENWL customers realise benefits from smart meters, and co-operated with the delivery of the outputs from the Switching Programme.

We share a number of Ofgem's concerns regarding the DCC's performance and are disappointed to see that these are the same issues that we reported last year:

- lack of cost transparency and poor customer engagement – as a DCC user we incur costs that arise as a result of decisions made through DCC's internal governance processes and as such we would expect robust evidence of how DCC has taken customer views into account. We have concerns that DCC's customers have not been able to fully scrutinise costs on key DCC programmes such as business planning and SEC modifications to be able to feed into decisions.
- unjustified forecasted costs which don't meet certainty thresholds – as a DCC user and customer we use the DCC forecasts to estimate the impact on our cash flow and our own price control forecasts. Whilst we recognise there is some uncertainty around DCC's activities, the DCC are consistently over estimating costs against programmes and SEC modifications. This has eroded confidence in the DCC's financial forecasting over its last eight price control years. Ultimately, through the impact on tariffs, the resulting volatility in Year-on-Year DUoS recovery also impact consumers. We would welcome closer alignment of the DCC charging statements and invoicing with its price control forecasting.

Appendix 1 provides our detailed responses to each of the consultation questions.



I hope these comments are helpful. Please do not hesitate to contact me or Mark Bellman (07385 009419) if you would like to follow up on any particular aspect of our response.

Yours sincerely,

Paul Auckland
Head of Economic Regulation

Appendix 1 – ENWL detailed responses to each of the consultation questions

The following table includes our views on the consultation:

Ref.	Question	Response
Section 3: External Costs		
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 are unable to provide a view if the External Costs are economic and efficient as we do not have adequate transparency of DCC costs due to their restricted commercially sensitive nature.</p> <p>However, this said, we agree with Ofgem's observation that, as a monopoly service, DCC should provide more transparency of the costs and are happy to accept Ofgem's proposal to disallow these costs to the extent that Ofgem believe they are excessive, compared to what could otherwise be procured through a transparent, effective, <i>economic and efficient</i> competitive procurement process.</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 agree with the principle of disallowing these costs for the reasons outlined by Ofgem.</p> <p>We note that to do otherwise would be to accept DCC's failure to ensure that the costs of poor performance are borne by the responsible third party (3.71), much of which was evidently due to two service providers and observed by the independent auditor.</p> <p>We are also pleased to note that Ofgem "expect DCC to make improvements across the board." (as noted in the last paragraph of Summary of External Costs).</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 have no visibility of DCC's procurement process or what benchmarks (if any) it uses to determine that awards are economic and efficient.</p> <p>However, Ofgem have cited insufficient evidence that Direct Award was more efficient or economic than competitive procurement process. For this reason we agree with the proposal to disallow costs.</p> <p>As to the amount, ENWL can see an argument that the disallowed amount should represent the difference between the perceived excess of cost of the direct award over that from a competitively awarded contract. ENWL do not have a view on how that could be estimated but ENWL believe that the competitive process would ensure the most efficient service and cost and agree with Ofgem that any direct award needs to be shown to constitute a lower cost / better service / quicker delivery option.</p>
4	What are your views on our proposal to disallow £44.054m in forecast FSP External Costs?	<p>We have no visibility of DCC's forecasting process or what measurement and feedback mechanism (if any) it uses to ensure they are as accurate as possible, or indeed what challenges / improvement programmes are brought to bear on those process / contract costs to ensure they are economic and efficient.</p> <p>Without such evidence, ENWL cannot give a view on how much should be disallowed.</p>

		<p>ENWL believe that the move to <i>ex-ante</i> price control should (and should be used to) incentivise DCC to significantly improve their cost (and forecasting) performance.</p> <p>We note that Ofgem states at 3.105 that “DCC repeatedly resubmitted its regulatory reporting due to identified errors, many of which occurred in forecast costs” and at 3.106 that “DCC’s forecasting continues to be inconsistent”. In addition to the point Ofgem made in 3.105 about forecasts providing a baseline, ENWL would like to emphasise that inaccurate forecasting by DCC also presents a cashflow burden on all DCC categories who are charged including DNOs.</p> <p>ENWL would also like Ofgem to note that DCC forecasting issues are evident in areas other than their price control submission, one recent example of an in-year revision of forecast costs is the Nov-23 notice of £50m reduction in RY 2023/24 charges to industry, which sees a DNO £/mpan charge move by nearly 20%. Whilst this represented a recharge to DNOs the rationale provided was limited and referred to a correction factor in underspend and return of contingency. This is the second RY running the DCC has returned significant charges due to underspend via adjusted charges in the last quarters of the RY. We request more granular detail from the DCC for the rationale regarding their underspend and an improvement in the accuracy of the forecasting and analysis into whether their contingency is set too high.</p>
5	Do you have any other views on External Costs?	<p>We note that Ofgem states c. 70% of DCCs costs are External (notwithstanding a welcome “improvement in the permanent-contractor staff ratio”, ref 4.28))</p> <p>We also note Ofgem’s concerns about a lack of evidence of efficient and economic procurement of services.</p> <p>ENWL are concerned that these two together could present a significant exposure for the industry and consumer, and indeed a ‘perfect storm’ as the end of the existing DCC licence term approaches.</p> <p>The risk arises if i) the focus of DCC and potentially their contracted parties move to new revenue streams ii) expert resources start to move away from either DCC or their service providers.</p> <p>(ENWL note that the DCC Business Handover Plan is currently out for consultation and will respond accordingly.)</p>
Section 4: Internal Costs		
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>ENWL agree that, from what Ofgem has reported, if the Service Delivery team costs have increased by £2.682m there should be either a robust explanation or disallowance to some extent.</p> <p>Ofgem states (4.67) that DCC provided a list of activities carried out in RY22/23 that were in line with what had been forecast in RY21/22 for RY22/23, but that no evidence was provided to substantiate the cost variance of £2.682m.</p> <p>In addition, there does not appear to be any list of BAU activities carried out by the team in RY21/22 with which to compare.</p>

