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Sent by email to: DCCRegulation@Ofgem.gov.uk

Dear Jakub,

**DCC review: Phase 2 – Process for determination of Allowed Revenue**

Thank you for the opportunity to respond to the above consultation. Our response is not confidential and may be shared.

Centrica is supportive of DCC moving to an ex-ante cost control regime for its allowed revenue, and we broadly agree with most of Ofgem's proposals. We are also willing to join the Customer Challenge Group and will continue to work with Ofgem to ensure end consumers receive value for money from DCC2 (and DCC1 during the transition period). Whilst the performance framework and governance structure are our biggest concerns, we are willing to work with Ofgem to ensure further improvements once DCC2 is in place.

With respect to the **performance framework**, we agree that the monthly reports from DCC to SEC Panel should inform the evaluation of DCC's performance within its incentive regime. We would expect this self-reporting to consider customers' views from the SEC subcommittees and Panel and republish the reports if the original report contains material errors either in measurement or presentation. We hope the seven main reports under development for MP242 will all be used in the performance framework, and not exclude Firmware upgrades or Install and Commission as is currently the case.

Regarding DCC's **governance structure**, we are keen to understand the changes to DCC's performance regime and how governance will work if SECCo bids and wins, or is directed to take on, the DCC2 Licence. In any case, we are ready to work with Ofgem to ensure there is a framework with clear accountability.

Yours sincerely,

Will Webster
**Centrica Regulatory Affairs, UK & Ireland**

**Appendix – responses to consultation questions**

1 What are your views on our proposal to move towards a multiannual, *ex-ante* cost control with uncertainty mechanisms? Do you agree with our proposal to require from DCC a costed Business Plan to form part of its cost control submission?

We agree with Ofgem's minded-to position to move DCC to a full ex-ante cost control (option A). The vast majority of DCC's costs are stable and predictable through contract award. DCC should have a reasonable idea of the expected contracted costs that are in its procurement pipeline.

We agree that some uncertainty mechanisms could be useful but only where transparency is given to DCC's customers in the upfront business plan. DCC should not expect to use contingency or a reopener where it was ambiguous in the costs, assumptions or the performance expected in its business plan. Unless customers can be sure of the baseline, changes to assumptions or risks will be difficult to quantify.

We agree that DCC should produce a costed business plan as part of its cost control submission. The business plan must be detailed enough to explain to DCC's customers what output and performance we can expect from the costs incurred. For example, "by investing £xk in system x, we expect to improve the reliability of our motorway with y fewer major incidents per annum".

The biggest risk to DCC delivering its business plan is new programmes being instigated by Government (DESNZ), these unforeseen projects have often led to significant unexpected increases in investment over several years. Under the new approach we would expect to see less direction from DESNZ. We hope the move to enduring governance via the SEC Panel and Ofgem will be completed by the start date of DCC2; this should be the target date to minimise the complexity and the changes to the governance framework.

2 What are your views on the length of the cost control cycles under the Successor Licence? What are your views on the interaction between the Business Development Plan and a costed Business Plan?

We agree, (option B) a 2-year planning cycle feels reasonable, however regular scrutiny of DCC's actual costs and charges should be instigated through an official SEC Panel subcommittee (outside of the Customer Challenge group), such as a SEC finance subcommittee. This could be linked to the Customer Challenge Group, such as an official subgroup of the CCG.

The Business Development Plan should outline the strategy for DCC over the next 5 years, whilst the 2-year costed Business Plan turns the strategy into costs, charges and performance levels / outputs. DCC's strategy should be agreed with its key stakeholders ahead of the costed Business Plan being calculated and published. However, a merged final document should be published every two years.

3 What are your views on the outlined general approach towards determining efficient forecast costs?

Whilst we recognise that some flexibility may be needed for DCC within its cost control, we need to be mindful of the cumulative effect of each flexibility mechanism. For example, 2% to protect DCC from cashflow issues and small over runs, volume driven costs and external events could soon add 10% or £60m - £70m to DCC Allowed Revenue.

