Decision

DCC Review: Phase 2 – Process for determination of Allowed Revenue (conclusions)

Publication date:	09 May 2025
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This decision document responds to our consultation published in December 2024, which set out our proposals for the design of an ex-ante cost control regime to be implemented for the Data Communications Company (DCC) under the Successor Licence. We also consulted on proposals for a transition towards ex-ante business planning under the current Licence.

This document summarises the responses to that consultation and outlines our policy decisions on the areas we sought responses on, including:

- Cost control scope and cycle
- Managing risk and uncertainty
- Financial incentives
- Customer engagement
- The implementation of the first Business Plan

Contents

Executive Summary

The Data Communications Company (DCC) is responsible under the Smart Meter Communication Licence for establishing and operating a secure national communications network for smart metering in Great Britain. The current Licensee is Smart DCC Ltd ("DCC1") whose Licence was awarded by the Government in 2013 and is now due to expire in September 2027. We are reviewing the regulatory arrangements to be put in place for the Successor Licensee ("DCC2").

In August 2023 we concluded the first, scoping phase of our review with a set of key features to form the basis of the design of the new regulatory model. This document sets out the conclusions to our second policy consultation aimed at developing these key features into detailed policy proposals for new cost control arrangements to underpin the Successor Licence.

Through the reformed *ex-ante* cost control regime we aim to:

- Achieve greater overall control over DCC's expenditure
- Improve customer engagement and cost transparency for DCC customers
- Drive more accurate forecasting linked to business planning
- Put focus on efficient cost management

Cost Control scope & cycle

In our Phase 1 conclusion we said that costs "deemed to be sufficiently stable" should be subject to upfront approval by Ofgem through either a budget setting process or an ex-ante form of cost control. Based on our analysis of DCC's historic and forecast costs (as of RY23/24) we proposed to confirm a move to a full ex-ante cost control regime for DCC2. We received strong support for our proposal are decided to maintain our proposals and adopt a full, multiannual ex-ante cost control with Uncertainty Mechanisms for the Successor Licensee.

We also proposed to introduce a requirement on the Licensee to submit to us a costed Business Plan as part of its cost control submission to provide the basis for Ofgem's approval of costs upfront. We sought views on the duration of the cost control cycle under the Successor Licence and on a potential integration with the existing Development Plan.

We have decided to maintain our proposal and will require a costed Business Plan to be submitted ahead of each ex-ante cost control cycle.

We have also concluded that the ex-ante cost control process should move to a three-year cycle after 1st April 2028 under the Successor Licence. Noting the concerns raised by stakeholders, we will confirm our final decision via a direction issued under the Successor Licence and set the dates of the Second Price Control Period in a Business Plan Guidance in 2027 ahead of the next business planning cycle commencing.

We also confirm our proposal to merge the Development Plan and the costed Business Plan requirements into a single document.

Managing risk and uncertainty

We sought views on general requirements for evidence which we would need to see as part of DCC's Business Plan and cost submission to determine efficient costs. We have decided to maintain our proposal to introduce a bespoke Business Plan Guidance (BPG) and to set out requirements on forecasting and cost control processes and procedures therein. We have published a draft version of the BPG alongside this document for consultation.[1]

Once DCC's Business Plan has been approved, DCC will be expected to operate within the agreed cost envelope of its Allowed Revenue. However, in a multiannual cost control cycle, it is likely that DCC's Allowed Revenue will not perfectly match its forecasts. We have concluded that we will proceed with the following mechanisms to manage uncertainty:

First, DCC will be afforded a degree of flexibility to manage its budget. We have decided to revise our proposals for budgetary flexibility and allow in-programme flexibility for External Costs and cross-programme flexibility for Internal Resource Costs. We will implement these decisions through revised Regulatory Instructions and Guidance (RIGs).

Secondly, we have we have decided to allow the Successor Licensee to recover up to 5% in excess of its Annual Allowed Revenue (AAR) to manage its cashflow requirements and minor overruns. To strengthen the controls we intend to introduce new requirements into the Successor Licence in relation to the management, reporting on the use and the return of any over-recovered amounts.

Thirdly, we have decided to maintain our proposal to introduce three types of Uncertainty Mechanisms to manage uncertainty where budgetary flexibility and contingency are not appropriate or possible to use:

- Automatic adjustments to account for Pass-through or volume sensitive costs and contractual inflationary impacts agreed at the business planning stage

[1] Ofgem (2025), Consultation on […] draft Business Plan Guidance. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

- An end-of-year reopener with a set application window at the of Q3 to adjust the Allowed Revenue for the following Regulatory Year to account for new requirements, changes in assumptions or external factors
- An emergency reopener to account for external shocks or urgent changes

We also confirm that the reopeners will follow a budgeting approach, requiring the Licensee to apply for additional revenue before increasing charges to customers.

Financial incentives

We have previously concluded that DCC's "Core Mandatory Business" should be provided on a not-for-profit basis. We proposed to extend our conclusion to the entirety of DCC's Authorised Business, including any non-core service provision and Permitted Business. We have maintained our proposals and confirm that we will remove from the Successor Licence all aspects of Baseline Margin. We have also concluded that, in principle, the Successor Licensee should be able to apply for ringfenced funding for exploratory work for additional business as part of its Business Plan submission. However, we intend to phase in this decision by only allowing an application for innovative (public good) activities in the first Business Plan.

We also sought views on options to drive efficiencies in External and Internal Costs. Based on strong stakeholder support, we have decided to reserve the right to impose stretch targets across all costs to incentivise the Successor Licensee to seek efficiencies beyond the level of economic costs approved through the Business Plan. Any efficiency target would be consulted upon and determined as part of the Business Plan process for a set cost control period.

Financial incentives can still play an important role in a not-for-profit regime. We have decided to maintain our consultation position and require that the following four performance measures be reflected in a remuneration policy developed by an independent Committee of the Board:

- Customer satisfaction – using scores of customer satisfaction survey (subject to our proposal in our consultation on future governance arrangements)
- Performance and delivery – using DCC's reporting against code (SEC and if relevant, REC) performance measures
- Business planning – assessing the quality of DCC's submitted Business Plan
- Cost management – monitoring DCC's delivery to its approved Business Plan

We will publish a guidance document to develop these further. We recognise that the four measures do not include an explicit provision to replicate the BMPPA schemes aimed at incentivising the delivery of change programmes. We are open to considering further whether our guidance document, which we may from time to time modify, should further specify that the remuneration policy should focus on implementation of change programmes.

Customer engagement

To drive stronger customer engagement in the new model, we proposed to create a new Customer Challenge group ("the Group") under the Smart Energy Code (SEC) to have a role in the cost control process by providing feedback and challenge to DCC on its Business Plan. We sought stakeholder views on the scope, membership, focus and outputs of the Group.

Having considered all responses, we have decided to maintain our consultation position - we intend for the CCG to be established as a subcommittee by the SEC Panel, adopting the Terms of Reference which we are consulting upon alongside this decision document.[2]

We have also decided to proceed with the requirement for the Group to consist of core members drawn from DCC customers and consumer representatives, and non-core members as individual experts who may be invited to advise the Group at the discretion of the Chair.

We confirm the Group's role in providing feedback and challenge to DCC on its draft Business Plan, monitoring DCC's delivery to the Business Plan through quarterly reporting and providing feedback to DCC and a recommendation to Ofgem on reopener applications. DCC will be required to submit a draft Business Plan to the CCG and engage with the CCG at least 4 months prior to its Price Control submission to Ofgem. The Group would provide a written report directly to Ofgem, setting out its overall assessment of DCC's Business Plan and highlighting any areas of concerns or disagreement. We may draw on this report when undertaking our own review of DCC's submission.

We expect the CCG to be set up over the coming months to receive the first draft Business Plan submission by 29th August 2025 (subject to our statutory consultation published alongside this decision).[3]

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[2] Ofgem (2025), Consultation on draft Terms of Reference for Customer Challenge Group […]. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

[3] Ofgem (2025), Modifications to the Smart Meter Communication Licence for transition to ex-ante cost control and other changes required for Licence closure. www.ofgem.gov.uk/publications/modifications-smart-meter-communication-licence-transition-ex-ante-cost-control-and-other-changes-required-licence-closure

Implementation of the first Business Plan

We said that, where possible, we would consider bringing some changes early to drive the benefits of the new framework. We proposed to require DCC1 to prepare and submit to us the first fully costed Business Plan to cover the period April 2026-March 2028 to serve as the basis for the Successor Licensee's budget before the Successor prepares its own Business Plan with effect from 1st April 2028.

Having carefully considered all responses, and in recognition of the time required to deliver necessary Licence changes and set up the CCG, we have decided to change our proposal and delay the implementation by requiring DCC1 to prepare and submit to us a costed Business Plan covering the period from Transfer Date (expected to occur in or before November 2026) to 31st March 2028. The Plan will be prepared in accordance with a Business Plan Guidance, the draft of which is published for consultation alongside this decision.[4]

We intend to require DCC to make its submission to us no later than 31st December 2025 to ensure sufficient time for a consultation process and a final decision on the Successor Licensee's Allowed Revenue ahead of the Transfer Date. We also intend to require DCC to submit a draft version of the costed Business Plan to the Customer Challenge Group and to seek the Group's feedback no later than 29th August 2025. We have published a statutory consultation on interim Licence modifications to bring about these changes.[5]

DCC1 will remain subject to ex-post Price Control arrangements until the expiry of its Licence, with the final ex-post Price Control expected in the first half of 2027. We are consulting on statutory changes to account for the Transfer Date in relation to the Price Control submission and other regulatory requirements.[6]

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[4] Ofgem (2025), Consultation on […] draft Business Plan Guidance. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

[5] Ofgem (2025), Modifications to the Smart Meter Communication Licence for transition to ex-ante cost control and other changes required for Licence closure. www.ofgem.gov.uk/publications/modifications-smart-meter-communication-licence-transition-ex-ante-cost-control-and-other-changes-required-licence-closure

[6] Ibid.

Overview of our main conclusions

Area	**Questions**	**Main Conclusions**
Scope and Cycle	Q1. Scope	Move to a full ex ante cycle and require DCC to produce a fully costed business plan
Scope and Cycle	Q2. Cycle and integration with Development Plan	First full ex ante cycle to take effect from 1st April 2028, cycles should be three years long, to be confirmed via direction by Ofgem Fully costed Business Plan to be integrated with the Business Development Plan
Managing Risk and Uncertainty	Q3. Determining efficient costs	Requirements on forecasting set out in a bespoke Business Planning Guidance
Managing Risk and Uncertainty	Q4. Flexibility	Allow fungibility on External Costs within defined programmes Allow fungibility across programmes for resource-related Internal Costs
Managing Risk and Uncertainty	Q5. Contingency and cashflow management	Allow the Licensee to recover 5% above its Annual Allowed Revenue subject to Licence limitations and requirements
Managing Risk and Uncertainty	Q6&7. Uncertainty Mechanisms	Introduce three broad types of UMs: • Automatic adjustment (passthrough costs, inflation and pre-agreed customer demand or volume sensitive costs) • Annual reopener to account for change and new contracts/programmes • Emergency reopener with defined criteria
Incentives	Q8. Non-for Profit arrangements for Authorised Business	All of DCC's Approved Business to be provided on a not-for-profit basis. Consequently, all Baseline Margin to be removed from the calculation of Allowed Revenue
Incentives	Q9. Ringfencing	Allow the Licensee to apply for a ringfenced budget for additional activities To be implemented in phases with the first Business Plan permitting application for a ring-fenced budget for public policy initiative subject to requirements in a Business Plan Guidance
Incentives	Q10. Cost efficiencies	Ofgem to reserve the right to set stretch targets as part of Business Plan assessment
Incentives	Q11. Cost management and performance	Implement targeted remuneration-based incentive model focused on four core measures: • System performance • Customer satisfaction • Business Plan quality • Business Plan delivery

Area	**Questions**	**Main Conclusions**
		Develop further via a guidance document which also will consider further whether incentivisation of change delivery is required
Customer engagement	Q12-15. Customer engagement	Implement a Customer Challenge Group under the Smart Energy Code to challenge DCC's draft Business Plan and monitor DCC's delivery to the Plan
Implementation	Q16. Implementation of the first Business Plan	DCC1 to submit to Ofgem no later than 31 December 2025 an *ex-ante* Cost Control submission including a costed Business Plan for the period from Transfer Date to 31 March 2028 DCC1 to submit a draft Business Plan to the Customer Challenge Group and consult on the Plan with the group, by 29th August 2025

1. Introduction

Background

1.1 This document is a response to our consultation on the process for determination of Allowed Revenue of the Successor Licensee. The consultation was published on 12 December 2024 and closed on 16 February 2025.

1.2 DCC is the term used to refer to the holder of the Smart Meter Communication Licence ("the Licence").[7] It operates under the conditions of its Licence and is regulated by Ofgem. Smart DCC Ltd is the legal entity that holds the Licence, following a competitive tender process that took place in 2013. The Licence will expire in September 2027.

1.3 DCC is responsible for establishing and operating a secure national communications network for smart metering in Great Britain, which connects smart meters in people's homes and small businesses. Its key role is to effectively manage large contracts with communication and data service providers to ensure a stable and secure service that is value for money.

1.4 Ahead of the expiry of the Licence (due on September 2027), we are carrying out a programme of work ("DCC review") with the objective to:

- Put in place a new regulatory regime for DCC under the Successor Licence
- Select and appoint a Successor Licensee ("DCC2") to hold that Licence

1.5 We published a decision in August 2023, which concluded the first (scoping) phase of our review. The decision outlined considerations for a way forward to a detailed design of the new framework and its implementation. We concluded that the new framework should be based on a set of key features, which included:

- Key feature #3: Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an ex-ante price control or a budget-setting process.
- Key feature #5: DCC's Core Mandatory Business will remain funded by charges on users.

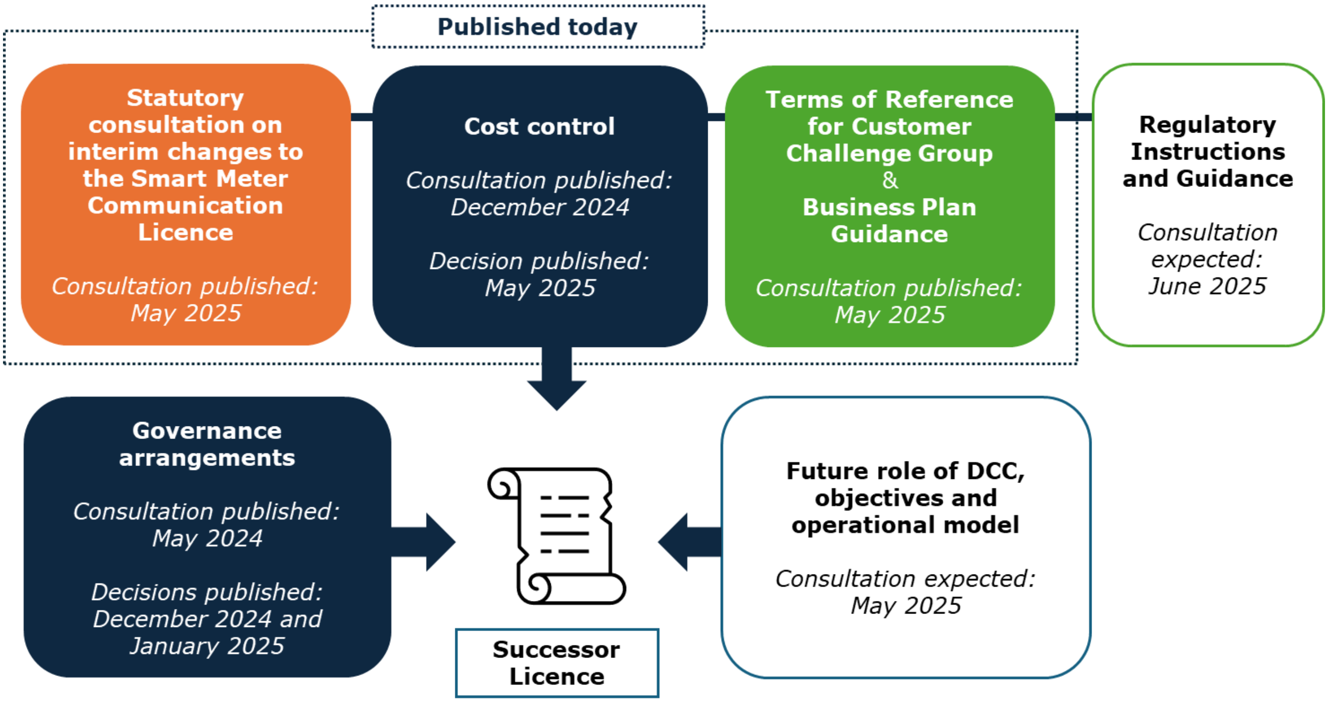
[7] Throughout this decision document, we refer more broadly to "DCC", meaning the holder of the Licence (in its generic sense) and the organisation currently carrying on the Authorised Business, and our references should be interpreted in accordance with the context to which they relate, whether that be the current licensee or the future DCC.

