Consultation on DCC Review – Process for Determination of Allowed Revenue

E.ON Next Response (February 2025)

General Comments

E.ON welcome the opportunity to respond to the latest consultation on processes and principles for the to-be DCC Licensee (DCC2), which we believe provides additional clarity in several key areas.

Several processes appear to rely on the setup of the proposed Customer Challenge Group, and the timescales outlined raise several significant risks. Appointing the independent chairperson and core industry representatives and defining the Terms of Reference for the Customer Challenge Group in the four months to June 2025 appears very challenging. Where there are delays in doing so, this could impact the appointment of relevant external experts supporting the group ahead of Ofgem's timetable for reviewing the DCC's draft Business Plan. Overall, we are concerned that this could lead to a situation where the Customer Challenge Group's first report is called into question or disputed.

The Customer Challenge Group's work is also reliant on the publication of other guidance or publications. Where publication of the finalised version of 'DCC Business Plan Guidance' or decisions on the 'DCC's Future Role' consultation are delayed, this would materially impact on delivery by the Customer Challenge Group.

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?

We agree.

Moving to an ex-ante model will drive the DCC to improve the planning, scoping and resourcing of its activities. In turn, we believe this will support improved cost control from the DCC.

As Ofgem have outlined, an ex-ante model does potentially increase cost uncertainty risks. We believe these risk factors can be appropriately addressed through 'uncertainty mechanisms', provided the rules and governance around the use of these mechanisms is robustly defined and controlled.

The ex-ante model will only function well if the DCC is obligated to share supporting evidence and information in an efficient way, but also to the appropriate level of detail to support scrutiny. Historically, the DCC has cited commercial or contractual confidentiality as a reason for limiting the sharing of key information (e.g., on penalty clauses with its External Service Providers), even though this could support industry decision-making. Under the ex-ante model, DCC will need to be suitably obligated to provide detailed evidence to relevant industry groups in a way that supports decision-making. It is also crucial that DCC demonstrates it has evolved its business plans having considered feedback from funding DCC Users or stakeholders.

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?

Reviewed in the round, Option B is more likely to deliver the expected benefits in a cost effective way.

Option A – Annual Cycle

Where Option A is adopted, it would impose additional resource demands on the DCC, energy suppliers, and industry stakeholders due to the requirement to review detailed submissions on an annual basis. We agree with Ofgem's assessment that an annual cycle regime would not ensure a longer term link between the DCC strategy and its cost forecasts. It is conceivable that an annual cycle regime could also increase costs to DCC Users in different areas, with DCC increasing its staff headcount to deliver the planning and engagement requirements resulting from this option.

Option B – Multi-Annual Cycle

Different risk factors potentially emerge with the choice of Option B.

The multi-annual cycle regime increases the risk that DCC will over inflate its forecasts to address potential risks or uncertain costs in future years. Conceivably this risk can be addressed, provided the DCC is obligated to provide suitable and detailed evidence (i.e., it cannot withhold information due to contract confidentiality, etc.), and evolve its Business Plans following feedback from stakeholders.

Recognising that 'uncertainty mechanisms' would need to be introduced under Option B, we believe that the design of, and governance around, these mechanisms will be crucial. For example, we would expect there to be certainty over the DCC activities or cost categories where 'uncertainty mechanisms' would be permitted. We also believe that the triggers or factors that allow the DCC to initiate the 'uncertainty mechanisms' should be appropriately defined, along with the stakeholders who approve the use of the mechanism.

Additionally, it is unclear how the DCC would forecast costs for mandated changes requested by either DESNZ or Ofgem within the multi-annual cycle, but after the budget process has concluded. This also potentially applies to the scoping and delivery of SEC Modifications. These and other factors increase the likelihood of the 'uncertainty mechanisms' being initiated on a regular basis, with the resulting workload demand on DCC, funding DCC Users and stakeholders. We would welcome additional clarity on this topic area.

