

Jakub Komarek
DCC Oversight and Regulatory Review
Retail Systems and Processes
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

16 July 2024

Dear Jakub

DCC Review Phase 2: Governance and Centralised Registration Service arrangements

We welcome the opportunity to respond to the DCC Review: Phase 2 Consultation. Our answers to the consultation questions are in Annex 1.

Although we have previously supported the not-for-profit model for the future DCC, our support for this model is contingent on there being sufficient well qualified bidders coming forward on this basis. If there is any doubt over the likelihood of such bidders coming forward, we believe a more prudent approach would be for Ofgem to proceed with a for-profit model, albeit with carefully designed governance and incentive mechanisms to ensure positive outcomes for suppliers and their customers.

If the future DCC is to operate on a not-for profit model, we would support a majority independent led Board. However, if the DCC operates on a for-profit basis our preference would be for the Board to be run on a stakeholder majority led model comprised of all stakeholders and independent directors.

We also support removing the Centralised Registration Services (CRS) from the DCC's core mandate and moving the obligation to the Retail Energy Code with the CRS managed by Retail Energy Code Company.

If you would like clarification of any of the matters raised in this response, then please do not hesitate to get in touch.

Yours sincerely,

A handwritten signature in blue ink that reads "Richard Sweet". The signature is written in a cursive, flowing style.

Richard Sweet
Director of Regulatory Policy

**DCC REVIEW PHASE 2: GOVERNANCE AND CENTRALISED REGISTRATION
SERVICE ARRANGEMENTS – SCOTTISHPOWER RESPONSE**

Q1. What are your views on the presented options for the future DCC board composition? Do you agree with our analysis that Option 4 (majority independent model) is the most appropriate to take forward? Please state your reasoning.

Although we have previously supported the not-for-profit model for the future DCC, our support for this model is contingent on there being sufficient well qualified bidders coming forward on this basis. If there is any doubt over the likelihood of such bidders coming forward, we believe a more prudent approach would be for Ofgem to proceed with a for-profit model, albeit with carefully designed governance and incentive mechanisms to ensure positive outcomes for suppliers and their customers.

If the DCC is to operate as a not-for-profit entity, then we would favour Option 4, which is a majority independent model.

However if the DCC is to operate on a for profit basis (which we believe may be the more prudent approach), our preference would be Option 1, a stakeholder majority model controlled by representatives of the DCC's customers. We would expect a for profit model to include representatives from both large and small suppliers, as well as network parties, to ensure all stakeholders were represented and to protect and balance the interests of different groups.

Q2. What are your views on the current and proposed licence requirements on sufficiently independent directors? Do you agree that one or more of the current licence-imposed requirements may be relaxed in favour of more discretion afforded to the board?

The current and proposed licence requirements on sufficiently independent directors each have their merits and potential drawbacks. The current licence requirements define clear criteria for what constitutes a sufficiently independent director with a 12-month restriction on previous employment and business relationships, to mitigate conflicts of interest and maintain a high standard of independence. However, we acknowledge that a strict 12-month requirement may exclude potential directors with more valuable contemporary industry experience; as such, this lack of flexibility might prevent the board from appointing highly qualified individuals who could offer significant insights and expertise.

Option 1 of the proposed changes maintains the current level of board independence but may continue to exclude experienced candidates. Option 2 provides greater assurance of independence by extending the "cooling-off" period but risks widening the expertise gap. Option 3 offers flexibility for the Board to exercise judgment in appointments, potentially balancing independence with expertise; it also gives room for tailored appointments thereby enabling the Board to justify exceptions, ensuring that highly qualified candidates are not excluded by rigid rules and Ofgem's oversight ensures that any relaxation of requirements does not compromise the Board's integrity.

However, increased discretion may introduce subjectivity into the appointment process, potentially leading to the inconsistent application of independence standards and, without strict rules, there is a risk that the Board could justify appointments that do not fully meet independence criteria and lead to potential conflicts of interest.