1.6 In December 2024 we published a consultation on detailed policy proposals building on these two key features to which this document responds. On 21st January 2025 we held a virtual stakeholder workshop to focus on our proposals in respect of setting up of the Customer Challenge Group (chapter 5).

Context and related publications

1.7 This decision concludes the second of three policy consultations to form part of the second (detailed design) phase of the DCC review programme. These three consultations (and our decision in response to these) should be taken as a whole.

Figure 1.1: Visualisation of the main Phase 2 publications



1.8 We published our first policy consultation of the second (detailed design) phase in May 2024. It focused on the future governance arrangements, including the future arrangements for the Centralised Registration Service ("Switching").[8] We

[8] Ofgem (2024), DCC Review Phase 2: Governance and Centralised Registration Service arrangements. www.ofgem.gov.uk/consultation/dcc-review-phase-2-governance-and-centralised-registration-service-arrangements

published our decisions in December 2024 (Switching)[9] and January 2025 (governance).[10]

1.9 We anticipate publishing the third consultation on the future role of DCC, its objectives and operational model in May 2025 with a conclusion expected in summer 2025.

1.10 Alongside this decision we are also publishing two consultations:

- A statutory consultation on interim changes to the DCC licence to:
  - (1) Implement our conclusions on the transition to an *ex-ante* cost control arrangements (our conclusions outlined in chapter 6)
  - (2) Account for the end of the Licence as pertains to Price Control and other regulatory reporting, including the Baseline Margin and External Contract Gain Share mechanisms
- A consultation on two draft guidance documents to help DCC prepare the first Business Plan and *ex-ante* cost control submission
  - (1) Terms of Reference for Customer Challenge Group
  - (2) Business Plan Guidance, including cost control processes and procedures

1.11 We anticipate publishing consultation on draft *ex-ante* version of the Regulatory Instructions of Guidance (RIGs) – the templates through which DCC submits its Price Control data to us – in June 2025.

[9] Ofgem (2024), DCC Review Phase 2: Centralised Registration Service arrangements – decision. https://www.ofgem.gov.uk/decision/dcc-review-phase-2-centralised-registration-service-arrangements-decision
[10] Ofgem (2025), DCC Review Phase 2: Governance arrangements – conclusions. www.ofgem.gov.uk/decision/dcc-review-phase-2-governance-arrangements-conclusions

Table 1.1 Overview of publications

Document	Publication date	Link
Determination of Allowed Revenue (conclusions) = this document	09 May 2025	www.ofgem.gov.uk/publications/dcc-review-phase-2-determination-allowed-revenue-conclusions
Statutory consultation on interim changes to the Smart Meter Communication Licence	09 May 2025	www.ofgem.gov.uk/publications/modifications-smart-meter-communication-licence-transition-ex-ante-cost-control-and-other-changes-required-licence-closure
Draft Business Plan Guidance	09 May 2025	www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance
Draft Terms of Reference (ToR) for Customer Challenge Group (CCG)	09 May 2025	www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance
Draft Regulatory Instructions and Guidance (RIGs): templates and guidance	Expected June 2025	-

Timeline

1.12 We have already commenced work on the selection of the Successor Licensee through market engagement and a webinar in November 2024. We also published an Expression of Interest in the spring 2025.[11]

1.13 Under our current assumptions, we anticipate the appointment of the Successor Licensee to occur in the spring 2026, followed by a 6-8 month Business Handover period.

1.14 We expect to formally set the Transfer Date (whereafter DCC2 will be solely responsible for delivering Mandatory Business under the Successor Licence) using powers under LC 43.7(b) in summer 2025. Our current best assumption is that the Transfer Date will occur before or in November 2026.[12]

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[11] Ofgem (2025), Expression of Interest in the new Smart Meter Communication Licence. www.ofgem.gov.uk/call-for-input/expression-interest-new-smart-meter-communication-licence

[12] For further details on our timing assumptions, please refer to our decision on Licence extension, available at: www.ofgem.gov.uk/decision/decision-continuation-smart-meter-communication-licence-and-rate-shared-service-charge-and-baseline-margin

Our decision-making process

Date	Stage description
12/12/2024	Stage 1: Consultation opened
21/01/2025	Stage 1a: Stakeholder workshop
06/02/2025	Stage 2: Consultation closed (awaiting decision), Deadline for responses
09/05/2025	Stage 3: Responses reviewed and published
09/05/2025	Stage 4: Decision published

General feedback

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

Please send any general feedback comments to DCCregulation@ofgem.gov.uk.

2. Cost control scope & cycle

Section summary

In our Phase 1 conclusion we said that costs "deemed to be sufficiently stable" should be subject to upfront approval by Ofgem through either a budget setting process or an *ex-ante* form of cost control. Based on our analysis of DCC's historic and forecast costs (as of RY23/24) we proposed to confirm a move to a full ex-ante cost control regime for DCC2. We received strong support for our proposal are decided to maintain our proposals and adopt a full, multiannual *ex-ante* cost control with Uncertainty Mechanisms for the Successor Licensee.

We also proposed to introduce a requirement on the Licensee to submit to us a costed Business Plan as part of its cost control submission to provide the basis for Ofgem's approval of costs upfront for a period of, initially, two years, from 2026 to 2028. We sought views on the duration of the cost control cycle under the Successor Licence and on a potential integration with the existing Development Plan.

We have decided to maintain our proposal and will require a costed Business Plan to be submitted ahead of each ex-ante cost control cycle.

We have also concluded that the *ex-ante* cost control process should move to a three-year cycle after 1st April 2028 under the Successor Licence. Noting the concerns raised by stakeholders, we will confirm our final decision via a direction issued under the Successor Licence and set the dates of the Second Price Control Period in a Business Plan Guidance, updated ahead of the next business planning cycle commencing in 2027.

Finally, we confirm our proposal to merge the Development Plan and the costed Business Plan requirements into a single document.

Questions posed at consultation

Q1. 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?

Q2. 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?

A. Cost control scope

Background

2.1 In our Phase 1 conclusion we said that costs "deemed to be sufficiently stable" should be subject to upfront approval by Ofgem through either a budget setting process or an *ex-ante* form of cost control. Our analysis of DCC's historic, current and forecast costs (as of RY23/24) showed a clear trend towards stabilisation of costs overtime. We therefore consulted on a move to a full ex-ante cost control regime for DCC2 with Ofgem approval of costs based on a submission of a costed Business Plan.

2.2 We set out the key benefits of this approach including:

- Stronger cost control by imposing an obligation on DCC to operate within a pre-agreed cost envelope
- Better incentive for customer engagement – it will be in the interest of both DCC and customers to agree on a level of Allowed Revenue to finance DCC's Mandatory Business
- Less burden to administer compared to a hybrid regime

2.3 We presented key trade-offs associated with adopting a multiannual, fully *ex-ante* approach; notably the need to account for cost uncertainty and mitigate risks to DCC's ability to progress work if it experiences cost overruns due to external factors.

Summary of responses

2.4 All respondents supported the move to a full *ex-ante* regime. Respondents recognised a number of benefits including improving cost predictability and encouraging stability. One stakeholder agreed with our assessment that the majority of DCC's costs are sufficiently stable, whereas another pointed out that there is a precedent for a similar approach in the regulation of other bodies operating in the energy sector (DNOs and code bodies).

2.5 Most supported our proposed multi-annual approach, although recognising that *ex-ante* requires forecast costs and therefore the chance of unexpected cost revision (up and down) and therefore the need for UMs.

2.6 One respondent argued that there remains too much uncertainty in costs and forecasting to warrant moving to multiannual *ex-ante* cost control. They argued that the proposed annual reopener Uncertainty Mechanism would in effect make the process annual. However, they did recognise the benefits of *ex-ante* in improving forecasting and performance and noted support for a multiannual process if it led to stabilisation of charges on customers.

2.7 All those who gave a response supported the proposal to require DCC to submit a costed Business Plan. Some noted the need for a strong customer engagement and scrutiny of the plan.

Our decision

2.8 Having reviewed the consultation responses carefully, we have decided to maintain our proposals and adopt a full, multiannual *ex-ante* cost control for the Successor Licensee.

2.9 Accordingly, we have also decided to maintain our proposal to introduce a requirement on DCC to submit to Ofgem Price Control submission no later than 31st July of the year preceding the first regulatory year of a set multiannual cost control cycle and that the submission will comprise:

- Cost information submitted in line with Ofgem-issued Regulatory Instructions and Guidance (RIGs)
- A costed Business Plan submitted in line with Ofgem-issued Business Plan Guidance (BPG)

Rationale for our decision

Adopting a full ex-ante cost control

2.10 A key feature of *ex-ante* regimes is that they set a control total for expenditure by the regulated business *ahead* of the costs being incurred. Compared to an annual *ex-post* regime, the move to an *ex-ante* regime has the following beneficial incentive effects:

- Because control totals are set in advance it sets a strong incentive to both forecast accurately and to manage budgets and programmes effectively so that spend remains within forecast levels.
- A strong and clear linkage between the Price Control submission and activity in the control period and Corporate Strategy: The control period activity is much more clearly couched as operational delivery of a longer term plan. In that context a strengthened requirement to ensure that DCC strategy is the result of meaningful stakeholder engagement, and that the speed and way it is given effect, through price control submissions, is clearly understood and supported by stakeholders.

2.11 From our analysis of consultation responses we believe that stakeholders also recognise the value of a move to *ex-ante*, especially in relation to its incentive properties on forecasting and cost control.

Adopting multiannual controls

2.12 Our rationale in moving to a multiannual control has three elements.

- Firstly, moving to a multiannual control period will reduce the need for DCC to submit annual price control submissions. We will require annual reporting from DCC and recognise that there will be some burden associated with managing potential annual reopeners; however, on balance, the regulatory burden on DCC, industry and Ofgem will be much reduced in a multiannual process compared to an annual one.
- Secondly, the longer the control period, the stronger the incentive on DCC to forecast its expenditure accurately and manage its Allowed Revenue (budget) effectively within the control period.
- Thirdly, setting a multiannual *ex-ante* control gives stakeholders and consumers certainty over both what they can expect from DCC over the control period and the level and price path for DCC's charges. This gives regulatory certainty for DCC and stakeholders and consequently a better basis on which they can plan their own activities and investments.

2.13 Extending to a multiannual process therefore reduces regulatory burden, strengthens the incentives on forecasting and cost control, and gives greater regulatory certainty.

Adopting Uncertainty Mechanisms

2.14 We recognise that the longer the control period that is set, the more likely it is that the Allowed Revenue, based on our assessment of efficient costs of DCC's forecasts, will differ from actual expenditure. It is important, therefore, that DCC is provided with mechanisms that allow it to deal with unexpected events and rises in costs. One of the ways in which this can be done in *ex-ante* regimes is through the adoption of Uncertainty Mechanism.

2.15 We discuss our decision on the shape and types of Uncertainty Mechanisms later in this document (see Chapter 3, Part D). However, at this stage it is important to note that the decision to adopt Uncertainty Mechanisms should not be seen as replacing or reducing the need for accurate forecasting and the proper and rigorous control of costs within the control period.

B. Cost control cycle

Background

2.16 We presented in chapter 6 of the consultation our proposal for an initial Business Plan to be prepared by DCC1 and to cover the period until 31st March 2028. We then sought views on whether we should move to a three-year cost control cycle from April 2028. We posited that a two-year forecast may lack a strong link to long-term strategy and not give customers the desirable level of cost certainty. We said that a three-year cycle could help address these issues, highlighting nonetheless the key trade-off in a potential repeated applications of uncertainty mechanisms as some costs will become harder to forecast three years in advance.

2.17 We also sought views on a possible integration of the Business Plan with the current Development Plan. We proposed that the Development Plan would provide a qualitative overview of development opportunities as a preamble to the costed Business Plan, which would in turn function as a delivery plan for the cost control period.

Summary of responses

2.18 We received mixed responses on the duration of the cost control cycle.

2.19 The main stated reason for support of a shorter period was to allow new processes and controls to bed in and to provide greater predictability and certainty of forecasted costs while reducing the need for reopeners.

2.20 Six respondents supported a two-year cycle. Three of these noted that a two-year business plan would be suitable until further evidence from the first cycle was available to assess whether a longer cycle would be appropriate. One respondent supported a two-year control with a recommendation to move to a three-year cycle within five years. They said that incentives could be used to encourage DCC to accelerate its readiness and transition to a three-year Business Plan cycle.

2.21 One respondent recommended an annual cost control with a key concern about DCC’s ability to accurately forecast, given past performance.

2.22 Three respondents supported the introduction of a three-year cycle from 1 April 2028. The main argument in favour was that longer cycle would provide more certainty on costs. One respondent also noted that a longer-cycle could make DCC appear a lower risk for third party providers of finance.

2.23 There was a general support for integration of the Development Plan with the Business Plan. The general view was that producing a single document would be more efficient than two separate submissions.

Our decision

2.24 Having carefully considered all responses; firstly, we have concluded that the *ex-ante* cost control process should move to a three-year cycle after 1st April 2028 under the Successor Licence. However, noting the concerns raised by stakeholders, we will confirm our final decision via a direction issued under the Successor Licence and set the dates of the Second Cost Control Period in a Business Plan Guidance, updated ahead of the next business planning cycle commencing in 2027. We believe that, balanced by our decision on Uncertainty Mechanisms and provision for risk, this gives an appropriate level of regulatory certainty for DCC1, industry and the Successor Licensee. However, our approach will allow additional flexibility; for example, if during the course of the exercise to appoint a Successor Licensee it becomes clear that potential bidders would prefer a two-year control period for their first control then we may consider that in the round of their overall bid. Equally, this will allow us to consider some initial lessons learnt from the business planning undertaken by the current Licensee, although a decision on the length of the second cycle will have to be reached by early 2027 to allow the Successor Licensee to prepare a compliant second Business Plan in time.

2.25 Secondly, we have also concluded that in order to maximise the linkage between DCC's Development Plan and the costed Business Plan, these documents should be merged.

Rationale for our decision

Adopting a three-year cost control cycle from April 2018

2.26 The decision on the length of a regulatory control period is based on finding the optimal balance between the benefits of a longer control versus the risks that arise from a longer control period.

2.27 A three-year control period offers the following benefits over a two-year control:

- Greater regulatory certainty for DCC and its stakeholders
- Stronger linkages between the costed Business Plan and the Business Development Plan

- Greater cost transparency as deviations from forecast would need to be justified
- Stronger incentive on DCC to continue to improve its forecasting accuracy and project and cost control in period
- Reduced regulatory burden – on balance, we consider the amount of work required for a new Business Plan to be produced every two years to be greater than the application of Uncertainty Mechanisms in a three-year period

2.28 We recognise that the longer the control period, the more likely it is that actual costs will diverge from the initially approved Allowed Revenue. We have considered how to deal with this risk in the context of two and three year controls. DCC has been in operation for over a decade, and the majority of its costs are known and relatively stable. In our decision on the structure of the regulatory regime, we have made provisions for the risk that actual efficient costs may diverge from efficient forecast costs for good reason. This provision includes our decisions on fungibility, contingency and Uncertainty Mechanisms set out in Chapter 3 of this document.

2.29 We deem that these mechanisms can be just as robust and suitable for a three-year control as a two-year one. Consequently, we believe that any additional risk from moving from a two-year to a three-year control is mitigated by regulatory design. In addition, DCC already has experience of producing two-year forecasts in the *ex-post* regime and will have experience of a two-year *ex-ante* forecast when it submits its costed Business Case for the first *ex-ante* cost control period. Its forecasting and cost management systems should already be robust and a further incentive to continue to improve should not be unduly stretching.

2.30 After a careful examination of the relative costs and benefits of different control periods, we feel that the appropriate balance between risk and benefits is for a three-year control period for the first successor licence.

Interaction between the Development Plan and the costed Business Plan

2.31 An essential part of effective governance of any business is a strong linkage between its strategic plan and the day-to-day operational delivery of that plan. Under the current *ex-post* regime DCC is required to produce an annual *ex-post* price control submission and, separately, a five year Business Development Plan. We are keen to improve both the integration of these documents and consequently improve both the transparency of DCC's decision making and stakeholder engagement.

2.32 Combining the two documents will:

- Provide better context for stakeholders to engage meaningfully on the costed Business Plan
- Give DCC a stronger incentive to align strategy and operational delivery and take a longer term view
- Reduce administrative costs for DCC and stakeholders

2.33 We will consult further on the approach towards long-term strategy-setting in our upcoming consultation on the future role of DCC, objectives and operational model.

2.34 Taken together, we believe these decisions represent the optimal balance between risk mitigation, regulatory certainty for DCC, and certainty for DCC's customers on what DCC will deliver and at what price over the length of the control period.

3. Managing risks and uncertainty

Section summary

We sought views on general requirements for evidence which we would need to see as part of DCC's Business Plan and cost submission to determine efficient costs. We have decided to maintain our proposal to introduce a bespoke Business Plan Guidance (BPG) and to set out requirements on forecasting and cost control processes and procedures therein. We have published a draft version of the BPG alongside this document for consultation.