		<p>Ofgem notes “.... we have not received any satisfactory explanation of how the increased costs relate to an increase in activity relative to RY21/22” (4.67). Ofgem note they will (4.68) “reduce the proposed disallowance accordingly” in the light of any further evidence.</p> <p>In this case and without any rationale for a disallowance of 50%, ENWL’s initial view is that Ofgem should propose disallowance of 100% of the unexplained variance of £2.682m, unless satisfactory evidence is received during consultation per 4.68.</p>
7	<p>What are your views on our proposals on DCC’s approach to benchmarking of staff remuneration for both contractor and permanent staff?</p>	<p>ENWL note that DCC’s contractor costs are not economic and efficient by Ofgem’s definition, viz.:</p> <ul style="list-style-type: none"> • 4.35 “DCC benchmark contractors based on the 50P10 benchmark” • Ofgem states in 4.37 that “our position is that hiring <i>up to the median of the benchmark</i> is the economic and efficient approach”. <p>DCC’s governance for contractor hire embeds this 50P10 benchmark, viz.:</p> <ul style="list-style-type: none"> • DCC’s internal approval process allows discretion for the hiring manager and Business Partner up to 50P10 without a business case. <p>We agree that the DCC needs to continue to provide evidence of their benchmarking with their submission to demonstrate i) their approach to benchmarking (as it changes from year to year in response to Ofgem challenge and other factors) and ii) that rates remain economic and efficient.</p> <p>ENWL agree with the proposals in 4.43. We would add that Ofgem should request DCC report their benchmarking against the median rather than the median +10% measure (50P10). This is to better compare with Ofgem’s economic and efficient condition as noted in 4.37.</p> <p>We agree with Ofgem’s proposal to disallow £0.402m of contractor costs in RY22/23.</p>
8	<p>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>	<p>We agree with the proposal to disallow these costs.</p> <p>We are disappointed that DCC continue to pursue non-mandatory activities.</p> <p>ENWL agree with Ofgem that the priority should be core services, and furthermore that Baseline service needs to be stable and performing effectively before DCC consider branching out to provide further services ... if DCC are developing profitable channels using ‘IP’ and/or knowledge gained through its licensed activities, they should show how that additional value will flow to industry parties and ultimately to the consumer.</p>
9	<p>What are your views on our proposal to disallow a proportion of the costs linked to the activities that we consider not have been</p>	<p>We agree, provided that the evidence supports Ofgem’s finding. Refer to the answers above for External Costs.</p>