Overall, we believe Option 3 strikes the best balance between maintaining board independence and allowing for the inclusion of directors with relevant industry expertise. This approach ensures that while the board has the discretion to appoint the most qualified individuals, there are still safeguards in place to protect the board's integrity.

Q3. Do you agree with our proposal that the Chair of the future DCC board should meet the requirements on 'Sufficiently Independent Directors' without exception?

Aligning DCC's governance practices with the UK Corporate Governance Code represents a positive move towards enhancing transparency, accountability, and stakeholder trust. This alignment ensures the Chair can lead discussions objectively, participate impartially in the appointment of directors, and potentially exercise a casting vote without bias. We support these objectives.

However, while independence is crucial, it must be balanced with the competency and expertise necessary for effective board leadership and organisational guidance. Therefore, while the proposal to enforce strict independence requirements for the Chair of the DCC board is aligned with best governance practices, careful consideration of its potential impacts on board dynamics and candidate appeal is essential. Finding a balance between independence and practicality will be key to ensuring the Board operates effectively and ethically.

Q4. What are your views on our analysis and proposal not to introduce additional requirements or restrictions on the size of the future Board and on the number of executive members and shareholder representatives?

We acknowledge that, as the new DCC licence will be competitively awarded, any restrictions on Board size or composition could be viewed as unnecessarily restrictive. We also recognize Ofgem's preference for allowing the determination of Board size and composition based on the operational needs of the DCC rather than imposing strict regulatory mandates.

In the event that the DCC operates on a not-for-profit basis, we support the proposal to refrain from imposing additional requirements or restrictions on the size of the future Board. However, should the DCC transition to a for profit model, it would become necessary to introduce appropriate restrictions. We believe that without such safeguards, there exists a risk that shareholder representatives or executives could disproportionately influence Board decisions. This may lead to choices that prioritize short-term shareholder interests over the long-term sustainability and stakeholder interests of the DCC.

While flexibility and adaptability are important, introducing some level of regulation or guidance on Board composition and size can mitigate risks related to governance, accountability, and stakeholder representation.

Q5. Do you agree with a possible requirement on the Board to possess expertise in certain core areas? Do you agree with the areas we have identified? What are your views on the implementation options?

Yes, we endorse the proposed requirement that the DCC Board should possess expertise in specific core areas. Ensuring the Board encompasses a comprehensive range of skills and knowledge is crucial for effective governance and strategic decision-making, particularly given the evolving nature of the network and the services the DCC provides. Having individuals with defined expertise on the DCC Board can serve to ensure the DCC is well-equipped to navigate market complexities, leverage data and communication technology, prioritize stakeholder interests, enhance satisfaction, and foster trust.

We concur with the areas identified except the option on consumer advocacy. Our reservation on this point arises from our understanding that the DCC does not directly interface with consumers. The DCC's customers are Suppliers and any issues arising from its role as a service provider are typically escalated through those parties. We are, of course, open to the idea of including a consumer advocate on the Board, but invite Ofgem to clarify the role they anticipate for such an advocate when the DCC has no consumer facing responsibilities. Moreover, we are concerned that a consumer facing DCC could result in inconsistent and confusing consumer messaging, which would prove unhelpful.

Overall, we support Option 2. This approach provides greater flexibility and adaptability, crucial for the DCC to remain responsive to evolving market conditions and regulatory requirements. By embedding the requirement at the Board level, the DCC can readily adapt to changes, mitigate risks associated with individual turnover. This approach not only supports effective governance and strategic decision-making but also fosters long-term sustainability and stakeholder confidence.

Q6. do you agree with our proposal to represent consumer voice via a requirement on the appointment of a Sufficiently Independent Director with consumer advocacy experience?

We disagree with this proposal for the reasons given in our response to Question 5, above.

Q7. What are your views on Ofgem's role in the Board appointment process? Do you agree with our proposal that the Authority could have a role in the appointment process of non-executive directors? Which option would provide the most appropriate and effective accountability framework, and why?