Once DCC's Business Plan has been approved, DCC will be expected to operate within the agreed cost envelope of its Allowed Revenue. However, in a multiannual cost control cycle, it is likely that DCC's Allowed Revenue will not perfectly match its forecasts. We have concluded that we will proceed with the following mechanisms to manage uncertainty:

First, DCC will be afforded a degree of flexibility to manage its budget. We have decided to revise our proposals for budgetary flexibility and allow in-programme flexibility for External Costs and cross-programme flexibility for Internal Resource Costs. We will implement these decisions through our Regulatory Instructions and Guidance (RIGs).

Secondly, we have we have decided to amend our consultation position and intend to allow the Successor Licensee to recover up to 5% in excess of its AAR to manage its cashflow requirements and minor overruns. To strengthen the controls we intend to introduce new requirements into the Successor Licence in relation to the management, reporting on the use and the return of any over-recovered amounts.

Thirdly, we have decided to maintain our proposal to introduce three types of Uncertainty Mechanisms to manage uncertainty where budgetary flexibility and contingency are not appropriate or possible to use:

- Automatic adjustment to account for Pass-through or volume sensitive costs and contractual inflationary impacts agreed at the business planning stage
- An end-of-year reopener with a set application window at the of Q3 to adjust the Allowed Revenue for the following Regulatory Year to account for new requirements, changes in assumptions or external factors
- An emergency reopener to account for external shocks and urgent changes

We also confirm that the reopeners will follow a budgeting approach, requiring the Licensee to apply for additional revenue before increasing charges to customers.

Questions posed at consultation

Q3. What are your views on the outlined general approach towards determining efficient forecast costs?

Q4. What are your views on flexibility within DCC's Allowed Revenue? At what level should DCC be afforded flexibility to manage overspend/underspend?

Q5. 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?

Q6. What are your views on the proposed three types of Uncertainty Mechanisms?

Q7. 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?

3.1 In a multiannual cost control cycle, it is likely that DCC's Allowed Revenue will not perfectly match its forecasts. As per our decision in Chapter 4, Part A, DCC2 will operate on a not-for-profit (NFP) basis without any Baseline Margin to account for the risk of cost disallowances. A NFP DCC will therefore have to recover all of its costs and no costs will be capable of being disallowed retrospectively. We sought view on:

- Determining the level of efficient costs
- Accounting for small (2-5% of annual Allowed Revenue) overspends to either manage (temporary) cash shortfalls or to fund limited (permanent) cost overruns
- Dealing with significant overspends (over 2-5% of Annual Allowed Revenue)

A. Determining efficient costs

Background

3.2 As per our decision in Chapter 2, Part A, all costs will be subject to *ex-ante* reporting; therefore, going forward, it will be important to ensure that DCC's Business Plan contains both accurate forecasts as well as appropriate justifications.

3.3 We explained that, historically, DCC has adopted different forecasting methods for its Price Control submissions and to provide customers with an advanced view of the Charging Statements. At present, DCC only includes in its Price Control submission forecast costs that it considers "committed" (based on contracted terms) and DCC has argued that its internal forecasting for the purposes of setting own budget and customer charges has been more accurate on account of inclusion of other, less certain, costs.

3.4 We expressed our view that DCC should be able to accurately forecast under the existing Price Control arrangements and forecasts can be allowed if sufficient evidence and justification are provided. We said we would not fundamentally change how we assess the economy and efficiency of DCC's forecast cost under the *ex-ante* regime but proposed to introduce forecasting requirements through a bespoke Business Plan Guidance. To that end, we identified and sought views on general requirements for evidence needed to assess forecast External and Internal Costs.

Summary of responses

3.5 Most respondents agreed with our proposals, none disagreed. There was support for our proposed approach and identified principles and requirements. Several stakeholders voiced support for a wider use of benchmarking to justify value for money, including of External Service Provider contract rates.

3.6 Several respondents commented on the existing issue of diverging forecasts. One specifically agreed that the practice of using different bases for different forecast purposes (charging statement vs price control) must be stopped. Referring to Ofgem's guidance, several respondents nonetheless argued that the certainty threshold under the existing regime may have been set too high ("cost *significantly* more likely than not to occur")[13] leading to the exclusion of costs of known projects from the Price Control reporting and confusion among DCC customers. One noted a risk of delays to investments if uncertain costs are not approved. DCC itself argued that all of its costs should be included in the Business Plan, including 20-30% of costs of change which may be subject to uncertainty.

3.7 A couple of respondents expressed concerns about overly complex and burdensome reporting requirements, noting the importance of striking the right balance between rigorous assessment and complexity.

[13] Ofgem (2022), DCC Price Control Guidance: Processes and Procedures 2022. Price control guidance, paragraph 2.20. www.ofgem.gov.uk/publications/dcc-price-control-guidance-processes-and-procedures-2022

3.8 Several respondents voiced support for the role of the proposed Customer Challenge Group (see Chapter 5) to scrutinise the forecasts in DCC's draft Business Plan. However, concerns were raised about relevant information being withheld due to commercial confidentiality.

3.9 A couple of respondents asked for further clarification on the treatment of large new contracts subject to non-objection from DESNZ.[14] One asked for clarification on what costs should be included in the Business Plan for new procurements – costs in the most recent approved business case or the most up to date estimates.

3.10 One respondent also raised the issue of SEC mods: they highlighted the issue of cost differences between Preliminary and Final Impact Assessment, noting that mods may require reopeners to ensure work is not delayed. They also asked about the treatment of multicycle mods. This respondent also suggested that DCC should specify expected milestone invoice payments to External Service Providers.

Our decision

3.11 We have decided to maintain our proposal to introduce a bespoke Business Plan Guidance (BPG) and to set out requirements on DCC's forecasting therein. These will be based on the requirements we have consulted on, as well as the existing price control processes and procedures, and will be presented in the form of both requirements on the content of DCC's Business Plan and principles that we will apply in determining whether forecast costs are economic and efficient and should be allowed. We have published a draft version of the Business Planning Guidance alongside this document for consultation.[15]

Rationale for our decision

3.12 We agree with stakeholders that under the *ex-post* arrangements, DCC should produce only one forecast to be included in its costed Business Plan and Price Control submission. For clarity, DCC will be asked to include in its forecast all economic and efficient costs; no costs should be purposely reserved for a future application of Uncertainty Mechanisms. We recognise that this will mean inclusion of some costs subject to a degree of uncertainty. We are of the view that DCC

[14] Under LC16.6A-C

[15] Ofgem (2025), Consultation on […] draft Business Plan Guidance. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

has enough experience and sufficient information to be able to produce a good quality forecast.

3.13 However, any good quality forecast must be supported by strong justifications. DCC's focus has historically been on justifying variance in incurred costs and forecast costs have not been well explained, leading to their repeated exclusions in our Price Control decisions. There will have to be a step change in the quality of justifications DCC provides for forecast costs. Our guidance will help DCC understand what kind of evidence we will need to assess its forecast; however, the burden of proof will remain with DCC. We cannot assume that forecast costs are economic and efficient. If DCC does not provide us with enough justifications, we may remove costs from its forecasts. We agree with respondents that the use of benchmarking would be important to verify that DCC's costs provide value for money. We have included a requirement on benchmarking evidence in the draft Business Planning Guidance requirements. Additionally, if DCC's forecasts are not well justified, we may carry out our own benchmarking to determine the right level of efficient costs, as we have done in the past.[16]

3.14 We are mindful of the regulatory burden associated with cost reporting and our intention is not to have an excessively bureaucratic regime. The BPG will seek to provide a clear guidance on the evidence required and we are supportive of DCC providing the requested information concisely, so long as it is complete and allows us to assess forecasts. Equally, although the guidance is intended to assist DCC in its preparation of the Business Plan and cost submission, it can never be exhaustive. If DCC holds evidence that Ofgem would reasonably require to assess the forecasts and to determine the Allowed Revenue, it should provide it, even if it is not specified in the BPG.

3.15 As set out in further detail in Chapter 5 and the draft Terms of Reference for a Customer Challenge Group (hereafter "CCG") published alongside, we agree that the CCG should have a role in scrutinising DCC's draft Business Plan. This means that the members will require access to some commercially sensitive information, including on costs.[17] It is important to note that while the Business Plan should be part of DCC's justification for the Price Control Information submitted to Ofgem in the RIGs templates, other evidence is likely to be needed. The CCG will not be

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[16] Ofgem (2024), DCC Price Control RY22/23 – Decision. 2.61-2.70. www.ofgem.gov.uk/decision/dcc-price-control-decision-regulatory-year-2022-2023
[17] Please see paragraphs 3.33-3.35 of the draft CCG ToR. Ofgem (2025), Consultation on draft Terms of Reference for Customer Challenge Group […]. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

expected to scrutinise the full Price Control submission and therefore some evidence will only be relevant to Ofgem's assessment.

3.16 We address points relating to specific aspects of DCC's Business Plan and cost items (such as contracts in procurement and SEC mods) in the draft BPG.

B. Business Plan fungibility & managing underspend/overspend

Background

3.17 Once DCC's Business Plan has been approved, DCC will be expected to operate within the agreed cost envelope of its Allowed Revenue.

3.18 However, DCC should be afforded a degree of flexibility to manage its budget. In the extreme, DCC would be unable to deviate from the cost submitted for each line item of its submission. On the other hand, unrestricted flexibility could create the risk of unauthorised expenditure or poor cost management being obscured by forecast inflation or diversion of funding from core services impacting performance across the business.

3.19 In relation to External Costs, we sought views on either making External Costs fungible within the same programme (Option A) or keeping them non-fungible (Option B.) Option B was our preferred option on account of limited actual flexibility that DCC has to flex External Costs and the risk that coincidental simultaneous overspends and underspends would obscure potential cost overruns, leading to repeat and greater overspends in future, which may not be offset by concurrent underspends.

3.20 In relation to Internal Costs, we proposed to allow cross-programme fungibility but restrict it to Internal Costs correlated with resourcing. We recognised that DCC should be able to manage its internal resources such that it can effectively prioritise and, where needed, redeploy its workforce. Unlike in the External Costs area, DCC can flex its resource to respond to any cost challenges as they arise. However, we said that full fungibility, including non-resource Internal Costs, especially non-resource External Services (third-party contracts that do not meet the definition of Fundamental Service Capability), could lead to the same risk as fully fungible External Costs.

Summary of responses

3.21 Most respondents were in favour of our proposal to allow fungibility on resource-related Internal Costs. They agreed with our view that DCC should have flexibility over its internal resources. Several also supported extending flexibilities to

External Services to allow DCC access to specialist advice; others were however concerned about potential overreliance on temporary consultancy spend.

3.22 Respondents' views on the question of External Costs were mixed. A plurality argued in favour of limited flexibility on External Costs within programmes. The main argument was that removing flexibility altogether could have unintended consequences, such as delays and increased reliance on Uncertainty Mechanisms. A couple of respondents also cautioned against creating highly codified rules for cost management with over-justification of costs, restricting the ability of the new DCC2 Board to deliver within a set budget. DCC provided illustrative examples of the risks and unintended consequences of an overly restrictive approach resulting in a lack of incentive to manage costs/perverse incentive to overspend. In the extreme, DCC may be forced to delay delivery or be driven towards contingency funding due to overspend even if there is underspend to be reallocated. DCC also argued that, despite limitations on its ability to flex External Costs (which are based on contracted terms), there are cases where it may be able to reduce lower priority activity or deliver activity for less than originally forecasted in the Business Plan, with such underspends used to compensate for limited cost overruns in other projects within the same programme. DCC argued that it should be these constraints that determine how widely fungibility can be applied, rather than a regulatory decision to not allow additional fungibility as a point of principle.

3.23 One respondent, who argued in favour of in-programme flexibility, suggested that programmes should be defined with independent cost-drivers so that a variance in one programme is unlikely to have an equal and opposite variance in another.

3.24 Several respondents agreed that External Costs should be afforded no fungibility. Their key argument was that External Costs should be sufficiently stable and predictable and that additional flexibility could lead to DCC working towards a target without seeking efficiencies. One respondent agreed with our observation regarding operational and contractual constraints on fungibility due to limited internal management ability to change/tighten contractual arrangements in the short term.

3.25 To lessen the time and effort required from industry to engage in the budget approval cycles, one respondent asked that Ofgem consider harmonising its approach to regulation of NFP bodies, suggesting a comparative assessment with similar bodies such as NESO and Elexon.

3.26 Several respondents also explicitly agreed with our observation that underspends should be returned to customers. One suggested cross-year fungibility would allow funding to be re-profiled across years in case of delays to deliverables (where costs nonetheless remained the same), arguing that reprofiling of costs would be easier than applying for additional Allowed Revenue through a reopener.

Our decision

3.27 In respect of External Costs, we have decided to change our consultation position and allow fungibility within individual programmes (Option A).

3.28 In respect of Internal Costs, we have decided to maintain our proposal and allow fungibility across programmes for resource and resource-correlated costs. We will allow the inclusion of resource-related External Services (eg consultancy) but not non-resource External Services which fulfil distinct functions, eg Smart Metering Key Infrastructure (SMKI).

3.29 The implementation of these decisions will depend on the definition of:

- "Programmes" (for External Costs): As a principle, we agree that programmes should be independent of each other but internally consistent and that clear lines of accountability for programme management should exist within DCC. We also want to avoid bundling together of a large number of contracts within individual programmes to mitigate against the risk of large scale and non-transparent cost reallocation.
- Resource v non-resource ledger codes (for Internal Costs): It may be necessary to split the current ledger code used for External Services reporting into resource and non-resource ES, the former of which would enjoy the benefit of cross-programme fungibility, whereas the latter would default to in-programme-only fungibility.

3.30 We intend to set the programme structure and ledger codes reporting via our Regulatory Instructions and Guidance and plan to publish our consultation on the draft *ex-ante* RIGs in June 2025.

Rationale for our decision

3.31 In principle, DCC's costed Business Plan is a commitment to undertake a set of activities and/or deliver a set of outcomes for a fixed price (subject to contractual commitments around volume charges and inflation etc). We recognise that each programme may involve multiple elements and contracts and that, in the absence of systematic errors in DCC's forecasting, it is as likely to underspend as it is to overspend. Consequently, in any programme there are likely to be elements underspending and overspending. We recognise that not allowing any flexibility could have adverse impacts on DCC's ability to manage its revenue and potentially unintended consequences. On balance, we are persuaded by the argument that limitations on fungibility should come from real operational constraints rather than regulatory limitations. Additionally, managing each programme as a portfolio of contracts allows risk to be pooled and generates more efficient programme management. What matters, from a programme perspective, is that DCC delivers what it undertook to deliver on time and to budget. In-programme fungibility introduces flexibility and reduces the need for DCC to trigger the Uncertainty Mechanism process.

3.32 Nevertheless, we remain concerned about the risk of non-transparent reporting and cost misallocation which could obscure emerging risks of overspends. This reinforces our decision to confirm the monitoring function of the CCG (Chapter 5) and to require DCC to report at least quarterly on its business plan delivery to the CCG. We will also expect that any end-of-year reporting or application for a reopener (Chapter 3, Part D) should include an explanation of how DCC has utilised its budgetary flexibility.

3.33 We recognise the concern raised by those stakeholders who argued that increased flexibility may lead to a tendency to restructure reporting to meet the budget with limited incentive to realise further efficiencies. As set out in our consultation, we remain of the view that, where efficiencies can be made, DCC should do so and pass savings back to customers. As per our decision in Chapter 4, Part B, we reserve the right to set stretch targets within DCC's Plan to provide this additional incentive. However, on balance, we believe that additional flexibility would be appropriate to give DCC Board sufficient degree of operational independence.

3.34 We have considered the regulatory arrangements in place for similar entities, including Elexon, NESO or the future code managers; where relevant, we have drawn on lessons learnt and good regulatory practice. For example, our proposals on a targeted remuneration-based incentive model (Chapter 4, Part C) follow a similar approach within the NESO Licence; similarly, our decisions to implement a CCG (Chater 5) and treat cost uncertainty using a combination of Uncertainty Mechanisms (Chapter 3, Part D) follow learnings from energy networks regulation. However, it should be recognised that DCC does have certain unique characteristics, for example its asset-light nature and management of large External Service Provider technology contracts, mean we have developed certain

DCC-specific approaches and processes. We are mindful of the regulatory burden associated with the cost control reporting. Our intention is to strike the right balance between efficient oversight and operational flexibility. After each cost control cycle, we may review how DCC has performed under the regime in place and make changes to either relax or introduce new requirements.