While we expect that DCC will submit proposals on how it would implement Option B, it is important to note that these have not been shared with funding DCC Users for review or comment. On that basis, E.ON cannot confirm if any of the DCC's proposals fully or partially address Option B risks, or even introduce new risks and overheads to DCC Users.

Three-year Cycle

Historically, the inconsistency of DCC's cost forecasting and lack of supporting evidence has been questioned through the annual DCC Price Control process. While we recognise the ambition to move to a three-year cycle from April 2028, this timeframe is relatively close to the expected transition to the incoming DCC2 Licensee. Rather than targeting a precise date for introducing a three-year Business Plan cycle at this stage, an alternative approach could be to define a timeframe within which the move would occur. Moving to a three-year cycle within the first five years of the DCC2 Licence signals a clear intention, allowing DCC and industry the time to address process and risk factors associated with the move to ex-ante and transition to the DCC2 Licensee. Incentives could be used to encourage the DCC to accelerate its readiness and transition to a three-year Business Plan cycle.

Current DCC Business Development Plan

Although the DCC's Business Development Plan provides an annual status update, the value of the document is increasingly limited. While the DCC does consult on the document, it is unclear how DCC User requirements and feedback is considered during the preparation or finalisation of the proposals the document contains. Overall, we believe that the content of the Business Development Plan should be integrated into the structure of the to-be DCC ex-ante Business Plan.

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

Overall, we agree with the principles outlined in the consultation document.

While it is reasonable to expect the DCC to provide accurate forecasts and supporting evidence under the ex-ante regime, this may vary depending on the status of a contract, new service procurement, or change activity. Routinely disallowing cost estimates presented by the DCC for future activities or programmes could result in impactful unintended consequences. The proposed Customer Challenge

Group should be permitted and supported to review and evaluate DCC's cost estimates, and ultimately express opinions on these elements in their report to Ofgem and industry. Provided the Customer Challenge Group is given access to relevant backing data by the DCC, this additional scrutiny should help inform Ofgem's subsequent decision-making and any requests to initiate the 'uncertainty mechanisms' at a later point.

Where DCC routinely and repeatedly fails to provide evidence in a structured or sufficiently detailed way, then this should be tackled through the various mechanisms available to Ofgem. Adopting a range of mechanisms (e.g., renumeration of senior executives), rather than solely resulting in a cost disallowance could drive the expected behaviour and avoid unintended consequences to DCC's operational services.

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

While limited fungibility offers benefits, it does increase the risk that DCC will become reliant on use of the proposed 'uncertainty mechanism(s)'. Any over-reliance on these mechanisms would introduce operational inefficiency and process overheads, including externally to the DCC (e.g., Customer Challenge Group, industry forums, and Ofgem).

We expect that DCC will need to procure specialist advice (e.g., legal, tax, etc.) at relatively short notice during each Business Plan period. Due to their nature and the underlying triggers, these costs will be difficult to predict or forecast, and delays to accessing such specialist advice could have significant financial impacts in the short to medium term. The fungibility arrangements proposed by Ofgem will need to account for uncertainty and allow DCC to quickly access appropriate funding for agreed specialist advisor categories where there is suitable justification. The consultation document does not appear to clearly clarify this area.

Ofgem have proposed no fungibility for External Cost categories, which could result in unintended consequences in certain areas. In the case of major programmes, preventing the DCC from deviating from its line-by-line submissions helps prevent cost overruns, but is likely to force the DCC to delay the implementation or de-scope service elements. While this may be appropriate on certain programmes, on others this could result in additional Charge Request costs or in-life issues on operational services at a subsequent point. The costs of the resulting remedial actions could conceivably exceed the original project cost overrun. Provided the Customer Challenge Group maintains an oversight role, we believe that limited fungibility at a programme level with clearly defined and strict boundaries may have merits.

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?