Both options outlined in the consultation have their merits and challenges; our thoughts on each are outlined below.

Option 1 allows a review if the appointment does not meet licence requirements and offers a balance between regulatory oversight and operational flexibility for the licensee. However, this mirrors existing arrangements and maintains a reactive regulatory stance where Ofgem can only assess and provide views on appointments leaving the final decision to the licensee, potentially overlooking concerns.

Our preference is for Option 2, which would ensure a more proactive oversight function via a thorough vetting process, creating a formalised process for oversight to ensure higher accountability and adherence to regulatory standards. Incorporating a comprehensive suitability assessment also offers greater stakeholder assurance that Board appointments are being thoroughly vetted for suitability and compliance, and that the Board is equipped to govern effectively and in the best interests of all stakeholders.

The Chair should be a direct Ofgem appointment in the case of a not-for-profit DCC.

Q8. What are your views on the role of DCC customers and other stakeholders in the Board appointment process? Do you agree with our proposal to provide representation for DCC customers on the Nomination Committee? What should be the role of an industry representative in such an arrangement?

The composition and operations of the DCC Board are pivotal to its function and the value stakeholders derive from its activities. Therefore, we endorse the notion of stakeholders having a role in the appointment process. Our preference is for Option 1, specifically advocating stakeholder involvement through the Nominations Committee. This approach allows stakeholders to directly influence the appointment process, ensuring their perspectives are considered.

However, it would be helpful if Ofgem could clarify the proposed procedure for appointing the initial Board. Understanding this initial appointment process is crucial for establishing a transparent and effective governance framework from the outset.

Q9. What are your views on our proposals for an additional requirement on the Chair's experience and Ofgem's role in the initial appointment of the Chair? In what other way should the appointment process for the Chair be different to that of other DCC Board members?

The appointment of the Chair of the Board holds significant importance due to the Chair's influence on Board dynamics, decision making processes, and overall governance. Given this unique role and responsibilities, we agree that the appointment of the Chair should be handled with additional scrutiny and a distinct process from the other Board members. Furthermore, we propose the Chair need not exclusively possess direct experience within the energy sector, provided they demonstrate substantial experience and expertise in leading organisations to the highest standards.

Our endorsement, therefore, broadly aligns with Option 1 as it strikes a balance between regulatory oversight and operational independence ensuring that Ofgem can provide valuable input and reassurance; concurrently, it allows the DCC the flexibility to manage its selection processes while ensuring that regulatory insights and assessments are considered thus providing some level of assurance to stakeholders. However, as noted above, we consider that the Chair should be a direct Ofgem appointment in the case of a not-for-profit DCC.

Q10. What are your views on changes to the term of appointment of non-executive directors? Do you agree with our proposals to limit the initial term of appointment for non-executive directors to 3 years, and to allow for up to two reappointments with the total term limited to a maximum of 9 years?

Overall, the proposed changes to establish a three-year initial term limit for non-executive directors, with the potential for up to two re-appointments and a maximum term of nine years are well-founded and beneficial. These adjustments adhere to best practices, encourage periodic performance reviews, and have the potential to enhance governance and organisational effectiveness. Allowing for up to two reappointments strikes a balance between retaining experienced directors and introducing fresh perspectives. While the cap is beneficial, there may be exceptional cases where retaining a director beyond this period could be advantageous. Having a provision for such rare exceptions with rigorous checks could be considered.

Q11. What are your views on the identified reputational incentives and associated enhanced regulatory requirements? How effective do you believe these incentives can be?

The identified reputational incentives and enhanced regulatory requirements aim to ensure high performance and accountability from the DCC in a not-for-profit model. Reputational incentives can be highly effective in promoting high standards and accountability especially when financial margins are removed. However, their success depends on the design and implementation of the associated metrics, the accuracy of feedback mechanisms and the robustness of oversight processes.