3.35 In relation to cross-year fungibility, we recognise that there may be instances where DCC may defer expenditure into a following Regulatory Year on account of delays to programme implementation. However, cost deferrals must not be treated as an underspend to be reallocated to programmes which are running over budget. We will therefore expect DCC to report on any such reprofiling as part of its end-of-year reporting and to explain it within any reopener application. DCC should also explain any delays to the CCG as part of its quarterly reporting.[18]

C. Contingency

Background

3.36 It is important that DCC has access to sufficient funding to discharge its Licence obligations and maintain operations. In addition to its set budget, DCC will require access to additional funds above the approved Allowed Revenue (hereafter "AR", or "AAR" for annual Allowed Revenue) to:

- Mitigate risk to its cash position: DCC's monthly incomings and outgoings are not perfectly aligned to the charges recovered from customers, *eg* DCC may receive a large invoice from a service provider on completion of a programme milestone. This means that DCC will need to have access to additional funds to mitigate temporary cash shortfall although its cash position will balance out over time. At present, DCC is required to justify the amount of cash that it has recovered over its ARR once it recovers more than 5% over that AAR.[19]
- Account for minor overruns where it may not be practical or proportionate to reopen the Business Plan

3.37 However, we also recognised that it is important to ensure that customers' cash is not unnecessarily withheld and accrued over time.

3.38 We sought views on three options to ensure that the funding arrangements are adequately managed in the enduring regulatory framework:

[18] Terms of Reference, paragraph 4.1

[19] Under LC 36.20(a). If DCC breaches this over-recovery threshold it must justify the breach to Ofgem. Ofgem may direct DCC to apply a penalty interest rate to any proportion of the over-recovered amounts that have not be justified.

- Flexible charging to customers
- Maintaining existing mechanism allowing DCC to over-recover a "surplus" of 5% in excess of its approved AAR
- Use of over-recovery (surplus) set at a lower level of 2% of the annual Allowed Revenue with the ability to replenish the surplus after a Regulatory Year has passed and a requirement on DCC to explain as part of its reopener application how it has managed the surplus and the circumstances which led to the utilisation of the contingency. We identified this option as our preferred option.

Summary of responses

3.39 We have received mixed responses to our proposals. For the purposes of this question we present DCC's arguments separately from those of other stakeholders.

DCC's response

3.40 DCC disagreed with our proposal. It argued that cashflow management and small overruns should be managed separately because they serve fundamentally different purpose: cashflow shortfalls are temporary imbalances, whereas overruns, albeit small, remain permanent.

3.41 DCC argued that setting the contingency at 2% of the AAR would be too low to account for volatility in DCC's contracts (*eg* volume driven overages, milestone payments, programme changes and financing milestones) creating a risk that DCC would require more dynamic charging to meet its obligations. Instead, DCC asked that Ofgem accepts its current liquidity policy centred around a "healthy cash range" of 4-8% of AAR, with a target of 6% (±2%). DCC sought to justify this policy by an advisory report commissioned with a banking partner.

3.42 DCC also noted that it has been considering replacing some of its current cash facility with competitively procured Revolving Credit Facilities to reduce dependency on withheld customer charges.

3.43 DCC agreed with a 2% allowance for the first period for small overruns ("limited mitigation to inaccuracies in DCC's forecasts for controllable costs") so long as:

- Costs subject to the Automatic Adjustment UM (passthrough, inflation and volume sensitive costs) would not be subject to the contingency cap
- Fungibility would be allowed on External Costs

3.44 DCC suggested that contingency would likely be needed for advance work ahead of an approval of a reopener.

Other responses

3.45 The plurality of other respondents agreed with our proposal. Several argued that the basis for the level of any allowed contingency should be in historical reporting.

3.46 Several respondents warned that additional allowance could lead to a use-it-or-lose-it institutional mentality and lead to overreliance on contingencies to the detriment of efficient cost management.

3.47 One respondent explicitly affirmed a customer priority to maintain stability in DCC's charges to industry.

3.48 A couple of respondents suggested that cashflow management and cost overruns should be treated separately.

3.49 One respondent noted that due to a lack of visibility of DCC's financial arrangements, they were unable to comment on the level at which a contingency should be set but argued that a key principle should be to discourage DCC from becoming too reliant on the use of the contingency. One respondent agreed with a 2% contingency for "unforeseen items of spend that will not be automatically restored by the passage of time"; whereas another suggested an even lower contingency set at 1% of AAR to cover most unforeseen expenses and cash flow fluctuations in the short term, citing concerns about DCC's past use of customer funds.

3.50 Two respondents suggested alternative approaches:

- One proposed that contingency be consulted on for each cost control period separately and that smaller, temporary, cash flow variances be managed using overdraft facilities.
- Another recommended a one-off amount of cash being made available for working capital, supplemented by a flexible short-term borrowing for day-to-day shortfalls such as an overdraft. Alternatively, they asked that bank loans, government loans, industry participant loans or commercial debt be considered.

Our decision

3.51 We carefully considered all responses and sought further evidence from DCC to understand the basis for its current policy. We also requested additional data for

RY24/25 to help our analysis. Having considered all evidence in the round, we have decided to amend our consultation position and intend to allow the Successor Licensee to recover up to 5% of its AAR to manage its cashflow requirements and minor overruns. To strengthen the controls we have further concluded that we will insert the following requirements into the Successor Licence:

- Mandate that the mechanism must provide value for money to customers. We are open to working with DCC1 (ahead of the Business Handover) and subsequently with the Successor Licensee to determine an optimal split of the contingency allowance between cash from customer charges and a Revolving Credit Facility (RCF). The proportion would be determined on the basis of further economic analysis at the time of decision on Allowed Revenue for a given cost control period
- Reserve the power to require the Licensee to report to Ofgem every 6 months on its cash position and explain any combined amount of charges and RCF held above 5% of AAR. In case of an unsatisfactory explanation being provided, Ofgem would be able to direct that any excess charges be returned to customers via amendments to the charging statement
- As part of end-of-year reporting, require a statement from the Board to assure proper use of the overcharged amounts
- Mandate that any overcharged amounts (incl. any RCF) in excess of 5% of AAR be returned at the end of a RY

Rationale for our decision

3.52 Through our decision we sought to balance key trade-offs of the policy objectives which are to:

- Ensure DCC can finance its activities
- Prevent withholding of unnecessary cash from customer charges
- Encourage better forecasting and prudential financial management
- Mitigate against risk of improper use or overspend

3.53 Firstly, we considered what should be the optimal level of contingency. We recognise that setting the headroom too low could create a risk of financial instability and could lead to more dynamic charging and potentially delays to operational delivery. Equally, however, DCC's claim that it needs to maintain a range of 4-8% in excess of its AAR solely to protect its cash position has not been borne out in the evidence made available us. We recognise that DCC's cash position may be impacted by variable aspects of its outgoings, such as payment milestones or demand-driven charges; however, actual data for RYs 23/24 and 24/25, which includes the impacts of this volatility DCC argues could endanger its position, shows that DCC has consistently maintained a cash surplus in excess of 5% of AAR with the exception of only one month in the 24-month period analysed. On balance, we believe the over-recovery threshold of 5% of AAR, which we set in 2023 remains appropriate.[20] The impact of our decision to set the contingency level at 5% of AAR should result in a return of further cash to customers without endangering DCC's position.

3.54 Secondly, we considered the arguments in favour of separate contingency mechanisms for cashflow management and for managing small overruns. We remain of the view that a single contingency would be sufficient for the following reasons:

- We have decided to implement several types of Uncertainty Mechanisms (Chapter 3, Part D) to allow for adjustments in Allowed Revenue, including automatic adjustment for pre-agreed volume-sensitive costs and contractual indexation, annual reopeners for new requirements or changed assumptions and emergency reopeners for *force majeure* type events. We have also decided to grant the Successor Licensee significant degree of flexibility to manage underspends and overspends within its Business Plan (Chapter 3, Part B) with in-programme fungibility for External Costs and cross-programme fungibility for resource costs. The need for contingency to account for any residual uncertainty should be, as DCC states, limited to advance work on re-opener applications.
- Providing a single contingency mechanism both empowers and incentivises the organisation to prudently manage its finances. We will allow the contingency "pot" to be replenished at the end of a Regulatory Year if sufficient justification has been provided for its utilisation for permanent overruns. Setting the contingency amount to 5% and limiting the amount of residual uncertainty by providing Business Plan flexibility and Uncertainty Mechanisms should grant the Licensee sufficient headroom.

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[20] Ofgem (2023), Decision on Ofgem proposals to modify arrangements for the Over-Recovery of Allowed Revenue […]. www.ofgem.gov.uk/decision/decision-ofgem-proposals-modify-arrangements-over-recovery-allowed-revenue-housekeeping-changes-licence-and-baseline-margin-indexation-change

- Our analysis of DCC's procurements under the current Price Control regime has revealed the inclusion of contingencies within contracted prices. Allowing additional contingency could create a perverse situation where the Business Plan includes numerous stacked contingencies.

3.55 Thirdly, we have considered what instruments would provide best value for money to consumer and what safeguards may need to be introduced to guard against unnecessary accrual of customer charges. We welcome DCC's initiative to explore the use of competitively procured RCFs from commercial lenders. Further analysis would be needed to determine the economy of such a solution, for example by comparing the cost of procuring, maintaining and drawing on a RCF with industry's cost of capital. We therefore do not intend to mandate how much contingency should be held in cash vs other forms of finance. However, as a principle, the selected approach should provide value for money to consumers. We intend to work with the current and Successor Licensees to determine the optimal split, which may be approved as part of the business planning process. We note that in 2023 we introduced a backstop date (being the Transfer Date) by which all over-recovered revenue must be returned to customers.[21] Any residual amount of over-recovery will be transferred to the Successor Licensee,[22] which will ensure that the Successor Licensee has sufficient operational funds on day 1. The transferred amount may include contingency in the form of an RCF; however, together with any retained cash, this should not exceed 5% of AAR.

3.56 In respect of additional safeguards, we agree with respondents that there is a risk of overreliance on the contingency. We believe this is mitigated by our decision to maintain a single contingency allowance. However, we are mindful of the risk of a repeat accrual of customer charges and will therefore mandate that any overcharged amounts over 5% of ARR must be returned to customers by the end of every RY. Equally, we intend to introduce a mid-year checkpoint, reserving the power to require a cash statement from the Licensee. These provisions would be kept under review.

Price control reporting

3.57 We have also consulted on requiring DCC's *ex-ante* RIGs reporting to be on an accruals-basis with an additional report showing the cash view used for charging purposes. We explained that, compared to the cash view, an accruals view could

[21] Ibid, 2.8. LC 27.3A.
[22] Under LC 43.16

provide a better reflection of the costs incurred and forecasted and therefore potentially provide a better basis for evaluation of DCC's Business Plan. DCC would justify the scope and the cost of work needed to be delivered across the cost control cycle, regardless of when those costs are reflected in DCC's accounts.

3.58 All respondents, including DCC, agreed with this proposal and we have therefore decided to implement it as consulted on. We will implement this decision via changes to the RIGs templates and guidance, which we intend to consult on in June 2025.

D. Uncertainty Mechanisms

Background

3.59 We explained that a range of factors can give rise to change in DCC's Allowed Revenue after the Business Plan approval. We identified and sought views on nine general factors that may require an Uncertainty Mechanism to be used.[23] We consulted on introducing a range of Uncertainty Mechanisms (UMs) which would enable an in-period adjustment of DCC's Allowed Revenue where a contingency, in line with our proposals in Part C, would not suffice to address the impact of those factors. We also presented our view of the application of different UMs to different types of DCC costs.

3.60 We proposed to introduce three types of UMs:

- Automatic adjustments for passthrough costs, contractual indexation and pre-approved volume-sensitive costs
- End-of-year reopener allowing the Licensee to apply for an adjustment to its Allowed Revenue to account for unforeseeable changes in regulatory, technical or customer requirements
- Emergency reopener to account for *force majeure*

3.61 We asked for views on the reopener process, criteria and risks, as well as trade-off between allowing DCC a more flexible approach to receive additional Allowed Revenue. We proposed to adopt a budgeting approach whereby DCC would have to apply for an adjustment to its AR before incurring further expenditure (above any contingency funding and excluding Automatic Adjustments).

[23] Ofgem (2024), DCC Review Phase 2: Determination of Allowed Revenue, table 3.2. www.ofgem.gov.uk/consultation/dcc-review-phase-2-determination-allowed-revenue

Summary of responses

3.62 Respondents generally agreed that UMs would be required in a multiannual *ex-ante* regime and supported the three UMs that we described in our consultation. Many commented on the specific aspects of each proposed type of UM which we discuss below.

Automatic adjustment

3.63 A number of respondents agreed with the principle of including Pass-through, volume-sensitive costs and inflationary impacts into an automatic adjustment-type UM. However, they also asked that the CCG be involved in the assessment of any pre-approved costs. One respondent agreed with our view that this adjustment could happen in-year through the reopener of DCC's charging statement or as part of an end-year process and adjustment of AR for Y2.

3.64 One respondent noted that for volume-sensitive costs it will be important to ensure baseline allowances reflect agreed forecast assumptions, which will help stabilise customer charging.

3.65 DCC noted that future charging for the fitting of 4G CHs to replace 2G/3G hubs ahead of 2G/3G sunsetting may be classed as Pass-through costs as DCC will not have direct control over the process. DCC asked that Ofgem confirm that these costs be classified as Pass-through in the *ex-ante* RIGs.

3.66 DCC also suggested that fixed CH charges, currently classified as External Costs, either be reclassified as Pass-through costs or funded through the volume-driver automatic adjustment mechanism as these charges are a function of customer demand.

3.67 DCC set out that volume variation occurs primarily in the following areas:

- Numbers of meters installed
- Number of CHs on the network
- Number and size of messages to/from smart meters
- Incident/service request volumes related to service desk provision
- Number of users of software licences
- Cloud platform capacity
- Mandatory security/software updates and technology refresh activities

3.68 DCC explained that it deals with these variations via different types of contractual provisions, chiefly: defined capacity (where a contract variation is required to exceed it), purchased capacity (where excess capacity is subject to pre-specified charging arrangements) and unit cost (where DCC has secured a price against a specific unit of measure). DCC noted that one variable may impact on several contracts and asked that the automatic adjustment will allow the use of all three mechanisms.

3.69 DCC further explained that it generates a capacity plan on a quarterly basis with insights from customers' forecasting. DCC suggested that as part of the business planning process, it would prepare evidenced forecasts for volume sensitive costs and indexations for scrutiny by the CCG, on which basis Ofgem would provide allowances for the associated costs with adjustments in-period in line with actual data. DCC would then adjust customer charging, either in-period or at the end of the RY, depending on its cash position.

<u>Reopeners</u>

3.70 Most respondents supported our proposal for the reopener process, although there was a tension in the comments between a desire for a rigorous process with involvement form the CCG whilst also looking for a speedy procedure to avoid unnecessary delays.

3.71 Several stakeholders commented on the treatment of code modifications under the *ex-ante* regime:

- One noted that SEC and REC modification costs can cumulatively amount to several million pounds in each release and asked that those costs should therefore be covered by the proposed reopener processes.
- One warned of a risk of delays if DCC had to suspend work until additional funding was approved. A couple of respondents suggested making SEC mods subject to the automatic adjustment process and one suggested the emergency reopener process for high priority mods.

3.72 Some identified the revised SEC process as a benefit and DESNZ-driven changes as a key UM risk.

3.73 One stakeholder asked whether the end-of-year reopener process would be available at the end of each RY in the event of a longer cost control cycle.

3.74 Referring to our overview of costs affected by uncertainty presented in table 3.3 of our consultation, DCC asked for inclusion of corporate overheads into the UM arrangement, citing the example of Business Handover related costs as unforeseeable drivers of change.

3.75 Some respondents were concerned about the risk of DCC relying on UM at the expense of proper forecasting and cost management. One respondent noted that many of the examples of needs for UMs could be foreseen in a 2-year control and the use of UM should be minimal. Some concerns were raised in particular in the context of an emergency reopener. Several respondents agreed that the use of this UM should be subject to strict criteria and agreed that it should be reserved to addressing *force majeure* events within DCC's supply chain.

3.76 One respondent welcomed our proposal not to apply a materiality threshold, other than the contingency allowance, but suggested that there will be an opportunity to review this after the first cycle.

3.77 One respondent disagreed with our proposal on account of their support for an annual process. They argued that the inclusion of an annual re-opener would reduce the multiannual cycle to an annual process with an unnecessary administrative and regulatory overhead burden. Nonetheless, they were supportive of an emergency reopener which, they said, may be needed during the course of a RY.

Other comments

3.78 One respondent cautioned against excessive administrative burden as a result of a highly codified process. They argued that more should be delegated to governance structures via the SEC.

3.79 One stakeholder suggested that the introduction of a strategic direction statement under the code reform could be helpful in predicting costs.