	resourced in the most economic and efficient way?	
10	What are your views on our proposal to disallow costs directly associated with the Business Accuracy Programme?	<p>ENWL believe that DCC's BAP is an acknowledgement of significant opportunity for cost reduction, and furthermore, indicates that industry has paid for DCC inefficiencies to date of £11.8m to RY25/26 (4.98)</p> <p>Given that there is apparently opportunity here, ENWL believe that Ofgem should incentivise DCC to create the efficiencies ASAP, provided that i) the benefits are transparent, relevant, real and incremental to plan, and that ii) such benefits can be shown to flow back ultimately to the consumer. The incentive under the current ex-post price control would be for Ofgem to disallow the BAP costs in full, and also impose a cost-efficiency Disallowance on the underlying operating costs of an amount equal to the claimed BAP efficiency, acknowledging that DCC have over-expended on the activities.</p> <p>If there are not expected to be such benefits or they're not incremental to plan or they cannot be demonstrated, or if benefits are to be retained by DCC, then the costs of the BAP activity should certainly be disallowed in full.</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 agree. Refer to the answers above for External Costs.</p> <p>ENWL welcome the scrutiny all contract awards, especially non-competitive. This should lead to improved efficiency in industry processes and ultimately benefits to the consumer through reduced costs and potentially improved service.</p>
12	What are your views on our proposals on the Shared Service Charge?	<p>ENWL agree with Ofgem's proposals to disallow these costs.</p> <p>ENWL would go further to suggest that the charge should represent only the marginal cost of the DCC's use of those services and should not include any element of cross-subsidy or double-counting of Capita's SSC costs. And that it would be appropriate for Ofgem to re-examine the % that was submitted during the Licence tender process in the light of increasing Internal Costs since the tender.</p>
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?	<p>ENWL agree with this proposal in the light of inadequate justification. (refer again to previous points about volatile forecasts from DCC)</p>
Section 5: Performance Incentives		
14	What are your views on our proposed position on DCC's System Performance?	<p>ENWL welcome the functionality available to DNOs regarding outage and restoration alerts to enable us to realise the benefits from the Smart Meter Implementation Programme. However due to the radio communication technology constraints for our region we receive a reduced benefit with minute lead in times (rather than seconds) as was originally anticipated. Whilst outside the scope of this price control ENWL are aware of the shift in the costs of the DCC communication providers for each region, with costs for the cellular technologies continuing to</p>

		increase (we suspect this is due to the Network Evolution programme focus on improvements to the cellular technology service). ENWL request the DCC be asked to monitor and report on the cost differentiation between the communication providers for the regions for the next price control period.
15	What are your views on our proposed position on DCC's Contract Management?	ENWL agree with Ofgem's proposed reduction of £0.489m of DCC's margin and note Ofgem's reporting of concerns expressed by SEC Panel and DESNZ about the direct award (rather than competitive award) for the DSP contract (5.71)
16	What are your views on our proposed position on DCC's Customer Engagement?	ENWL agree with Ofgem's proposed reduction of £0.381m of DCC's margin.
17	What are your views on our proposed position on the assessment of the SMETS1 Baseline Margin Project Performance Scheme (BMPPAS)?	<p>ENWL support Ofgem's rebuttal of DCC's proposal to redistribute the margin adjustment and retaining the BMPPA for RY 22/23 at £6.955m.</p> <p>ENWL would emphasise that to realise the full benefits presented by SMIP it requires an early and high level of penetration, so we are keen that such schemes incentivise roll-out and implementation.</p>
Section 6: Baseline Margin adjustment and External Contract Gain Share		
18	What are your views on our assessment of DCC's application to adjust its Baseline Margin?	<p>ENWL agree with Ofgem's reduction to DCC's request for £24.021m BMA, particularly the rejection of DCC's application for £1.352m over 3 years on the grounds of 'Increase in Customer Service Expectations'.</p> <p>However, ENWL would be interested to understand how the allowance of a further £9.08m (compared to the request for £24m) features in DCC's published Business Plan figures because volatility in their cost forecasting burdens our cashflow.</p> <p>Volatile forecasts are one of the reasons why ENWL would be very sceptical about any claims for savings or benefits arising from the various initiatives, because unless they can be shown to be (and outturn) incremental to that plan, then they can be of no economic value to DCC's funders.</p>
19	What are your views on our assessment of DCC's application to adjust its ECGS?	ENWL understand Ofgem's rationale for the minor (£0.051m) adjustment to, and accepting the remainder of, DCC's request for £5.208m ECGS adjustment.
Section 7: Switching		
20	What are your views on our proposed position on DCC's costs associated with Switching?	ENWL note the costs for Switching were moved from the SEC to the REC from the 1 st April 2023 and as such we have no comments as the REC charges (including DCC switching costs) are predominantly recovered from Suppliers.
21	What are your views on our assessment of Delivery Milestone 5 of the Switching Programme?	
Section 8: Proposals to amend future Baseline Margin and Shared Services Charges		

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>ENWL agree with Ofgem’s proposal but consider there may be arguments for an even lower BM for DCC’s Smart Meter and Switching businesses, particularly noting:</p> <ul style="list-style-type: none"> i) the unique way it is funded ultimately by the consumer, leaving little financial risk. ii) the lack of commercial risk, given that its service is mandated by industry Code. iii) the prospective move to ex-ante price control which should further reduce the risk compared to the uncertain outcome of an <i>ex-post</i> process. iv) Those parties dependent on DCC have considerably lower margins. <p>ENWL believe the BM should be benchmarked to establish a reasonable and evidenced basis, noting that these costs are passed onto the consumer so efforts should be made to avoid them being excessive.</p>
23	Do you agree with our proposal to adjust the Shared Services Charge (SSC) from 9.5% to 4.5%?	ENWL agree with this. Refer previous comments about SSC costs recovery now compared to start.
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?	ENWL agree with this.