DCC must specify in its Business Plan which cost items are volume related, such as Communication Hubs (CHs) and SEC Modifications requiring system change, and what underlying volume assumptions have been used in estimating its Business Plan. DCC shouldn't be allowed to introduce a volume related cost without outlining its initial assumptions.

We would not want DCC delaying investment or excluding contracts being retendered due to uncertainty. Perhaps DCC could have a subsection of its business plan that is closely monitored by the Finance sub committee (mentioned above) for unknown items. This would allow DCC's customers to understand and challenge those emerging costs and speed up any review process. We expect DCC to provide the Finance subcommittee with evidence that the costs to be incurred are economic and efficient.

We are wary of the emergency reopener and believe Ofgem needs to spell out exactly what is considered an emergency, particularly given DCC's use of work orders to modify fully costed change or project requests.

4 What are your views on flexibility within DCC's Allowed Revenue? At what level should DCC be afforded flexibility to manage overspend/underspend?

We believe that option A is more beneficial to end consumers, and DCC should be able to reallocate resources to fund core services that are impacting performance or required for new developments as directed by the Authority. Any reallocation should be transparent to DCC's customers via the monthly Finance subcommittee, where challenge and agreement can be sought. It is likely that the reallocation will mainly impact internal costs, however some reallocation of external costs could be permitted with a clear business case.

DCC should not reallocate resources that leads to duplication, i.e. two service providers with the same / similar service unless under agreed handover procedures. DCC should always seek to recover costs from the original contract if overruns occur, unless via an approved (by the Finance subcommittee) change request.

5 What are your views on our proposal to allow DCC to access working capital through a contingency set at 2% of its annual Allowed Revenue? Would this level of contingency be sufficient to manage risks to DCC's ability to finance its Mandatory Business? What are your views on the risk and benefits of cash v accruals-based reporting of Price Control information?

We agree with Ofgem's minded-to position of option B2.

Stability in DCC's prices is very useful to energy suppliers, regardless of whether there is a price cap in place or not. DCC's prices being set once a year helps to reduce the risk in consumers bills, especially for small non-domestic businesses. Therefore, if allowing DCC a 2% contingency means that prices are only adjusted once or twice a year that would be a balanced outcome between risk and benefit.

We are pleased to see the percentage surplus in option B2 based on previous DCC monthly incomings and outgoings, rather than an arbitrary number. We believe this is a sensible approach and would welcome oversight of drawing down the contingency in the Finance subcommittee.

Most commercial organisations' financial reporting is on an accrual basis, and we believe DCC should be no different.

6 What are your views on the proposed three types of Uncertainty Mechanisms?

**Automatic adjustments –** We look forward to DCC being able to inform Users about volume drivers (outside of Comms Hubs) and the impact these have on charges. We suspect DCC will need to bring in new accounting practices and rigour to enable this.

For clarity, we agree that Alt HAN, Ofgem and SECCo costs should be dealt with as passthrough (as they are now).

**End-of-year reopener –** We have concerns about several of the areas mentioned in section 3.54 of the consultation. DCC needs to ensure it states its assumptions within its Business Plan across all these areas to enable the Customer Challenge to assess the impact of change.

**Emergency re-opener –** We believe this UM is highly unlikely to occur and we welcome more oversight on this type of cost increase than the current ex-post price control allows.

7 What are your views on the reopener process, criteria and risks? What are your views on the trade-off between allowing DCC a more flexible approach to receive additional Allowed Revenue?

We are concerned that the regulatory burden will increase with the reopener process rather than decrease. The reopener window (figure 3.1, page 47) of the consultation has a significant number of steps and consultations for what could be a relatively small amount of additional cost. The regulatory process needs to be balanced with the value it's overseeing.