Our decision

3.80 Having carefully considered the evidence; we maintain our consultation position to introduce the following types of UM:

- *Automatic adjustment* for Pass-through costs defined in DCC's Licence and other costs outside the Licensee's control which are pre-agreed through the business planning process, including contractual obligations for inflation adjustment and volume-sensitive costs where actual volumes vary from forecasts
- *End-of-year reopener* allowing the Licensee to submit to Ofgem an application for a proposed adjustment to its AR in line with Ofgem's guidance during a pre-defined application window at the of Q3 of each RY (except in the RY preceding a new cost control cycle) showing at minimum:

(1) Why the proposed adjustment is needed – how circumstances or assumptions have changed within the Business Plan, referring in particular to the factors and areas identified within Ofgem's guidance

(2) Why the proposed adjustment is economic and efficient, including how the Licensee sought to manage the uncertainty by using Business Plan fungibility and contingency allowance

- *Emergency reopener* to make provision for unforeseen events which may need an immediate change in the Allowed Revenue, rather than waiting for the end-of-year reopener. This will allow the Licensee to submit to Ofgem an application for a proposed adjustment to AR at any point during a RY, subject to strict pre-defined criteria set out in Ofgem's guidance. This measure is provided as a contingency measure and we do not expect it to be used as a matter of routine

3.81 We present further details on the process for application of these UMs, based on the principles and process set out in our consultation, in our draft Business Planning Guidance published alongside this consultation.[24]

3.82 We have decided to maintain our proposal to adopt a budgeting approach to Allowed Revenue and its variation. This means that all costs will have to be approved before they are recovered through charges.

3.83 We also intend to maintain the process for Undertakings as an option for the Successor Licensee to avoid a cost disallowance of uneconomic costs that the Licensee may already be contractually or legally liable for.

Rationale for our decision

Adopting three types of Uncertainty Mechanisms

3.84 Our decision to introduce UMs should be read in conjunction with our other conclusions to introduce flexibility into the Business Plan (Part B of this chapter) and a contingency (Part C of this chapter). Based on our analysis and evidence from consultation responses we are confident that these UMs will cover the ways in which efficient actual costs may diverge from forecasts where the other provisions are either not appropriate or sufficient.

[24] Ofgem (2025), Consultation on […] draft Business Plan Guidance. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

3.85 We agree with respondents that the option to apply UMs should not be a substitute for proper forecasting of efficient costs and effective management of spend by the Successor Licensee. Rather, we accept that there are circumstances in which, despite DCC's best efforts, efficient costs may diverge from those estimated at the time of our decision on efficient allowed revenue. The existence of an end-of-year reopener should not be seen as a weakening of the requirement for DCC to demonstrate that its costs are efficient.

3.86 In relation to the automatic adjustment mechanism, we agree that the CCG should have a role in reviewing the proposed drivers and forecasts of volume-sensitive costs as we recognise that DCC's forecasting in this area is informed by customer insights and data. As per our consultation proposal, DCC should submit evidence to justify:

- A regulatory obligation to incur these costs
- That these costs are outside DCC's control
- The relevant factors, dependency and unit price impacted, as well as forecast volumes for the duration of the cost control

3.87 If approved, DCC would be able to reflect changes in these costs directly in its Charging Statement, without additional requirement to ask for Ofgem's approval. This can happen either within a year if the Licensee reopens its Charging Statement or at the end of the year in preparation of the charging statement for the following RY. If an allowance is granted for volume sensitive costs and approved to be subject to the Automatic Adjustment UM, we expect that portion of the Allowed Revenue to be ringfenced. If customer demand is lower than the forecast used to set the allowance, the Automatic Adjustment mechanism should be used to adjust the revenue downwards and any overcharged amounts should be return to customers.

3.88 The Automatic Adjustment UM would also include contractual indexation, although we would expect this element to require comparatively less scrutiny by the CCG. The Licensee should nonetheless strive to ensure that any provisions linked to inflation provide value for money and seek efficiencies where possible. The Pass-through cost element would be based on the Licence definition of Pass-through costs.[25] In future, this may include the cost of CH replacement noted by DCC. We do not intend to modify the Licence ahead of the first Business Plan to

[25] LC 36.8 – principally SECCO and AltHANCo charges

change the definition of Pass-through costs but we are open to DCC bringing CH charges to the CCG for consideration of inclusion into the automatic adjustment process if it can demonstrate a clear link to customer demand.

Reopener process

3.89 We have decided to allow DCC the ability to apply for an end of year reopener for where unexpected and efficiently incurred costs mean that costs are above forecast. It is pragmatic to approve potential adjustments to AR for the following RY through one application, so that stakeholders have more certainty and confidence in the Licensee's AR in period. This approach will give DCC and customers more certainty on DCC's charges for the year and allow more efficient planning and management. We note the concern that an annual process could be bureaucratic; however, we do not agree that it is equivalent to an annual budget process. A reopener process subject to predefined criteria should on balance reduce regulatory burden.

3.90 We also recognise the concern raised by some respondents about the time available to approve an annual reopener application. We remain of the view that a window at the end of Q3 (December) strikes the balance between inviting an application sufficiently ahead of the commencement of the next RY but not too early such that the application and the adjustment may themselves become outdated early in the following RY. We agree that the CCG should have a role in the reopener process and expect the Licensee to engage with the CCG ahead of its application submission to Ofgem as part of its regular updates to the CCG on the Business Plan delivery throughout the RY. We have set out further details in Chapter 5 and draft Terms of Reference for the CCG published alongside this document.[26] Engagement on the annual reopener application will allow industry to challenge changes to the Business Plan and AR and provide the Licensee with feedback ahead of its submission to Ofgem. Ofgem may then take into consideration the Group's recommendation in respect of the application which could help the approval process such that it can complete within three months before the commencement of the following RY.

3.91 We note respondents' concerns and suggestions in relation to SEC and REC mods. We would expect that a majority of modifications, which are to be implemented in the first RY of the cost control cycle, would be known at the time of the Business

[26] Ofgem (2025), Draft Terms of Reference for the CCG, paragraph 4.1. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

Plan approval – the costs of mods which have been approved, or are expected to be approved, should be included in the Business Plan with forecasts based on Impact Assessments. We agree that the strategic statement can be helpful in informing the forecasts and the Licensee should refer to it where relevant. New code mods for Y2 (and subsequent RYs) would be capable of being included into an end-of-year reopener application. We would not expect releases to contain a significant number of mods which had not been anticipated at the time of either the Business Plan approval or the latest reopener application and DCC should be able to account for these using its Business Plan flexibility and contingency in the first instance. Where implementation is critical, we may consider allowing an emergency reopener application to be submitted.

3.92 We recognise that from time to time new policy and regulatory requirements may be imposed on the Successor Licensee. Where the Licence or the codes are modified by Ofgem or the Department mandating delivery of new activities, appropriate funding should be provided. As changes typically follow a public consultation process, we would expect the majority of new requirements to be met via an annual reopener; however, we may ask DCC to submit an emergency reopener where this is not the case. We may also make a provision for an Authority-led reopener to direct adjustment to the AR.

3.93 We note DCC's argument for inclusion of corporate overhead costs into the UM process. We maintain our view that these costs are within the Licensee's control and should be forecastable and met via budget flexibility as a matter of principle. Nonetheless, we do not intend to exclude one type of cost from the reopener process altogether as this may ignore genuine cases where an adjustment may be justified and create the risk of regulatory gaming where costs are reassigned by the Licensee to obscure true overruns. Our position is that the Licensee should be able to submit a reopener application for any type of cost and our Business Plan Guidance sets out the process with reference to specific factors and evidence; however, the justification for any proposed Internal Costs adjustment must clearly state why the Licensee has not been able to control these costs and how additional funding provides value for money.

3.94 We have decided to adopt a budgeting approach which would require the Licensee to apply for additional Allowed Revenue prior to varying its charges. The Licensee would be unable to vary its charges to levy more than the agreed Allowed Revenue (plus contingency) until Ofgem had approved any adjustment via the UMs. This is a pragmatic balance between granting flexibility to respond to unexpected changes in efficient costs and protecting the consumer from inefficient spend.

Adopting the option for undertakings

3.95 DCC has the obligation to show that its costs (proposed and incurred) are efficiently and economically incurred. Where it fails to do so, Ofgem can disallow such spend by removing it from the calculation of the AR. We are aware that in the new regime, we may find Unacceptable costs that the Successor Licensee is contractually committed to honour. Given that DCC2 will be operating as a NFP entity, where this is the case we will allow the Licensee to submit an undertaking. The purpose of the undertaking would be to:

- Allow the Licensee to show that it has a contractual or legal obligation to pay, and there is no other mechanism to meet the liability
- Explain what changes it will make to ensure that this situation will not arise again and that those costs are avoided in the future

3.96 On the basis of the undertaking, Ofgem may decide a temporary inclusion of Unacceptable costs in the calculation of the AR.

4. Financial incentives

Section summary

We have previously concluded that DCC's "Core Mandatory Business" should be provided on a not-for-profit basis. We proposed to extend our conclusion to the entirety of DCC's Authorised Business, including any non-core service provision and Permitted Business. We have maintained our proposals and confirm that we will remove from the Successor Licence all aspects of Baseline Margin. We have also concluded that, in principle, the Successor Licensee should be able to apply for ringfenced funding for exploratory work for additional business as part of its Business Plan submission. However, we intend to phase in this decision by only allowing an application for innovative (public good) activities in the first Business Plan.

We also sought views on options to drive efficiencies in External and Internal Costs. Based on strong stakeholder support, we have decided to reserve the right to impose stretch targets across all costs to incentivise the Successor Licensee to seek efficiencies beyond the level of economic costs approved through the Business Plan. Any efficiency target would be consulted upon and determined as part of the Business Plan process for a set cost control period.

Financial incentives can still play an important role in a not-for-profit regime. We have decided to maintain our consultation position and require that the following four performance measures be reflected in a remuneration policy developed by an independent Committee of the Board:

- Customer satisfaction – using scores of customer satisfaction survey (subject to our proposal in our consultation on future governance arrangements)
- Performance and delivery – using DCC's reporting against code (SEC and, if relevant, REC) performance measures
- Business planning – assessing the quality of DCC's submitted Business Plan
- Cost management – monitoring DCC's delivery to its approved Business Plan

We will publish a guidance document to develop these further. We recognise that the four measures do not include an explicit provision to replicate the BMPPA schemes aimed at incentivising the delivery of change programmes. We are open to considering further whether our guidance document, which we may from time to time modify, should further specify that the remuneration policy should focus on implementation of change programmes.

Q8.	Do you agree with our proposal to require that all of DCC's Authorised Business should be carried out on a not-for-profit basis?
Q9.	What are your views on the proposal to allow DCC to apply for ringfenced funding to enable potential development of commercial or innovative services?
Q10.	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?
Q11.	What are your views on the proposed measures to be considered as part of any targeted incentive model on senior managers and staff?

A. Not-for-profit arrangements for Authorised Business

Background

4.1 We have previously concluded that DCC's "Core Mandatory Business" should be provided on a not-for-profit (NFP) basis.[27] By "Core Mandatory Business" we meant services and activities which relate directly to ensuring the continued provision of a secure, reliable and efficient smart metering service defined in the DCC Licence and industry codes. We left open the possibility for DCC to carry out "Additional Mandatory Business" or "Permitted Business" and did not specify whether these activities could be provided on a for-profit or NFP basis.

4.2 Through our consultation, we proposed to extend our conclusion that the Core Mandatory Business should be carried out NFP to the entirety of DCC's Authorised Business. Consequently, we proposed to remove from the Successor Licence all aspects of Baseline Margin, which is currently applied on DCC's Internal Costs. The key rationale for our proposal was that a part for-profit, part NFP arrangement would likely prove to be a distraction away from the (NFP) Core Business leading to the Successor Licensee's unduly focus on the area(s) where it could earn profit.

4.3 However, we also sought views on whether to retain the possibility of DCC carrying out Permitted (*ie* non-Mandatory) Business subject to customer support for inclusion of a ringfenced budget into DCC's Business Plan. This would allow for a controlled diversification of DCC's role if there was a clear benefits case.

[27] Ofgem (2023), DCC Review: Phase 1 Decision. www.ofgem.gov.uk/decision/dcc-review-phase-1-decision

Summary of responses

Requiring that all of DCC's Authorised Business be carried out on a NFP basis

4.4 We have received responses with mixed views on our proposal. A plurality of five respondents supported our position, agreeing with our argument that a mixed regime would lead to selective focus on for-profit activities. There was also a recognition that this would bring the Successor Licensee in line with other central system delivery bodies.

4.5 Four respondents disagreed with our proposal due to their opposition to the concept of NFP regulatory model for the Successor Licence but none argued in favour of a split model. One of these stakeholders argued that the decision would restrict the number of potential applicants for the Successor Licence. In their view competitive tension between bidders would be more likely to realise value for money and innovative proposals. Similarly, one respondent expressed concerns about uncertainty as to the effectiveness of the proposed incentive model in driving the required performance improvements. Another suggested that the profit question be determined via a competitive process amongst bidders.

4.6 Three respondents took the position that regardless of the selected economic model, their preference lay in an efficient delivery of DCC's mandate.

4.7 A couple of stakeholders (one in favour and one against our proposal) recognised that DCC's contracts with External Service Providers, which are expected to be procured on a competitive basis, would continue to operate on a for-profit basis even if DCC itself was fully NFP.

Ringfenced funding for additional business

4.8 Our proposal received mixed responses from respondents.

4.9 DCC presented an argument to treat "innovative" and "commercial" services separately from each other. DCC argued that "innovative services", being additional services with the primary purpose of delivering public policy objective (eg helping to address fuel poverty and vulnerability by a wider use of system data), should receive ringfenced funding through the Business Plan. DCC's main argument was that an agreed ringfenced fund would help solve the current reliance on *ad hoc* funding of individual projects which has held back potential wider benefits realisation of innovative services due to:

- Restricting DCC to a specific project at a time

- Government sponsorships often requiring matched funding or at least a contribution from participating organisations
- Unclear regulatory processes

4.10 DCC also argued that there was a precedent in the regulation of energy networks with RIIO-2 determinations awarding 0.3% of companies' allowed revenue to innovation projects meeting defined criteria.

4.11 On the other hand, DCC argued that "commercial services", being services where the primary purpose is financial gain, should only be considered if they do not put at risk the delivery of core services and demonstrably provide a net overall benefit to customers.

4.12 Other respondents supported our proposal to varying degrees. Four were in favour, noting that DCC should be allowed to apply for ringfenced funding where there is a demonstrable benefit to the industry as a whole and where there is industry support. Support was contingent on profits flowing back to the funding parties. One respondent clarified that while they did not want to foreclose the possibility for opportunities which could lead to cost reductions, the added value should come from DCC users themselves, providing innovative products and services to energy consumers.

4.13 Three respondents were opposed to DCC carrying our any additional non-mandatory business. Their key argument was that DCC should stick to the knitting and focus on improving and maintaining the performance of the network.

4.14 Three respondents expressed reservations noting risks to the proposal, including distraction to management, speculative behaviour (any diversification should be supported by a clear business case) and a lack of clear case for additional services to date. There was a general view that strong governance was needed to protect the provision of the core business.

4.15 One respondent did not give a view but argued that any additional services should be approved via SEC governance.

Our decisions & rationale

Requiring that all of DCC's Authorised Business be carried out on a NFP basis

4.16 After careful consideration of the responses to our consultation, our decision remains unchanged from our original proposals – that all of DCC's Authorised Business will operate on a NFP basis. Consequently, we will remove all Baseline Margin from the Successor Licence.

4.17 Our principal argument remains that a mixed regime would not be logically and internally consistent and would run a risk of distraction away from the core service provision. We note that no respondent supported this approach.

4.18 We note the concerns voiced by several respondents in relation to a full NFP regime; however:

- As set out in our Phase 1 decision, a NFP arrangement is a natural extension of our decision to move to a majority-independent, purpose-driven model.[28] The rationale for this decision follows from a move towards purpose-driven governance. With a duty to act directly in the interests of its customers rather than a shareholder, there is no central rationale for the organisation to seek to maximise profit
- Our analysis suggests that these are strong incentives that can replace the profit incentive on DCC as additional assurance on performance and efficient cost management

4.19 In principle, the removal of pricing for profit in DCC's charges has two effects. On the one hand it could put downward pressure on prices by removing the profit element. On the other hand, stripped of the ability to earn profit, it could reduce the incentives on DCC to improve efficiency. In a regulated market, it is the role of the regulator (in this case Ofgem) to place an incentive structure around the regulated business (in this case DCC) so that it acts as if it were a competitive business in a competitive market. The key issue in respect of DCC as a NFP entity is therefore whether there are sufficient incentives for it to be efficient and responsive to stakeholders without the profit motive.

4.20 We believe that our decision to link DCC executive and staff pay to DCC performance (Part C of this chapter) will have three positive effects:

- It is a more direct incentive on those who can influence DCC costs and performance than profit for a shareholder
- The ability to link DCC bonus outcomes to specific behaviours outcomes is a more focused incentive
- By publicly announcing the criteria for staff and executive bonuses, as well as the decision of the Remuneration Committee as to whether bonuses can be paid, a strong reputational effect is created

[28] Ofgem (2023), DCC review: Phase 1 Decision, 2.55. www.ofgem.gov.uk/decision/dcc-review-phase-1-decision

4.21 In addition, we must also consider the impact on DCC behaviour and performance of the Customer Challenge Group (as per our decision in Chapter 5) and the incentives to forecast and manage costs effectively.

