

# ELEXON

05 January 2024

By e-mail to: [DCCregulation@ofgem.gov.uk](mailto:DCCregulation@ofgem.gov.uk)

Dear DCC Oversight and Regulatory Review team,

Re: DCC Price Control: Regulatory Year 2022/23

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

Elxon is an independent, not-for-profit company that is the Code Manager for the Balancing and Settlement Code (BSC) for the electricity market. We provide governance, settlement and data platforms (Elxon Kinnect) that enable the smooth operation of the electricity market, which incorporates energy suppliers, generators, flexibility service providers and network companies across the UK.

Our end-to-end expertise in governance, assurance, technology platform development and electricity market data is available to support the industry, Government and Ofgem as the energy sector transitions to net zero. Building on our purpose of serving the industry, the electricity market data we hold is open and available for anyone to access, modify and distribute. As a trusted, independent and reliable market expert we continuously look to evolve and innovate for the benefit of customers and consumers.

Most recently, we utilised our domestic and non-domestic half hourly consumption data alongside our extensive knowledge to administrate the Government's Energy Price Guarantee and Energy Bill Discount Schemes, processing up to £650m of subsidy payments per week, providing support for consumers. We also calculate, collect and distribute payments to Contract for Difference (CfD) generators and Capacity Market (CM) providers, on behalf of the Low Carbon Contracts Company (LCCC), through our subsidiary, EMR Settlement Ltd.

Please find some general observations which summarise the key points of our response to the DCC Price control consultation:

- **Value for money and burden of proof.** We support Ofgem in scrutinising DCC costs and only allowing what it deems economical and efficient, in order to guarantee best value for money for the industry and, ultimately, consumers. We believe that this is particularly important given that DCC operates as a monopoly in a non-competitive environment. We therefore support Ofgem in asking DCC to demonstrate and evidence that the routes it has chosen for procuring services, including both internal and external, are economic and efficient. However, we are not in a position to be able to express a specific and precise assessment of the magnitude of these external and internal costs, also considering the openly available detailed information (or the lack of thereof). Our observations, therefore, focus on some general principles relating to Ofgem's methodology in scrutinising these costs.
- **Process and Procedures.** In July 2022 Ofgem published a guidance on "*DCC Price Control: Processes and Procedures*." The aim of this guidance is to help ensure the principles and criteria that Ofgem will apply in conducting the DCC price control assessment are clear. We believe that this guide is a very useful tool for interpreting Ofgem's position on the assessment, and that it lays solid foundations for reducing

areas of uncertainty making the cost assessment process easier to understand. However, given the complexity of the price control mechanism, we believe that the stakeholders would benefit from having a more detailed illustration of the functioning of price control and the methodology used to evaluate costs. We believe it would be beneficial to update this guide to respond to the questions raised by stakeholders during the workshops.