The DCC must not only collect feedback but also demonstrate how it acts upon it. Clear processes for addressing stakeholder concerns and transparent reporting on actions taken can strengthen the effectiveness of the incentive. The simplicity and clarity in the metrics used will provide stakeholders with a meaningful insight to the DCC's performance in the areas that matter to them. Continuous engagement will help to refine these metrics to maintain their relevance.

Q12. What are your views on direct financial incentivisation of executive leadership and key staff? What would make those incentives effective? Please consider their interlink with the reputational incentives.

Direct financial incentivisation of executive leadership and key staff can serve as a tool to align DCC senior leadership actions to remain focused on delivering organization objectives. Incentivisation should be tied explicitly to achieving regulatory requirements, delivering high quality services, and maintaining a strong reputation. It must also be designed to promote long term success rather than short term gains. We agree that the remuneration committee should comprise independent non-executive directors and the remuneration committee must have due regard to DCC's performance against its reputation incentives when setting remuneration principles, targets and policies for executive directors and other key staff. This would give the committee the discretion to adjust incentives based on performance ensuring flexibility and responsiveness to stakeholder satisfaction.

Q13. What are your views on the proposal to grant stakeholders the power to issue a (non-binding) motion of "no confidence", its objective and requirements? If implemented, what should be the methodology for determining a qualified majority and distribution of votes among stakeholders.

The proposal to grant stakeholders the power to issue a (non-binding) motion of no confidence in DCC is a constructive approach to enhance accountability/value for the money between DCC and its stakeholders. It could serve as a formal avenue for stakeholders to express dissatisfaction and the establishment of a formal accountability link for DCC allowing stakeholders to intervene in areas of significant concern without waiting for regulatory intervention, potentially preventing larger issues from developing. Limiting the option of raising the motions to once in a 12 month window should serve to prevent abuse, but there should be a provision for exceptional cases where such may be necessary.

On vote distribution, our preference would be for Option 2 – vote allocation proportionate to share of funding by parties.

Q14. Do you agree with the identified priority areas of interim changes? Are there other governance changes that should be implemented in the Licence extension period?

We agree with the identified priority areas for interim changes. The changes are well targeted to enhance governance and consumer focus. In addition to these changes, we advocate for the implementation of regular independent audits and reviews of the DCC's operations and governance practices. Such audits and reviews will serve to increase accountability, provide transparency and ensure the DCC adheres to best practices in governance and bolster stakeholder confidence in DCC's operations.

15. What are your views on the possible retention of current Sufficiently Independent Directors on the Board of DCC2? What new provisions may need to apply to facilitate this?

Please see our response in Question 2 above.

16. Do you agree with our proposal that it would be appropriate to remove provision of Centralised Registration Service (CRS) from the DCC Licence and transfer the obligation to the Retail Energy Code (REC) to be delivered by RECCo?

Based on the analysis provided we support the decoupling of the Central Registration Service from the Smart Meter Communications Licence. It is our opinion that the delivery of switching services represents a distinct responsibility separate from the DCC's core obligations. Removing these services from the DCC mandate will ensure a clarity of purpose ultimately benefiting both the DCC's service delivery and the stakeholders involved in the provision of smart service obligations.

17. What are your views on the considerations we have identified under option 1?

The considerations identified reflect a comprehensive approach to evaluate the potential transition of the CRS from the DCC to the Retail Energy Code Company. Indeed, the shift from DCC to REC governance may impact the oversight and assurance mechanisms currently in place and ensuring that the REC Board and Performance Assurance Board provide robust independent oversight is crucial to maintain industry confidence in the reliability of the switching service. The final decision should balance the benefits of potential efficiencies and improved governance and risks associated with the transition. Ensuring minimal disruption to the switching service and maintaining high standards of service and compliance should be the primary objectives.

Overall Option 1 seems to present the most viable path forward, although this will require careful planning, robust risk management and active stakeholder engagement to ensure a smooth transition.

ScottishPower
July 2024