4.22 There are additional benefits that can come from moving to a NFP basis. It makes the regulatory regime simpler, removing the need for the BM and ECGS regime, thus reducing regulatory burden and the scope for gaming.

4.23 Through our decision on the future governance regime, we have also decided to introduce further regulatory incentives, such as a requirement to implement findings of the independent contract management auditor or to act on the outcome of a regular customer satisfaction survey. We will keep all of these under review and may adjust them based on the performance of the Successor Licensee in the first cost control cycle.

Ringfenced funding for additional business

4.24 Following our consideration of all responses, we maintain that, in principle, the Successor Licensee should be able to apply for ringfenced funding for exploratory work for additional business as part of its Business Plan submission. However, we intend to phase in this decision by only allowing an application for innovative (public good) activities in the first Business Plan. (As per our decision in Chapter 6 the first Plan would be prepared and submitted by the current Licensee and set the Allowed Revenue – budget – of the Successor Licensee until March 2028.) We may subsequently consider "switching on" the wider opportunity via a Licence change, direction or a change to our Business Plan Guidance, ahead of the second cycle commencing in April 2028.

4.25 We are persuaded by the argument that there are different aspects of additional services which merit different approach:

- First, Additional Mandatory Business which may be mandated by Ofgem, DESNZ or requested by DCC users. In principle, funding for Mandatory Business provided on the basis of Licence or code requirements should be justified as part of the Business Plan submission. We discuss the process for amending the scope of DCC's Authorised Business in more detail in our upcoming consultation on the future role of DCC where we seek further views on whether a ringfenced fund could extend to the development of additional user services with a potential to become Mandatory Business in future, subject to a positive proof of concept. *We do not intend to enable this for the first Business Plan Cycle.*

- Secondly, "public good" initiatives which, to date, have either required Ofgem's consent[29] or have been provided as Minimal Services.[30] We recognise that these initiatives have the potential to deliver consumer benefits without requiring significant investment and that approval of a ringfenced fund, agreed on in consultation with industry, could provide a transparent, structured way for benefits realisation. Consequently, *we will allow DCC to apply for these services in its First Business Plan submission. We will outline further details via our Business Plan Guidance.*

- Thirdly, commercial re-use (Value-Added Services) of the network for financial gain. As set out in our consultation, we have not seen any substantial evidence of viable VAS to be developed. *We do not intend to enable this for the first Business Plan Cycle.*

4.26 Our decision to proceed with a limited scope of the ringfenced fund in the first cycle is based on a number of factors:

- Management distraction – There is clear and widespread support for the move to a NFP multiannual *ex-ante* cost control and for the benefits that such a regime will bring. However, we are aware that such a move is a step change for the organisation. We are keen that DCC's leadership remains focused on the successful adoption of the new regime and on delivering the Authorised Business in an efficient and economic manner, at least in the first cost control cycle. We agree with the respondents who argued that it should be primarily DCC users operating in a competitive market environment, who should develop innovative products and services for energy consumers. DCC has a key enabling role by ensuring its users have access to the data they need to be able to innovate.

- Simplicity - We believe that the best way to ensure the successful adoption of the new regime for DCC to deliver accurate forecasts and manage its costs effectively and economically is to avoid making the regime unnecessarily complicated

- Regulatory gaming - The introduction of a ringfenced fund where profit can be earned introduces the potential for regulatory gaming, especially in an environment where the Authorised Business is regulated on a NFP basis

[29] under LC 9.6(c)
[30] LC 6.8(b)

4.27 We consider that this balanced approach is consistent with our duty to protect consumers whilst also enabling economic growth.

B. Driving cost efficiencies and the role of ECGS in a NFP model

Background

4.28 Under the existing framework, the External Contract Gain Share (ECGS) functions as an upward adjustment to the Allowed Revenue for where DCC can secure cost savings in the Fundamental Service Provider (FSP) contracts. At present, any such savings are shared amongst DCC, its customers and where relevant, the respective service provider that is party to the FSP contract. The scope of the ECGS mechanism is currently limited to the realisations of savings against External Costs.

4.29 In our consultation we assessed the relevance of the ECGS as a financial incentive in the context of a NFP model where financial gain will be removed (on a company level as a whole). Upon analysing different options, we proposed to remove the ECGS for External Costs with the possibility of introducing stretch targets (beyond the approved Business Plan forecasts) in the future. Our proposal to remove the ECGS at this stage was because costs will have been subject to challenges from Ofgem and industry as part of the Business Plan process, making it therefore an appropriate baseline for forecasts that are economic and efficient.

4.30 We also assessed the possibility of extending the scope of the existing ECGS to include the realisation of savings against all costs, including Internal Costs. As per our recommended option on External Costs, our minded-to consultation option was not to extend the scope of the existing ECGS to Internal Costs at this stage but reconsider, in the future, the possibility of introducing efficiency targets.

Summary of responses

4.31 A few respondents observed that the ECGS mechanism has minimal value in a NFP model and could therefore, in principle, be removed. Others noted that both Ofgem and the Customer Challenge Group (CCG) should, in theory, be able to ensure that cost savings are maximised without an additional incentive. Notwithstanding that, a few respondents argued that they do not share our view that the Business Plan process nor Ofgem's assessment will always result in the approval of the most economic and efficient costs.

4.32 Some respondents welcomed our proposal to keep the arrangements for a future inclusion of incentive targets under review, with one respondent explicitly requesting that these are introduced sooner rather than later to provide the benefits to customers as soon as possible. One respondent further noted that given that Internal Costs are exclusively within DCC's control, targets ought to be imposed on such costs to create clarity on the expected outcomes and set an objective benchmark for evaluating DCC's efficiency improvements.

4.33 Finally, a few respondents raised concerns about the unintended consequences of a cost efficiency incentive. For example, some respondents noted that it could result in inflated forecast costs being included in the business plan; others observed that it could lead to a disproportionate focus on cost reduction at the expense of the system's quality of service. Some respondents further commented that, whilst setting any stretch targets, culture and employee retention will need to be considered together with clear and objective measurable targets as well as an independent appraisal of the Board's performance.

Our decision

4.34 We confirm that we will not include an ECGS mechanism in its current form into the Successor Licence as the mechanism is not compatible with our decision on NFP operations. However, upon review of all responses and further analysis, we have decided to amend our consultation position and reserve the right to impose stretch targets across <u>all</u> costs to incentivise the Successor Licensee to seek efficiencies beyond the level of economic costs approved through the Business Plan.

Rationale for our decision

4.35 We remain of the view that a purpose-driven organisation would still be expected to deliver to its budget and Business Plan, and drive efficiencies as part of its exercise of a general objective to deliver Mandatory Business in an economic and efficient manner. Equally, however, it is common and expected standards for all businesses to find efficiencies and achieve ongoing improvements in OPEX (operating expenditure) productivity; in other words, deliver the same outputs with fewer inputs over time. We therefore consider it appropriate to reserve the right to set these expectations for DCC2. We do not intend to set a specific target within the Successor Licence itself; instead, an efficiency target will be consulted upon and determined as part of the Business Plan process for a set cost control period. Based on total factor productivity, we would expect this target to be in the region of up to 2%.[31]

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[31] ONS (2025), Productivity flash estimate and overview. www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/articles/ukproductivityintroduction/octobertodecember2024andjulytoseptember2024

4.36 We do not intend for these targets to reduce the Successor Licensee's Allowed Revenue (budget) upfront below the level of approved economic and efficient costs, so as not to put the Licensee at financial risk. Instead, the targets would be expected to be realised as savings and returned to customers through end-of-year reconciliation.

4.37 We consider it appropriate for potential efficiency targets to be set across all costs, rather than for a selected subset. This will give the Successor Licensee the flexibility to realise efficiencies where available across its portfolio and mitigate against the risk of an undue focus on cost cutting. In our consultation we discussed the differences between Internal and External Costs and the suitability of different target approaches (open vs closed). Although DCC may have more direct control over its Internal Costs, efficiencies in External Costs can and should be sought. DCC can exercise pressure through its existing contracts as well as via competitive procurements. It is also reasonable to assume that the External Service Providers should be able to achieve similar average efficiencies in their operations as the rest of the economy.

4.38 We recognise the concern that the setting of cost efficiency targets could lead to disproportionate focus on cost reduction at the expense of system performance. We would expect the Successor Licensee to take a balanced approach, reflected in a properly set Renumeration policy reflecting both cost and performance measures, as per our decision in Part C.

C. Targeted financial incentive model

Background

4.39 We said that financial incentives are still capable of playing an important role in a regulatory regime where DCC operates on a NFP basis. Instead of focusing on the shareholder's profit margin, through our consultation on future governance arrangements, we decided to implement a targeted financial incentive model centred on a remuneration policy as an assurance of cost management and good performance. We concluded that we would require DCC to submit its remuneration policy for approval to Ofgem and that the policy be developed by an independent remuneration committee of the Board. Ofgem would approve the policy, require further development and a resubmission, or (upon consulting with the Licensee) direct specific changes to the policy.[32]

[32] Ofgem (2025), DCC Review Phase 2: Governance arrangements – conclusions, paragraphs 4.53-4.60. www.ofgem.gov.uk/decision/dcc-review-phase-2-governance-arrangements-conclusions

4.40 We consulted on the following measures that should be reflected in any remuneration policy:

- Customer satisfaction, using scores from a newly required customer satisfaction survey
- Performance and delivery, using system performance indicators under the SEC/REC
- Business planning, based on Ofgem's assessment of the quality of the submitted Business Plan
- Cost management, reflecting the Licensee's ability to deliver to the set Business Plan and prudent financial management

Summary of responses

4.41 Most respondents agreed with our proposal, recognising that a remuneration-based incentive model would be appropriate for an organisation operating on a NFP basis.

4.42 Several respondents argued in favour of weighting of individual measures, noting that performance should be the top priority. Three respondents argued for a review of the way system performance is measured, noting that the existing system performance measures used under the Operational Performance Regime (OPR) do not reflect real-world user experience, in particular in the North Communication Region. One agreed that the monthly reports from DCC to SEC Panel should inform the evaluation of system performance within its incentive model but asked that the self-reporting consider customers' views from the SEC subcommittees and Panel. DCC itself reiterated its opinion that the Licensee should only be performance managed against measures that are fully within DCC's control (those which are used under the OPR).

4.43 A couple of respondents stressed the importance of corporate culture set by the Board and argued that the Board should have appropriate discretion over the monies set aside for incentives. Equally, however, one respondent warned against excessive bonuses.

4.44 One respondent asked that Ofgem reconsider the inclusion of a direct contract management incentive with a view that the performance of DCC's services is directly linked to its Contract Management functions and that assessing the effectiveness of DCC's contract management solely through cost management measure would miss other performance-related factors. On the other hand, DCC agreed with our proposal to withdraw the contract management incentive and instead set expectations that the DCC Board will follow up on required actions from the annual contract management audit.

4.45 A few respondents noted that customer satisfaction is a function of good performance and cost management and those measures should be given priority. With regards to our proposal to use scoring from customer satisfaction surveys, one respondent highlighted that the design and focus of the survey would determine its effectiveness and suggested that the SEC subcommittees have an opportunity to help shape its structure and contents. Another argued that the customer satisfaction survey should be run annually (instead of biennially) to accurately measure DCC's customer service.

4.46 One respondent disagreed with the proposals on account of their concerns about the NFP model. They contended that there was no conclusive evidence that the proposed remuneration principles would deliver the required outcomes.

4.47 Further comments we received included:

- A suggestion that the Business Planning incentives could be transitional if DCC can show it is capable of delivering a good quality BP
- Observation that the proposed measures do not include a change-focused programme management incentive (replicating the Baseline Margin Project Performance Adjustment schemes, "BMPPAs")
- The importance of the remuneration policy being set fairly without a detriment to staff morale and retention

Our decision

4.48 Having considered all responses and comments received, we have decided to maintain our consultation position and require that the four performance measure be reflected in a remuneration policy set by the Successor Licensee's independent Remuneration Committee. We intend to implement this decision by including into the Successor Licence a condition requiring the Licensee to have due regard to a guidance document published by the Authority. We will develop this incentivisation guidance setting out the application of the measures in more detail ahead of the Transfer Date.

Rationale for our decision

4.49 As set out in our decision on the future governance arrangements, we consider direct financial incentives to be the best vehicle to assure good outcomes in a model without shareholder margin at risk. We remain of the view that the four measures, which we identified, are appropriate to target the key measurable areas of DCC's performance.

4.50 We recognise concerns raised in relation to measuring system performance under the current OPR. We are encouraged by the collaboration between DCC and industry on the implementation of SEC Modification Proposal MP242 ('Change to Operational Metrics to Measures of Success') to introduce reporting on the success and failure rates across a series of DCC system processes.[33] We will consider whether to further specify the measures to be used for the purposes of remuneration policy in our guidance document (in effect replacing our current OPR guidance).

4.51 We understand the suggestion to introduce a specific contract management incentive measure. However, as the respondent acknowledges, the outcomes of good contract management are felt in the performance and cost management. We aim to ensure that the incentive metrics are measurable. In our decisions on the future governance model, we have concluded that we would maintain the annual independent audit into DCC's contract management processes and require the Successor Licensee to adopt the findings of the report. This process should be felt in improved performance outcomes which would remain incentivised under the remuneration scheme.

4.52 We note stakeholder views in relation to customer satisfaction and that it is shaped by the experience of DCC's performance and in the context of DCC's costs. However, as we said in our consultation on the future governance model, a survey can provide a true reflection of customers' views and experience, including where performance measures have not always revealed the accurate picture.[34] We therefore believe it has its place among the incentive measures. We agree that the design and the structure of the survey would be important and we have therefore decided to mandate assurance from an independent third party. We are open to exploring how industry could help input into the survey as part of the process.

4.53 We agree with respondents that it will be important that the Board have sufficient autonomy around remuneration. We would reiterate that while Ofgem will

[33] SEC (2023), MP242 'Change to Operational Metrics to Measure on Success'. https://smartenergycodecompany.co.uk/modifications/change-to-operational-metrics-to-measure-on-success/

[34] Ofgem (2024), DCC Review Phase 2: Governance and Centralised Registration Service arrangements, 4.19. www.ofgem.gov.uk/consultation/dcc-review-phase-2-governance-and-centralised-registration-service-arrangements

develop a guidance to set expectations on the measures which should be reflected in the remuneration policy and will have a role in approving it, the Board will be responsible for its development and implementation. We would expect the policy to promote good corporate culture and be set fairly to support staff morale and retention. This may include tailoring the policy for responsible decision-makers through personal objectives. Workforce remuneration should not be impacted by poor decisions made by the company executives. With regards to ensuring that bonuses are set at an appropriate level and do not become excessive, we are confident that this risk can be mitigated by the requirement on Ofgem approval of the policy and staffing costs (including pay) being subject to scrutiny via the cost control process.

4.54 Finally, we recognise that the four measures do not include an explicit provision to replicate the BMPPA schemes, currently set by DESNZ,[35] aimed at incentivising the delivery of change programmes. We believe that delivery of change can be incentivised via the incentive measure aimed at delivering the business plan which should include change programmes. However, we are open to considering further whether our guidance document, which we may from time to time modify, should further specify that the remuneration policy should focus on implementation of change programmes. Ultimately, the effectiveness of a programme-focused incentive may rely on suitable organisational structure, for example one with accountable programme owners whose personal objectives are tailored to deliver the expected outcomes. As noted above, the Board should have the autonomy in the policy implementation.

4.55 The incentive regime would be kept under review and to ensure its flexibility, we would reserve the right to modify the guidance from time to time.

[35] Under LC 38, Schedule 1, paragraph A2

5. Customer engagement

Section summary

To drive stronger customer engagement in the new model, we proposed to create a new Customer Challenge group ("the Group") under the Smart Energy Code (SEC) to have a role in the cost control process by providing feedback and challenge to DCC on its Business Plan. We sought stakeholder views on the scope, membership, focus and outputs of the Group.

Having considered all responses, we have decided to maintain our consultation position - we intend for the CCG to be established as a subcommittee by the SEC Panel, adopting the Terms of Reference which we are consulting upon alongside this decision document.

We have also decided to proceed with the requirement for the Group to consist of core members drawn from DCC customers and consumer representatives, and non-core members as individual experts who may be invited to advise the Group at the discretion of the Chair.

We confirm the Group's role in providing feedback and challenge to DCC on its draft Business Plan, monitoring DCC's delivery to the Business Plan through quarterly reporting, and providing feedback to DCC and a recommendation to Ofgem on reopener applications. DCC will be required to submit a draft Business Plan to the CCG and engage with the CCG at least 4 months prior to its Price Control submission to Ofgem. The Group would provide a written report directly to Ofgem, setting out its overall assessment of DCC's Business Plan and highlighting any areas of concerns or disagreement. We may draw on this report when undertaking our own review of DCC's submission.

We expect the CCG to be set up over the coming months to receive the first draft Business Plan submission by 29th August 2025 (subject to our statutory consultation).