As a funding DCC User, E.ON is looking for greater certainty on DCC's costs and its recharge. Reducing the contingency percentage from 5% reduces the sum that DCC can withhold from funding DCC Users and helps strengthen the controls around the use of these funds.

As we have limited visibility on DCC's financial arrangement, we cannot comment on whether a 2% contingency would result in risks to its Mandatory Business. We are reliant on Ofgem's assessment of DCC's reported monthly cash balances over RY23/24.

Ultimately, DCC should be discouraged from becoming reliant on use of this contingency.

We do not see any overwhelming benefit of cash versus accruals-based reporting. Overall, we would be generally supportive of including accruals-based reporting in addition to cash-based reporting, but not as a replacement.

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

Provided appropriate regimes are implemented to govern the use of the Uncertainty Mechanisms, then we agree with the principles outlined and the alignment with specific cost categories. Efficient and timely operation of the 'uncertainty mechanisms' will be crucial, as any delays in decision-making have the potential to impact DCC's operational activities and programmes. Ultimately delayed decision-making could impact services relied on by energy consumers.

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?

Overall, the criteria defined appears appropriate.

The effectiveness of the reopener process relies heavily on DCC's willingness to efficiently share detailed information on contributing factors, including insights that it has historically deemed commercially confidential. Where the DCC is either unable or unwilling to share with the proposed Customer Challenge Group detail (e.g., due to contractual confidentiality), then this would undermine the reopener processes.

As Ofgem have identified, there is a risk that the DCC could become unduly reliant on the 'Emergency Reopener' mechanism and use this route to secure additional funds. Linking use of the 'Emergency Reopener' to other DCC policies and incentives (e.g., senior executive renumeration) could help drive appropriate cost forecasting and proactive assessment or treatment of risk factors.

Where an 'Emergency Reopener' request is raised by the DCC, then they should be required to robustly evidence contributing factors, relevant risk assessments, and mitigating actions previously implemented. While we recognise force majeure events occur, requiring DCC to publish detailed evidence will enable funding DCC Users to validate the effectiveness of DCC's governance controls.

Q8. Do you agree with our proposal to require that all of DCC's Authorised should be carried out on a not for profit basis?

We remain concerned that the proposed 'not for profit' basis is likely to restrict the number of bidders for the DCC2 Licence. Competitive tension between bidders in the process is more likely to realise Value for Money and innovative proposals.

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?

Based on the limited information currently published, we agree.

Requiring the DCC to formally apply for ringfenced revenue enforces a rigorous governance regime, allowing funding DCC Users and industry stakeholders to formally scrutinise DCC's proposals.

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?

We agree with the proposals to remove the ECGS mechanism, and to keep the regime under review during the first price control and Business Plan cycles. DCC should be identifying and working to deliver cost savings on behalf of energy consumers and funding DCC Users as part of its routine business activities.

Historically, DCC1 has appeared to rely heavily on Comms Hub re-financing for savings, even though it manages a much broader range of services and providers. It is realistic to assume that DCC1 could have sought out cost savings in other areas and *should* have delivered on these during its licence term.

Q11. What are your views on the proposed measures to be considered as part of any targeted incentive model on senior managers and staff?

At a headline level, the measure categories appear appropriate. Ahead of further detail being published, we have highlighted specific comments below.

Weighting of Measures

The consultation document does not propose if, or how, the proposed measures would be weighted in the overall incentive model. While DCC Customer satisfaction is important, this potentially warrants a lower weighting compared to other factors which could materially impact energy consumers (e.g., DCC Performance and Delivery). Further clarity on proposed weightings would be welcomed.

Customer Survey

The effectiveness of this measure is broadly determined by the survey topics and the question design. Where the Customer Survey is weighted towards certain topics, this could conceivably benefit the DCC. We would expect the SEC Sub-Committees to have opportunity to help shape the structure and contents of a survey, should this measure be taken forward.