8 Do you agree with our proposal to require that all DCC's Authorised should be carried out on a not-for-profit basis?

Yes, we agree that all DCC's Authorised Business should be not-for-profit, this should avoid DCC being distracted by other profit-making ventures.

DCC should have a new general objective in its Licence that is end consumer focused, in terms of keeping the system stable and reliable.

9 What are your views on the proposal to allow DCC to apply for ringfenced funding to enable potential development of commercial or innovative services?

We agree that ringfenced funding could be useful, but DCC must keep the team involved in this ringfenced from BAU / other developmental activity and vice versa. DCC should bid for project funding to the Authority in a similar manner to the Distribution Networks under the Innovation funding (i.e. LCNF).

10 Do you agree with our proposal to remove the ECGS mechanism from the Successor Licence? What are your views on considerations to introduce open ended or set stretch efficiency targets on DCC in respect of its External and Internal costs for a future cost control cycle? What other mechanisms or approaches could be effective to drive cost efficiencies?

We agree with the removal of the ECGS mechanism from the DCC licence.

DCC should be a value for money service, where the system's performance enables the energy industry to operate efficiently and reliably at a cost that is reasonable. Given the impact to end consumers when the DCC's Ecosystem has an outage, issue or glitch, we do <u>not</u> want incentives on DCC that prioritise cost reduction over performance.

Also, an unintended consequence of a cost efficiency incentive could be to encourage over budgeting in the business plan, which would be detrimental to end consumers.

11 What are your views on the proposed measures to be considered as part of any targeted incentive model on senior managers and staff?

At a high level these incentives appear appropriate, however more detail is required to form a full view.

We agree that the monthly reports from DCC to SEC Panel should inform the evaluation of system performance within its incentive model. The self-reporting must consider customers' views from the SEC subcommittees and Panel and DCC must republish reports if the original contains material errors either in measurement or presentation. We would expect SEC Panel to decide whether republication is required or not.

We hope the seven main reports under development for MP242 will be used for the performance framework, including Firmware upgrades and install and commission.

12 Do you agree with our proposal to set up a customer challenge group under the SEC to have a role in the business planning process?

Yes.

We also agree that the CCG should be independent of, rather than reporting to, the SEC Panel.

13 What are your views on the Group's membership? Do you agree with our outlined core and non-core membership model?

We strongly believe that the Customer Challenge group should include more representatives from DCC larger funding customers, in the same way as the SEC Operational Group (i.e. 1 representative per large energy supplier). With more representatives the group has more chance to include the expertise needed to challenge DCC's plans. We hope the CCG could include expertise on procurement, finance, system design, legal, operational, programme management etc.

Having a representative from each major funding customer would also increase the transparency of DCC across the industry, rather than a subset, increasing the confidence in DCC's ability to deliver to cost and quality.

14 What are your view on the presented considerations for the scope, focus and responsibilities of the Group?

We agree with Ofgem's proposed scope and focus of the CCG (option C). However, we are concerned that that the timescales to implement the group and challenge the DCC's business plan is too short. Three months to get up to speed, review, challenge and report to Ofgem is too short, and we would expect a group to take at least 6 months to become effective.

We agree that the group should continue to monitor DCC's business plan against reopeners, this continuity should help question DCC further and build on knowledge gathered.

15 Do you agree with the proposed outputs of the Group?

Yes. However, if SECCo is granted the DCC Licence, Ofgem needs to consider how the Customer Challenge Group is governed to ensure no conflicts of interest.

16 What are your views on our proposed implementation approach, the requirements on the first Business Plan and the interaction with the current Price Control process?

We disagree with Ofgem's proposal, option A, and prefer option B.

We believe the interaction with the current price control is too complex and distract both DCC Licensees in the transition period, when we would rather, they focussed on a successful handover. Whilst we agree it would be useful to have a DCC1 comparator for DCC2, it should not be at the detriment of the handover process.