Questions posed at consultation

Q12. 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?

Q13. What are your views on the Group's membership? Do you agree with our outlined core and non-core membership model?

Q14. What are your view on the presented considerations for the scope, focus and responsibilities of the Group?

Q15. Do you agree with the proposed outputs of the Group?

Background

5.1 Under the current model, DCC already engages with its customers through the SEC governance, own forums as well as other governance groups. DCC also follows a customer engagement process as part of its preparation of business plans for major procurements under LC 16.6A-C and during development of its Business Development Plan. However, as set out in our consultation document, these processes have challenges in providing true transparency for customers on DCC's costs. There is currently no formal opportunity for customers to holistically review DCC's costs and plans as the established processes are piecemeal and focused on specific procurements and changes. The Quarterly Finance Forum (QFF) has historically not worked well as a two-way route for DCC and customers to holistically engage on service requirements and costs. Additionally, the current processes do not provide visibility of all costs, including DCC's Internal Costs and cost of change not subject to the SEC modification process (DCC-led change).

5.2 In an *ex-ante* cost control framework and a NFP model, customer engagement will be crucial to ensure DCC's forecasts are transparently agreed upon ahead of costs being incurred. This is particularly important to limit the risk of overspends in a model with limited clawback options and to provide transparency and budgeting certainty to DCC's customers who are subject to DCC's charges as paying users.

5.3 We consulted on proposals to establish a new Customer Challenge Group to have a role in the cost control process by providing feedback and challenge to DCC on its Business Plan seeking stakeholder views on the scope, membership, focus and outputs of the Group. We address each question and our decision in turn below.

A. Establishing a CCG under the SEC

5.4 The consultation assessed three options to identify the most suitable role for stakeholders in the preparation and scrutiny of DCC's Business Plan:

- Option A: Retain the status quo arrangements
- Option B: Introduce an independent engagement group akin to User/Customer Engagement Groups under RIIO-2
- Option C: Set up a customer challenge group under the Smart Energy Code

5.5 We consulted with a preference for option C which, in our view, would provide the best balance between formalising the role of customers in the cost control process with manageable regulatory burden. We also set out in more detail some considerations on the Group's membership, focus and outputs.

Summary of responses

5.6 Most respondents agreed with our preferred option to set up the Challenge Group under the SEC. Those in favour of this option argued that the formation of this Group is vital to ensuring both industry engagement and the cost effectiveness of the DCC. Many respondents stated that there is currently no way for DCC customers to effectively challenge the costs, therefore, having a Challenge Group with formal reporting responsibilities to Ofgem could ensure that stakeholders feedback is considered in regulatory assessments and business plans align with industry priorities.

5.7 A few respondents expressed that, while the set-up of the Group was a good idea in principle, it was important that the Group had a substantive role in the process of scrutinising DCC's Business Plan. They were keen to understand how the Group would operate within the existing landscape and how it will interface with existing SEC and DCC aligned groups and forums. Concerns were raised that the remit of the proposed challenge group could overlap with existing SEC-led bodies; however, it was noted that this concern could be addressed through the terms of reference of the Group.

5.8 One respondent preferred a hybrid option, where the DCC would be required to engage and account for the Challenge Group's views but also be able to compel the DCC to engage in SEC sub-committees.

5.9 One respondent raised concerns that neither DCC nor Ofgem would be bound to specifically address feedback provided to them by the group. They suggested that both DCC and Ofgem be obliged to address the feedback provided by the CCG and if changes were not made on account of the feedback received, for Ofgem to provide an explanation.

5.10 DCC favoured option B to introduce an independent engagement group, which it argued had precedent in other regulated utilities. DCC argued that this group would fill a strategic gap in customer engagement and create an open environment in which DCC could share challenges it faces, as the group's role would be focused on advising the company's executive and board. DCC stated that "with the tight timeline, a pragmatic approach may be required for the establishment of the first iteration of a representative customer group."

5.11 Some respondents raised concerns about potential conflicts of interest of option C in the event that SECCo seeks to bid to become the Successor Licensee and the importance of a clear distinction being made between the role of the group and the role of SEC Panel, its other sub-committees and SECCo Board. Concerns were also raised about potential changes under the Energy Code Reform and the need to review any potential challenge group under the SEC once the Code Manager licence terms are known.

Our decision

5.12 Having considered stakeholder feedback, we have decided to maintain our consultation position and proceed with option C to set up the Customer Challenge Group under the SEC.

5.13 We intend for the CCG to be established as a subcommittee by the SEC Panel, adopting the Terms of Reference which we are consulting upon alongside this decision document. DCC will be required to submit a draft Business Plan to the Group and engage with the CCG at least 4 months prior to its Price Control submission to Ofgem. DCC will also be required to have due regard to the CCG's views and reflect its feedback in its final submission. We will set out these obligations in the Successor Licence.

5.14 As per our conclusions on the implementation of the first Business Plan detailed in in Chapter 6, the CCG will have a role in the first business planning cycle. We are therefore also consulting on modifications to enable the current Licensee to prepare the first *ex-ante* business plan and seek formal feedback from the CCG. Further details of these proposals are set out in our statutory consultation, which we have published alongside this decision document, and in Chapter 6.

Rationale for our decision

5.15 We welcome that stakeholders have broadly agreed with our rationale and arguments. Our view expressed in the consultation remains unchanged in respect of the key benefits of setting up the Challenge Group under the SEC, which will:

- Help improve transparency on costs and requirements for both industry and DCC by formalising an engagement process focused on trade-offs between the scope of services to be delivered and their cost
- Allow customer representatives to get a full picture of DCC's plans and costs ahead of those costs being incurred; including costs which are currently not visible, such as Internal Costs and costs of DCC-led change
- Benefit from established SEC processes and administrative support provided by the SEC Administrator and Secretariat (SECAS). This means the Group will be set up in time to scrutinise DCC's first Business Plan to be submitted to it by end-August 2025

5.16 Nonetheless, we recognise the concerns raised by some respondents. Firstly, some stakeholders queried how the CCG would operate within the existing eco-system of various engagement forums, highlighting the risk of a potential overlap with existing bodies. We have sought to address this through the Terms of Reference, which have been published alongside this decision document. The CCG would be able to draw upon the existing SEC governance processes and resources; however, it will operate independently of the SEC Panel to ensure integrity of outputs and submit a report directly to Ofgem. The Group's remit will be focused on challenging DCC's plans and monitoring their delivery. This is different from the role of other sub-committees and groups within the SEC currently that work within an advisory capacity to the SEC Panel. The Group's role will be complementary and we do not expect it to repeat engagement which takes place in other forums. It will be able to invite chairs of other subcommittees to give advice or evidence, for example to verify that sufficient engagement on a specific element of the Business Plan, which the CCG scrutinises, has taken place and that it align to the Plan's contents.

5.17 Secondly, we recognise concerns raised about potential conflicts of interest with the establishment of the Group if a SECCo subsidiary company decided to bid for the Smart Meter Communication Licence.[36] As set out above, the Group will operate independently from the SEC Panel and no members of the Panel will be members of the Group. However, it will ultimately be the responsibility of any potential bidders to identify and address any potential conflicts of interest should they decide to bid for the SMCL Licence.

5.18 In relation to concerns raised about the interaction of our proposals with the potential changes under the Energy Code Reform, Ofgem has published a second consultation on the implementation of the reform work, which details proposals for Stakeholder Advisory Forums (SAFs).[37] We will consider any decisions from this consultation to ensure ongoing alignment.

5.19 We note the suggestion for both DCC and Ofgem to be obliged to specifically address the feedback provided by the CCG and if changes are not made due to

[36] DESNZ (2025), Conclusions document on modifications to the DCC Licence and the SEC to provide for a SECCo subsidiary that could seek to become the successor DCC Licence holder. Available at: https://smartenergycodecompany.co.uk/department-for-energy-security-net-zero-desnz-conclusions-document-on-modifications-to-the-dcc-licence-and-the-sec-to-provide-for-a-secco-subsidiary-that-could-seek-to-become-the-success/
[37] Ofgem (2025), Second consultation on the implementation of energy code reform. www.ofgem.gov.uk/consultation/energy-code-reform-second-implementation-consultation

feedback, for Ofgem to provide an explanation. Whilst we expect a dynamic iterative process of engagement between DCC and the Group to work such that DCC can receive feedback and address comments, DCC should ultimately maintain responsibility for the final Plan submitted to Ofgem. The aim of the Challenge Group would be to enhance the quality of DCC's submission, not to undermine the role of DCC's Board. Whilst we will aim to be as transparent as possible with the CCG in our decision-making, we do not intend for the Group to have decision-making powers in areas which are within the Authority's functions. Importantly, this includes the determination of DCC's Allowed Revenue which will remain Ofgem's responsibility.

5.20 We acknowledge DCC's preference for Option B, however we do not consider that an independent engagement group could provide an adequate level of scrutiny for the draft Business Plan and reopener applications or assume a monitoring function. Furthermore, whilst we have changed our consultation position for implementation of the first business plan (see Chapter 6), we remain of the view that it would be a significant resource burden on DCC and its customers to set up the new regulatory and governance arrangements for an independent group.

B. Membership

5.21 We proposed that the Group membership should consist of two groups of members – core (with prescribed minimal representation of DCC customers and consumer representatives) and non-core (additional experts invited at the discretion of the Chair).

5.22 We did not propose to prescribe detailed processes for establishing the Group. For the first Group to be formed, we said we would expect the SEC Panel to first appoint a Chair who would be required to act independently and deliver the mandate of the Group. Core members would be drawn from amongst DCC customers and should have suitable experience and qualifications required to fulfil the duties. The Chair could have the discretion to invite independent non-core members to assist with the Group's work.

5.23 We did not propose remuneration for the core members of the Group. However, we proposed that non-core members, non-customer affiliated individual experts in specific fields, could be entitled to receive remuneration at a reasonable rate at the Panel's (or Chair's) discretion.

Summary of responses

5.24 Most respondents agreed with the principle of having core members of the Challenge Group, derived from DCC's funding parties; however there were differing views on the inclusion of non-core members as well as the composition and numbers of the core members.

5.25 Three respondents expressed a view that the Group should include more representatives from DCC larger funding customers in same way as SEC Operational Group, with one representative per large supplier. Having a representative from each major funding customer, they argued, would increase transparency across industry.

5.26 Several respondents, including DCC, recommended to remove the option of representation by rota as they argued that it will hinder the Group's speed of work and disrupt development of shared understanding of plan. They emphasised that consistency of membership is crucial to retain corporate memory and ensure meaningful challenge to DCC's Plan. One respondent highlighted the risk that this could result in the group becoming a "talking shop", as there is no consideration of the need for continuity and building of knowledge for the group to be effective.

5.27 A couple of respondents expressed a view that the Group should draw on the existing SEC stakeholder community and proposed that, at a minimum, the chairs of TABASC and OPSG should be its key members. They also expressed a preference that in the immediate future any CCG is drawn from those members of SEC community with relevant expertise and experience.

5.28 A few respondents asked for a separation of membership from the SEC Panel, noting that if membership of the SEC Panel and the CCG was similar, it could limit the breadth of scrutiny and diversity of viewpoints. They suggested that Ofgem consider restricting membership to ensure SEC Panel representatives cannot be elected as core members to CCG and emphasised the importance of the CCG Chairperson operating independently of the SEC Panel.

5.29 Several respondents raised concerns regarding the appointment process, particularly the need for clarity on how core members would be appointed and ensuring they have the relevant expertise through structured pre-selection criteria.

5.30 DCC supported a "core member only" approach with balance between customers and subject matter experts. It argued that the current proposal runs the risk of a membership hierarchy developing, due to some members developing a greater understanding of the business plan whilst others potentially struggle to understand the context within which their input is requested. DCC suggested that some of the expertise required in the non-core membership could be drawn from DCC's customer base, but other areas of expertise, such as regulatory economics and cyber security, may need to be drawn from outside the customer base and could be included as requirements within the recruitment of the Group members.

Our decision

5.31 We have decided to proceed with the requirement for the Group to consist of core members, with the prescribed minimal and maximum representation, and non-core members, who will be individual experts and invited at the discretion of the Chair.

5.32 We have decided that Ofgem will be able to nominate a representative to act as an observer to any Group session, however they will not have any voting rights. We have also decided the DCC will be required to nominate a representative to the Group to present the Plan, respond to questions and receive feedback. The DCC representative should attend regular meetings of the Group. However, the Chair may ask the DCC representative to recuse themselves from a meeting (in part of in full).

5.33 We recognise stakeholders' concerns about our proposals to allow representatives of the Group to act on a rota basis, particularly the need to maintain corporate memory to ensure detailed scrutiny of DCC's Business Plan. We have therefore decided to remove this option in the draft Terms of Reference, with the exception of Other User representative as we recognise that this User Group is diverse and may choose to nominate different representatives, should they wish.

5.34 Confidential and commercially sensitive information which will be discussed in the Group will need to be protected and we have set out the details as to how this will be maintained in the draft Terms of Reference document.

5.35 Regarding the appointment process, we have decided that, initially, SECCo or the Panel will appoint a Chair, with the role being expected to be advertised online. The Chair would be required to act independently to deliver the mandate of the Group. The core members will be derived from the SEC constituencies and include a consumer representative; we have set out examples of desirable areas of experience in the draft Terms of Reference to help with the process.

5.36 We maintain our view that only non-core members should be entitled to receive remuneration at a reasonable rate, which will be subject to the Panel's discretion.

However, we will not preclude the Chair from being employed on a contract which includes remuneration.

5.37 We have also decided to implement transparent governance arrangements to ensure the Chair and members are, and are seen to be, independent from DCC, its parent and service providers, as well as from Ofgem. Please refer to our Terms of Reference document for further details on these arrangements.

Rationale for our decision

5.38 We note suggestions for the Group to include more representatives from DCC's larger funding customers to allow these parties the opportunity to provide insights and input into costs. Nonetheless, we remain of the view that an increase in the number of large suppliers could hinder the efficiency of the Group to provide constructive and meaningful scrutiny of DCC's Business Plan in a limited time period. We do not envisage that the Group would be a substitute for, or duplication of, DCC's wider stakeholder engagement; rather we expect it to operate in parallel and complement the existing processes, therefore, all large suppliers and network parties will still have the opportunity to engage with DCC on the development of the plan and provide feedback.

5.39 We recognise differing views in relation to the overlap between members of the Group and the existing SEC stakeholder community. We proposed through the ToR that the Chair will be able to invite chairs of TABASC, OPSG and other groups as non-core members to provide relevant expertise to provide additional expertise and diversity of views.

5.40 We note DCC's suggestion to only retain core members for the Group with balance between customers and subject matter experts, who hold expertise in different areas. Nonetheless, we remain of the view that, given that we expect core members to engage with the Group on a voluntary basis, it would be difficult to attract the diversity of expertise required. Similarly, it is unlikely that we will be able to retain a diversity of expertise for a prolonged period. The Group may choose to engage non-core members only for a set period of time to provide advice on specific matters.

C. Scope, focus and responsibilities

5.41 We said that, under our proposals, the Group would not be a substitute for, or duplication of, DCC's wider stakeholder engagement; rather we would expect it to operate in parallel and complement the existing processes. In general, we proposed that in challenging DCC's Business Plan, the Group would consider quality, engagement and costs and we identified suggested areas of focus for the Group. We also sought views on the Group's role in assessing reopener applications submitted by DCC during the cost control period.

5.42 We proposed for DCC and the Group to engage on the draft Plan for at least 3 months prior to DCC's submission to Ofgem.

5.43 We also asked for views on whether issues should be escalated to Ofgem in situations where there is disagreement either within the Group or between DCC and the Group during the engagement process prior to submission of the report, particularly if the disagreement delays the Group's ability to carry out is challenge function in respect of the draft Plan.

Summary of responses

5.44 The majority of respondents agreed with the proposed scope of the Group; one respondent did not express an explicit view.

5.45 A couple of respondents suggested additional scope areas for the Group to consider, including:

- How DCC's Business Plan proposals address existing operational issues, explanation on any major projects, programmes, or initiatives that have been specifically discounted by the DCC or postponed to later years
- Key DCC1 to DCC2 transitional risks, projects, or remedial activities in the years immediately following the business handover period

5.46 Some raised concerns about the ability of new members to get up to speed with the detailed components that will be required to properly engage with DCC's Business Plan within three months.

5.47 In relation to our proposals for measures to form part of a targeted remuneration-based incentive model (Chapter 4, Part C), one respondent stated that the Group should play a monitoring role, particularly in relation to the senior management and staff incentive scheme and performance and service delivery metrics as well as customer satisfaction.

5.48 Several respondents expressed support for issues to be escalated to Ofgem where there is disagreement between DCC and the Group during the engagement process.

5.49 One respondent stated that it was unclear whether the core members would be required to share insights or seek additional constituency input ahead of the Group's report being prepared.

5.50 Another respondent stated their expectation for the group to scrutinise pass-through costs as well as emergency reopener requests and any application for ring-fenced funding.