- **Workshops and Engagement.** We believe that the workshops on specific thematic areas are extremely useful and we thank Ofgem for involving us. As these workshops provide a space for debate and enable interactions between stakeholders relevant to both ongoing and future cost assessments, Elexon intends to keep participating actively in these meetings going forward.
- **Planning, scoping, and resourcing of projects.** We believe that, as a monopoly provider, it is important that DCC achieves value for money through the services that it procures. In RY22/23 Ofgem identified an over-reliance on external consultants as opposed to providing evidence that alternative, more economic and efficient, options had been considered. We support Ofgem's position about the importance of providing adequate evidence and we agree that DCC should make improvements in this area through better forward planning.
- **Contract management.** With ~70% of DCC's costs being attributed to External Costs, we agree that DCC's key role is to effectively manage and handle the large number of External Service Providers (and contracts) that make up the infrastructure of the smart metering and switching services. In order to improve DCC performance in this area, we believe it would be useful if Ofgem could offer some examples of best practices or benchmarking in contract management. We also recognise the complexity of guaranteeing good service standards without, at the same time, having direct control over it. For this reason, we believe that, in carrying out its assessment of the internal costs incurred, Ofgem should operate a thoughtful balance of interests between value for money and continuity of the service, as explained above.
- **Importance of continuity of service.** We believe that guaranteeing the continuity of the service in emergency situations is paramount and must always be guaranteed, even at the cost of sacrificing efficiency, but always and only for a period that is reasonable and for the duration of the 'emergency'. We note that DCC has always managed to guarantee this continuity and maintain a good standard of services. For this reason, we recommend that, in carrying out its assessment of the costs incurred, Ofgem would operate a thoughtful balance of interests between value for money and continuity of the service. In doing so it may be necessary to consider specific situations when DCC has been facing emergency circumstances due to events outside of its area of control (e.g. a subcontractor of one of DCC's service providers experiencing financial difficulties).
- **Procurement.** DCC operates using an outsourced service model, and efficient procurement is core to its role in delivering its services economically. A large proportion of external services were procured non-competitively in RY22/23 and Ofgem has not seen sufficient evidence that DCC made the necessary assessments to consistently follow a non-competitive route with the use of direct awards. We support Ofgem's position on the importance of providing adequate evidence and that labelling an operation as 'urgent' without further explanation is not sufficient evidence. Therefore, we agree with Ofgem's position that DCC should make improvements in this area.
- **Transparent process and importance of stakeholder engagement.** DCC should provide additional transparency on costs directly to its customers through its quarterly finance forums under suitable confidentiality arrangements. However, as discussed by DCC customers during the Ofgem workshops, these quarterly forums do not provide this level of transparency. We believe that greater stakeholder involvement in the cost forecasting and determination phase may be necessary. We therefore suggest that Ofgem can chair these quarterly forums or consider other improvements that can guarantee adequate stakeholder involvement at the appropriate times.
- **Baseline margin adjustment.** Baseline Margin Adjustment (BMA) mechanism was provided in the Licence in order to recognise the inherent uncertainty present at the time of the Licence award of the nature and risk of DCC's Mandatory Business over time, and to protect DCC against its margin being diluted over time due to material changes in the activities it carries out, the risks it faces, or the timescales or deadlines that it is required to meet. DCC has applied for a BM adjustment in each of its Price Control submissions since its Licence award, beginning with the RY13/14 submission. In each case DCC has applied for a margin value of 15% to be applied to qualifying additional internal costs, on

the basis that this was the percentage figure used at the time of the Licence award. Ofgem consider that it is now an appropriate time to apply a reduced figure (7/9% instead of 15%) based on the following characteristics of DCC business:

- A)** The contracts DCC was required to manage in its early years were inherited from the Department for Energy and Climate Change (DECC) that was originally responsible for procuring them. DCC has been managing these contracts for 10 years and procures/re-procures the majority of these contracts. Ofgem considers this has resulted in reduced supplier and contract management risk to DCC now, relative to its early years of operation.
- B)** DCC is now a mature organisation with years of experience of live smart metering communication service operations and a much greater ability to manage its business, forecast costs and scope work effectively. Throughout the Licence term, and particularly during the implementation period, a number of changes emerged to the scope, timescales, and volumes of the smart metering programme; many of these changes brought risks and uncertainties with them and underpinned the agreed 15% margin. Ofgem consider that today these risks and uncertainties have been significantly reduced or eliminated and therefore this justifies a lower margin figure being awarded as part of the BM adjustment process.
- C)** DCC continues to have limited fixed and tangible assets, and benefits from low exposure to financial risk through its user charging model.

We understand the reasons that drive Ofgem to consider it opportune to review the baseline margin figure for DCC in the light of the abovementioned considerations. We also agree with the main principle that the margin percentage should represent a suitable performance incentivisation measure for DCC, as a commercial organisation. We agree with the reduced margin figures proposed by Ofgem.

The consideration of the level of risk, especially during the start of operation / handover period, is linked in our view with another important element of the DCC future regulatory regime. We believe it will be important to design a cost adjustment mechanism, which will allow a new Licensee to have a contingency fund to respond to uncertainties and variations that may take place in certain areas of its Mandatory Business. While it will reduce the uncertainty around the overall budget significantly, an ex-ante regulation is not likely to completely eliminate all uncertainties and risks. It may become particularly important during the transition phase, as there could be a potential increase in uncertainty related in particular to the contract management of inherited contracts and the implementation of changes to business activities by the new Licensee. If unspent, the contingency fund can be returned to the industry (as is the case under the BSC governance) or transferred to next financial year (as is the case under the REC governance).

We have limited our response to areas where we feel we can add value. If you would like to discuss any areas of our response, please contact Marta Milan, Senior Advisor ([Marta.Milan@elexon.co.uk](mailto:Marta.Milan@elexon.co.uk)).

Yours sincerely,

Jessica McGoverne  
(Director of Corporate Affairs)