Performance and Delivery

Practically, the performance of DCC's services is directly linked to its Contract Management functions and their delivery. As evidenced by the ongoing CSP North underperformance, DCC's failure to robustly contract manage underperforming External Service Providers can lead to operational issues over the medium to long term. The lack of tangible progress on CSP North / Arqiva issues has meant that energy suppliers have directly incurred additional costs (e.g., due to failed installation appointments; investigations into non-operating meters; repeated remedial actions).

Assessing the effectiveness of DCC's Contract Management activities solely through the 'Cost Management' measure would likely miss other relevant operational performance-related factors or insights. We would welcome this element being reconsidered by Ofgem.

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?

We support Option C proposed by Ofgem. Overall, the SEC-led governance forums should hold key roles in the DCC cost control process, including the review and challenge on the DCC's Business Plan.

However, we are concerned that the remit of the proposed SEC Customer Challenge Group could overlap with existing SEC-led bodies (e.g., the SEC Panel, or SEC Operations Sub-Group). This can be addressed through suitable Terms of Reference, membership requirements, and clarity on reporting lines.

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

We disagree and believe the proposed membership could restrict scrutiny of the DCC's Business Plan proposals. Introducing a broader and larger representation from the supplier and network operator constituencies is likely to ensure that the DCC is scrutinised on the broadest range of operational topics, risks, and factors.

Limited Visibility of Industry Issues

Different operational risks and issues could materially impact elements or the direction of the DCC's Business Plan. Typically, these sensitive topics are discussed under a TLP:RED marking at the SEC Panel or other SEC Sub-Committees. Where membership of the Customer Challenge Group is limited, then the group's ability to consider and assess these operational factors, their effects, or their treatment could be negatively impacted.

Representation by Core Members

The scale of DCC costs funded by Large Supplier parties means that organisations will rightly expect to receive feedback on, and provide input to, discussions at the Customer Challenge Group. However, the limited membership model currently proposed by Ofgem will make this input extremely difficult. This, combined with the Business Plan review timeframes and the confidential nature of the material under discussion at the Customer Challenge Group is likely to unduly limit scrutiny of the DCC's proposals.

Additionally, it is unclear if the core members would be required to share insights or seek additional constituency input ahead of the Customer Challenge Group report being prepared and submitted to Ofgem. Where the report output is deemed confidential, areas of concern or disagreement may not be fully visible to other constituency members, especially redaction of content is used on key topics.

A situation where Large Suppliers and Distribution Network Operators are expected to fund DCC's operations without the opportunity to directly scrutinise the factors contributing to its business plans would not represent any material improvement on the current DCC1 arrangements.

Sourcing Specialist Skills or Support

Paragraph 5.36 suggests that the Customer Challenge Group will engage with the DCC "*…for at least 3 months prior to DCC's submission to Ofgem…*". Where the DCC is required or allowed to restrict the engagement timeframe, this is likely to limit the level of scrutiny. For example, in three months it could be difficult for the Customer Challenge Group to source, onboard, and brief specialist expert resource (e.g., legal, academia, economics, etc.), and secure their valuable opinion.

While we recognise the desire to minimise the industry overhead, there needs to be an appropriate timeframe allocated to scrutinising the DCC's Business Plan approach and outputs.

Customer Challenge Group – 'Corporate Memory'

Given the enduring role of the Customer Challenge Group, it is essential that the membership maintains a 'corporate memory' of DCC's approach, proposals, and areas warranting detailed scrutiny over several years. While rotating members can bring fresh or innovative viewpoints, frequent replacement of members could undermine the scrutiny of the DCC over the medium to long term. The membership model and supporting policies need careful consideration to protect this 'corporate memory'.