5.51 DCC supported the three primary focus areas; however, it emphasised the importance of the Group not overly focusing on cost at the detriment of other aspects. DCC raised concerns about the limited period for it to complete its feedback and for DCC to subsequently assess options and revise its plans. It expressed a preference for Ofgem to limit the scope in order to enable the Group to provide feedback within the proposed three-month period. DCC stated its expectation for the Group to conduct its business under red classification and emphasised the importance of the ToR clarifying that cost profiles for business cases, as well as any other investments or requirements already in receipt of support through industry do not require re-assessment.

Our decision

5.52 We have decided to proceed with the requirement for the Group to consider the quality of DCC's business plan, the level of engagement with DCC's customers, and the costs associated with the plan. We have also decided to maintain the list of areas of focus for the Group, as set out in our consultation, and extended the time period for the Group to engage on the draft plan to at least four months prior to DCC's submission to Ofgem.

5.53 The Group will be expected to meet on a quarterly basis at minimum to monitor DCC's progress against its Business Plan. This will include a formal role in receiving and commenting on applications for end of year re-openers. We also confirm that the Group will be able to assess applications for ring-fenced funding, which should be part of DCC's Business Plan. Further details of the role of the Group are set out in our draft ToR.

5.54 We will not mediate any disputes in respect of the contents of DCC's draft Business Plan through the framework of the Group's meetings. Where the Group and DCC disagree on any aspect of DCC's draft Business Plan, both the Group and DCC should highlight their views in their respective submissions to Ofgem.

Rationale for our decision

5.55 We note the proposals for the Group to focus on how the DCC's Business Plan proposals address existing operational issues as well as an explanation on any major projects, programmes, or initiatives that have been discounted or postponed by the DCC. We agree that these could be areas of focus for the Group and believe these will be encapsulated under the Group's scrutiny of the drivers, assumptions and engagement on proposed cost forecasts. Regarding the suggestion for the Group to focus on key transitional risks, projects, or remedial activities following the Business Handover, we remain of the view that it will be appropriate for these to be scrutinised by the Joint Handover Steering Group (JHSG) established to oversee the Business Handover process. Similarly, with regards to the Group playing a role in monitoring a staff incentive scheme, we remain of the view that the implementation of remuneration policy should sit with the independent Remuneration Committee of the Board. However, we will develop further guidance and consider how stakeholders may provide input.

5.56 The Business Plan will be subject to the established process currently in place for handling documents in the SEC Panel, where certain sections will be classified depending on the level of confidentiality of the data and will determine how this data will be handled, shared and stored by members. This means that core members will have comply with the Panel's information policy when determining whether to seek additional constituency input ahead of the Group's report being prepared.

5.57 We expect DCC to engage with the Group on its end-of-year reopener applications throughout at least Q3 (October-December) ahead of its submission to Ofgem during the reopener window at the end of Q3 (as per our decision in Chapter 3 Part D). However, we recognise that it may not always be possible for DCC to consult with the Group on emergency reopener applications due to urgent circumstances.

5.58 In relation to Pass-through Costs, we do not consider it necessary for the CCG to scrutinise these. For clarity, Pass-through Costs currently include SECCo and Alt HAN Co payments. However, we agree that the Group should review new costs which DCC proposes to be subject to an Automatic Adjustment Uncertainty Mechanism – in particular drivers of volume-sensitive costs (where a unit price and a link to a specific factor which can be determined).

5.59 Regarding concerns about limited funding being available for DCC to generate impact assessments, we would expect DCC to include a forecast for expected IAs required during the cost control period. We have also made the decision (Chapter 3, Part B) for External Costs to be made fungible within programmes, which will further mitigate against this risk.

5.60 We agree that the focus of the Group should not involve re-assessing or disagreeing with costs and requirements which have already been engaged upon via existing governance arrangements such as SEC Governance. We have clarified this view in the Terms of Reference document.

5.61 We understand DCC's preference to reduce the scope of the Group due to concerns surrounding the limited time period proposed for the Group to be set up and provide feedback on the Plan. As further explained in Chapter 6, we have decided to extend the time available for the Group to be set up and to engage with DCC on the first Business Plan.

D. Outputs

5.62 We proposed that the primary output of the Group would be an independent report on DCC's Business Plan. The Report would present a summary of the Group's assessment of the Plan, highlighting in particular any areas of concern where, in the opinion of the Group, the DCC's Plan may be weak or not properly justified.

5.63 We considered whether the final report should be submitted directly to Ofgem to uphold the independent nature of the Group. We also asked for considerations as to whether the reports of the Group should be made publicly available.

Summary of responses

5.64 Almost all of respondents agreed with our proposed output for the Group to submit a report, whilst one respondent did not express an explicit view.

5.65 Several respondents explicitly agreed that the report should be submitted directly to Ofgem.

5.66 All respondents agreed that the report should be made publicly available.

Our decision

5.67 We have decided to proceed with the requirement for the Group to submit a report directly to Ofgem. A non-commercially confidential version of the report will be made publicly available on the SEC website. The full report will also be issued to DCC and Ofgem, and the Group will also issue a non-commercially confidential version of this report to be circulated to the SEC Parties and the Panel. Further details on the report can be found in the draft Terms of Reference.

5.68 In line with our decision on the scope of the Group's role, the Group will also submit recommendations to Ofgem in respect of any reopener applications which DCC has consulted with the Group on. This recommendation will be in the form of a short report, setting out the Group's view on the proposed adjustment to the AR, submitted alongside DCC's application.

6. Implementation of the first Business Plan

Section summary

We said that, where possible, we would consider bringing some changes early to drive the benefits of the new framework. We proposed to require DCC1 to prepare and submit to us the first fully costed Business Plan to cover the period April 2026-March 2028 to serve as the basis for the Successor Licensee's budget before the Successor prepares its own Business Plan with effect from 1st April 2028.

Having carefully considered all responses, and in recognition of the time required to deliver necessary Licence changes and set up the CCG, we have decided to change our proposal and delay the implementation by requiring DCC1 to prepare and submit to us a costed Business Plan covering the period from Transfer Date (expected to occur in or before November 2026) to 31st March 2028. The Plan will be prepared in accordance with a Business Plan Guidance, the draft of which is published for consultation alongside this decision.

We intend to require DCC to make its submission to us no later than 31st December 2025 to ensure sufficient time for a consultation process and a final decision on the Successor Licensee's Allowed Revenue ahead of the Transfer Date. We also intend to require DCC to submit a draft version of the costed Business Plan to the Customer Challenge Group and to seek the Group's feedback no later than 29th August 2025. We have published a statutory consultation on interim Licence modifications to bring about these changes.

DCC1 will remain subject to ex-post Price Control arrangements until the expiry of its Licence, with the final *ex-post* Price Control expected in the first half of 2027. We are consulting on statutory changes to account for the Transfer Date in relation to the Price Control submission and other regulatory requirements.

Questions posed at consultation

Q16. 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?

Background

6.1 We said that, where possible, we would consider implementing some of the proposed changes early to drive the benefits of the new framework. Accordingly, we proposed (**Option A**) to require DCC1 to prepare and submit to us the first fully costed Business Plan to cover the period April 2026-March 2028. This

Business Plan would cover the final year of DCC1's operations, including the Business Handover period, and that it would then serve as the basis for DCC2's budget following the Transfer Date. We said that key benefits of this approach would be:

- Improvements to DCC1's planning, forecasting and customer engagement within the remainder of the Licence term
- Improved confidence in DCC's costs over the critical Business Handover Period
- An approved budget would allow the Successor Licensee to start operating on day 1, minimising a risk of disruption, and allowing sufficient time to commence the preparation of its own Business Plan to take effect from April 2028

6.2 We also considered and sought views on alternative options:

- To require DCC1 to prepare a Business Plan to cover the period from Transfer Date up to 31st March 2028 (**Option B**); or
- To make DCC2 responsible for preparing its own Business Plan from the Transfer date (**Option C**).

Summary of responses

6.3 We received general support for requiring a business plan before the Transfer Date to drive transparency and better forecasting. However, respondents were split on options A and B.

6.4 Those who agreed with our proposed approach noted the benefits to the transition to the Successor Licensee. A couple of respondents also noted the need for accountability with one expressly agreeing with our view that there was a risk of DCC1 not having sufficient vested interest to prepare a good-quality Business Plan for its successor unless it was, at least in part, also operating under it.

6.5 Several respondents expressly supported Option B citing concerns about Option A around:

- Time required to prepare the draft Business Plan and the impact of other Ofgem policy publications still in development, incl. guidance documents and consultation on the future role of DCC, on the business planning process
- Risk of insufficient time (3 months) for the Customer Challenge Group to be formed and to meaningfully scrutinise the draft Plan. One stakeholder highlighted that DCC would require time to reflect on the CCG's feedback prior

to final submission to Ofgem, thus further reducing the time available for engagement.

- The complexity of transition and split in Allowed Revenue between DCC1 and DCC2. A couple of respondents highlighted challenges in splitting of the Allowed Revenue approved for RY26/27 between DCC1 and DCC2. One noted that DCC2 would have a very short time to apply for a reopener to adjust its Allowed Revenue following the Transfer Date.
- Time available to Ofgem to arrive at the final determination by March 2026. One stakeholder drew attention to the timeline of the current *ex-post* process and questioned whether there would be sufficient time for DCC to reflect Ofgem's decision ahead of 1st April 2026.

Our decision

6.6 Having carefully considered all responses, we have decided to change our proposal and implement **Option B**. Consequently, we will require DCC1 to prepare and submit to Ofgem a costed Business Plan covering the period from the Transfer Date to 31st March 2028. The Plan will be prepared in accordance with a Business Plan Guidance, the draft of which is published for consultation alongside this decision.[38] To allow us to determine the efficient level of Allowed Revenue, the submission will also include Price Control information submitted in accordance with Regulatory Instructions and Guidance (RIGs). We will consult on the updated draft of the *ex-ante* RIGs in June 2025.

6.7 We intend to require DCC to make its submission to Ofgem no later than 31st December 2025 to ensure sufficient time for a consultation process and a final decision on the Successor Licensee's Allowed Revenue ahead of the Transfer Date.

6.8 We also intend to require DCC to submit a draft version of the costed Business Plan to the Customer Challenge Group and to seek the Group's feedback on the draft Plan at least 4 months prior to the due submission to Ofgem. This means that DCC will commence its engagement with the CCG no later than 29th August 2025.[39] As set out in further detail in Chapter 5, the CCG will be constituted under

[38] Ofgem (2025), Consultation on […] draft Business Plan Guidance. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance

[39] Please note that 31st August 2025 falls on a Sunday

the SEC and will operate on behalf of the SEC Panel under the Terms of Reference issued by Ofgem (subject to our consultation published alongside this decision).[40]

6.9 We will implement these policy conclusions via modifications to the current Licence. We have published statutory consultation on these and other Licence modifications alongside this document.[41]

Rationale for our decision

6.10 As set out in our consultation and recognised by many respondents, requiring the business planning process to commence in advance of the Transfer Date will help drive the benefits of the *ex-ante* regime and facilitate the transition to the Successor Licensee. However, we recognise the challenges highlighted by stakeholders in implementing Option A (*ie* from 1st April 2026). In particular, we agree that more time is needed to set up the Customer Challenge Group, including progressing the necessary Licence changes, and recruiting the Chair and members. We also agree that the need to determine an efficient split of the Allowed Revenue between DCC1 and DCC2 may introduce uncertainty about the budget available to the Successor Licensee at Business Transfer as our decision on the economy and efficiency of DCC1's expenditure between 1st April 2026 and the Transfer date will not be finalised until summer 2027.

6.11 Adopting Option B (implementation of the Business Plan from the Transfer Date) will still drive two of our stated benefits, namely improved customer engagement and forecasting commencing in 2025 with increased budget certainty for the Successor Licensee.

6.12 We noted two disadvantages to Option B. Firstly, there will not be complete certainty on the Transfer Date until after the appointment of the Successor Licensee, making it challenging for DCC1 to prepare a costed plan from an unknown date. However, now that we have carried out preparatory work for the selection process for the Successor Licensee[42] and have received further version of DCC's Business Handover Plan, we expect to formally set the Transfer Date using powers under LC 43.7(b) in summer 2025. Our current best assumption is

[40] Ofgem (2025), Consultation on draft Terms of Reference for Customer Challenge Group […]. www.ofgem.gov.uk/publications/draft-terms-reference-customer-challenge-group-and-draft-business-plan-guidance
[41] Ofgem (2025), Modifications to the Smart Meter Communication Licence for transition to ex-ante cost control and other changes required for Licence closure. www.ofgem.gov.uk/publications/modifications-smart-meter-communication-licence-transition-ex-ante-cost-control-and-other-changes-required-licence-closure
[42] Ofgem (2025), Expression of Interest in the new Smart Meter Communication Licence. www.ofgem.gov.uk/call-for-input/expression-interest-new-smart-meter-communication-licence

that the Transfer Date will occur before or in November 2026. On that basis, we will require DCC's submission by the end of 2025, allowing time for analysis and consultation throughout spring and summer 2026. This also means an additional month can be made available for DCC's engagement with the CCG.

6.13 The second risk of Option B is a lack of incentive on DCC1 to provide a good quality Plan and cost forecasts if DCC1 is not required to deliver against the Plan for any period of time. We are confident that this risk can be mitigated by enhanced engagement with the CCG and more time available for Ofgem analysis to robustly scrutinise DCC's cost forecasts and justifications. Our Business Plan Guidance will outline what evidence we will be looking for from DCC1 to support its submission. Subject to our statutory consultation,[43] the obligations on DCC in respect of the business planning process, including the production of the Plan, CCG engagement and submission to Ofgem, will be specified in the Licence.

6.14 While our decision means that the costs incurred during the Business Handover period (from 1st April 2026 to the Transfer date) will not be in scope of the Business Plan, DCC1 will remain subject to the existing Price Control regime. This means that all of DCC's costs until the Transfer Date will continue to be assessed and scrutinised by Ofgem, and capable of being disallowed if considered Unacceptable.

6.15 Through our statutory consultation we are proposing modifications to the Licence to facilitate the final Price Control. Assuming the Transfer Date is likely to occur in or before November 2026, it would not be practical to delay DCC's Price Control submission for the period from April 2026 to the Transfer Date until July 2027 as required by the Licence.[44] We are therefore consulting on a modification to bring the date of the final Price Control submission forward to a date no later than 3 months following the Transfer Date. This would allow us to complete the final Price Control before DCC Licence expires on 22 September 2027.

6.16 Table 6.1 below sets out the key dates related to this decision.

6.17 Finally, as the Transfer Date is expected to occur in the latter half of 2026, it is unlikely that the Successor Licensee would have sufficient time to submit an end-of-year reopener application in December 2026. We therefore do not expect the

[43] Ofgem (2025), Modifications to the Smart Meter Communication Licence for transition to ex-ante cost control and other changes required for Licence closure. www.ofgem.gov.uk/publications/modifications-smart-meter-communication-licence-transition-ex-ante-cost-control-and-other-changes-required-licence-closure
[44] LC32.4(b), LC37.3

annual reopener mechanism to apply in the first cycle. The Successor Licensee would still be able to submit an emergency reopener to account for any unexpected external shocks, urgent code modifications or new Mandatory Business designated by Ofgem or the Secretary of State where additional costs are unavoidable within the First Cost Control Cycle. Unless circumstances prevent it, the Licensee should consult with the Customer Challenge Group before submitting a reopener application.

Table 6.1 Overview of key dates

Date	Action	Basis
29th August 2025	Latest date on which DCC must share its draft Business Plan with the Customer Challenge group	Proposed LC 34A.12(a)
31st December 2025	Latest date on which DCC must submit its Business Plan and cost information to Ofgem	Proposed LC 34A.5 Proposed LC 34B.3
1st April 2026	Commencement of RY26/27	LC 1 Part A (Definitions arranged in alphabetical order)
31st July 2026	Latest date on which DCC must submit its Price Control Information for RY 25/26 (ending 31st March 2026) = penultimate *ex-post* Price Control submission	LC 32.4(b) LC 37.3
(indicative) September 2026	Ofgem publishes its decision on the *ex-ante* Business Plan and sets the Allowed Revenue for the Successor Licensee's First Price Control Period (from Transfer Date to 31st March 2028)	Assumption of the Transfer Date occurring in on before November 2026
(expected) by November 2026	Transfer Date = Successor Licensee solely responsible for the delivery of Authorised Business. RY26/27 ends for DCC1.	LC 43.7(b)
Transfer Date + 3 months	Latest date on which DCC1 must submit its Price Control Information for RY26/27 (ending on Transfer date) = the final *ex-post* Price Control submission	Proposed LC 32.4(b)(i)

Date	**Action**	**Basis**
28th February 2027	Ofgem published its decision on the RY25/26 *ex-post* Price Control = concludes the penultimate RY	Precedent
(indicative) August 2027	Ofgem published its decision on the RY26/27 *ex-post* Price Control = concludes the final RY	End of the Licence Term in September 2027