SEC Oversight

While we agree that the proposed Customer Challenge Group should sit under the SEC structure, the consultation document does not fully clarify interactions or reporting requirements to other SEC forums. Although oversight from the SEC Panel could be beneficial in certain circumstances, this could inadvertently constrain the approach and work of the Customer Challenge Group. We are also concerned that the membership of the SEC Panel and Customer Challenge Group could be very similar, further limiting the breadth of scrutiny over DCC's Business Plan. Ofgem could look at restricting membership to ensure that SEC Panel representatives cannot also be elected as core members to the Customer Challenge Group. Finally, while the SEC Panel could be involved in the appointment of the Customer Challenge Group Chairperson, it is important this appointee is allowed to operate independently of the SEC Panel.

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

We agree with the proposed scope areas in the consultation document, and suggest that the following are also considered:

- How the DCC's Business Plan proposals address existing operational issues (e.g., medium / long term technology issues; or underperformance by a DCC External Service Provider).
- Explanation on any major projects, programmes, or initiatives that have been specifically discounted by the DCC or postponed to later years, including the rationale for doing so.
- Key DCC1 to DCC2 transitional risks, projects, or remedial activities in the years immediately following the business handover period.

We support Ofgem's proposals for issue escalation. However, core members should also be allowed to seek the views of their constituency members on topics where disagreements exist.

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

We agree that the Customer Challenge Group should be required to deliver an independent report, outlining their assessment of the DCC's Business Plan. The structure of the report should broadly align with the suggested areas of focus defined in paragraph 5.35 of the consultation document, plus any relevant additional areas suggested to Question 14 through this consultation process. However, the DCC must be required to formally demonstrate how it has considered feedback from DCC Users and the Customer Challenge Group, <u>and</u> practically refined or evolved its Business Plan to address this.

Given that core membership could be limited, we would expect the independent report to be published alongside the DCC's Business plan document. While DCC is expected to request redaction of certain content, this should be kept to an absolute minimum to allow for comprehensive review by funding DCC Users and stakeholders. As DCC has historically cited commercial confidentiality reasons for restricting the sharing of information, it is likely that Ofgem will have a crucial role in approving or rejecting DCC's requests to redact certain content.

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?

We have considerable concerns around the selection of Option A as the preferred model. We believe the timescales associated with the implementation of this Option A are very challenging and could result in a range of transitional, operational and reputational risks.

Establishing the Customer Challenge Group, appointing the independent chairperson and core industry representatives, and defining its Terms of Reference in the four months to June 2025 appears extremely challenging. It is unlikely that the identification of relevant external experts, let alone their selection and appointment could be achieved ahead of the DCC's draft Business Plan being published in early July. Where the Customer Challenge Group setup is rushed and / or cannot be completed ahead of the target July date, then this could materially impact the level of scrutiny of the DCC's Business Plan in 2025. Additionally, the Customer Challenge Group will be expected to complete its work over the school summer holiday period, potentially impacting the availability of members. We are concerned that this could lead to a situation where the Customer Challenge Group's first report is called into question or disputed. This could damage the standing of the group at an industry level very early in its operation.

Under Option A, Ofgem would expect submission of DCC's Business Plan by 30 September 2025. This relies on the DCC and Customer Challenge Group having visibility of the Ofgem's Business Plan Guidance in early 2025. Although the consultation process on this guidance document is imminent, it is reasonable to assume the final version will be published in Q2 2025. This, and timescales for other publications (e.g., DCC Future Role) are likely to materially influence and impact DCC's ability to develop its initial Business Plan, and the resulting Customer Challenge Group activities.

The current uncertainty around the DCC1 to DCC2 Business Transfer Date could see other risks crystallising later in the transition process. DCC’s costs are unlikely to be incurred on a uniform basis, meaning appropriate processes would need to be established. The submission of evidence and determination of Allowed Revenue between DCC1 and DCC2 could be onerous and open to challenge. We are also concerned that this could lead to DCC2 having to initiate re-opener applications in the period immediately after the Business Transfer Date. Each of these elements could divert critical resource immediately around the transfer date, impacting delivery of key programmes or operational services.