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

EDF is the UK's largest producer of low carbon electricity. EDF operates low carbon nuclear power stations and is building the first of a new generation of nuclear plants. EDF also has a large and growing portfolio of renewables, including onshore and offshore wind and solar generation, as well as energy storage. With over five and a half million electricity and gas customer accounts, including residential and business users, EDF aims to help Britain achieve net zero by building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

EDF is committed to supporting all its customers to save cash and save carbon. It is why we have completed a successful migration to the Kraken platform. It is why this winter we have made an additional £29m of support available to help our customers most in need in response to the ongoing Cost of Living crisis. This commitment to our customers is reflected in our Trustpilot score recently increasing to 4.7 out of 5.

We broadly support the proposals for the design of the ex-ante cost control mechanism for the new DCC Licence. We have long argued for a move to an ex-ante regime as it will not only provide DCC Users with cost certainty and stability, but it should also drive DCC to improve its forecasting and become less reactive to developments in the market.

We agree that the initial cycle for the new cost control should be two years, and with the inclusion of Uncertainty Mechanisms to enable DCC to react to unforeseen changes that impact its cost forecasts for that period. However, we expect the use of these Uncertainty Mechanisms to be an exception, given the maturity and stability of DCC services the likelihood of real 'shocks' that require the costs to be reforecast should be low.

We agree with the principle behind the proposed customer challenge group, and that DCC Users should be involved in scrutinising and challenging DCC's Business Plan. This group must have a substantive role in the process and not simply become a 'talking shop'. We are concerned that there are no explicit requirements on DCC or on Ofgem to directly address the points of concerns raised by the group or to act on its recommendations. The membership of this group, must also have the right level of technical expertise required to conduct the level of scrutiny that we would expect. We urge Ofgem to, therefore, reconsider its proposals for the composition and vires of customer challenge group to ensure that it will truly add value to the cost control process.

We also remain disappointed that Ofgem has not reconsidered its decision to implement a 'not-for-profit' model for the new Data Communications Company (DCC) licence. We continue to disagree that a not-for-profit model is the right approach and that it will deliver the right outcomes for DCC Users. In our view a for-profit model, with adequate controls such as a regulated rate of return and a robust incentive regime, is the best mechanism for delivering high performance at a reasonable cost by placing commercial incentives on the Licensee to achieve those outcomes. We urge Ofgem to reconsider proceeding with a for-profit arrangement, or at least considering allowing both approaches as part of the bidding process for the new DCC Licence.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Paul Saker or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely

Denise Willis
Senior Manager of Industry Change

Attachment

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

EDF's response to your questions

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?

EDF agrees with the proposal to implement a full ex-ante cost regime for the new DCC Licence that requires all DCC costs to be forecast and approved upfront. This will not only provide DCC Users with cost certainty and stability, but it should also drive DCC to improve its forecasting and become less reactive to developments in the market.

We agree with Ofgem's view that DCC costs should sufficiently stable to enable those costs to be accurately forecast, and that the inclusion of uncertainty mechanisms such as reopeners will account for any unforeseen circumstances. We also agree with the proposal to require DCC to submit a fully costed Business Plan that sets out the forecast costs, and the assumptions that have driven them.

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?

EDF agrees with Ofgem's proposal that the initial length of the cost control cycle should be two years, subsequently moving to a three-year cycle if feasible. A longer cost control cycle is desirable as it provides greater long term cost certainty to DCC Users, however the administrative burden for DCC, Ofgem and DCC Users associated with reopeners also needs to be minimised.

We propose that the Business Development Plan be discontinued as a separate document under a two-year cycle, and instead that the content of the Business Development Plan is consolidated with the new Business Plan. There is only value in retaining the Business Development Plan as a separate document under an extended cost control cycle, as DCC's long term strategy will need to be updated more frequently than every three years.

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

EDF agrees with the proposed approach to determining whether DCC's forecast costs are economic and efficient. It is vital that DCC provide robust and detailed evidence that supports their cost forecasts and enables Ofgem to undertake a detailed assessment of those costs. We urge Ofgem to consider what lessons can be learnt from the current cost control process, especially regarding the submission of acceptable justifications for DCC costs, to ensure that the new ex-ante process operates as efficiently as possible.

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

EDF recognises that some level of flexibility will be required within DCC's Allowed Revenue to minimise the need for reopeners while still controlling costs.

We agree with Ofgem's proposal that DCC's External Costs should not be afforded any level of flexibility. As noted in the consultation document, External Costs should be stable and predictable costs; allowing DCC the flexibility to match overspend in one area with underspend in another could cover up poor DCC management of those External Costs.

We agree that DCC should be afforded some level of flexibility over its Internal Costs within its overall budget, and that this flexibility should be limited to resource costs and costs correlated with resourcing. DCC is likely to need to be able to flex its spending in these areas to meet the immediate needs of its customers.

While we support affording DCC a level of flexibility, DCC must always be able to explain and justify any variance, even where it is within a pre-agreed tolerance. Even where a variance does not result in an overspend overall, DCC needs to be accountable for the accuracy of its forecasts at a project level as well as an overall level.

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?

EDF agrees that a contingency of 2% of DCC's Allowed Revenue should be sufficient based on the information provided in the consultation. As noted in our response to Question 4, we recognise the benefits of enabling DCC to call on a level of contingency without a formal reopener; however, 5% of Allowed Revenue is more than we think should be allowed without a formal approval process.

While DCC should have the discretion to use that 2% contingency, it must always be able to explain why that use was necessary, and what actions it is taking to avoid a similar situation arising in the future. We agree that DCC should be required to explain how and why it has used any surplus as part of the reopener process.

While we agree with the inclusion of a contingency in the cost control arrangements, it should still represent an exception; we would not expect to see it called on in full in every cost control cycle. Continual use of the contingency would suggest a more fundamental issue with the accuracy of DCC forecasting, or the predictability of its costs.

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

EDF agrees that Uncertainty Mechanisms are necessary within an ex-ante cost control process. However, we expect the use of them to be minimal; the number of truly unforeseeable events should be very low. Many of the examples quoted in the consultation document should be able to be foreseen and accounted for within a two-year cycle.

At the same time, DCC must be able to be agile and respond quickly to external factors where necessary. The proposed Uncertainty Mechanisms should not prevent DCC from being able to take urgent actions where required.

Where Uncertainty Mechanisms are used by DCC any changes in DCC charges that result must be reflected through to the Default Tariff Cap (the 'Price Cap') as quickly as possible, so that suppliers are able to recover these additional charges on a timely basis and are not left 'out of pocket'.

Regarding the proposed Uncertainty Mechanisms:
- Automatic adjustment – we agree that changes in pass through costs and some elements of inflationary and volume adjustments should be automatically allowed as they are not within DCC control, and a reopener would involve an unnecessary burden on all parties. However, the triggers for these automatic adjustments need to be clearly defined and visible to DCC Users.
- End-of-year reopener – we agree that this Uncertainty Mechanism may be required but would expect that the level of contingency proposed, combined with a two-year cost control cycle, should minimise the need for such a reopener. Where such a reopener is required we agree that this should be undertaken on a budgeting basis i.e. Ofgem needs to approve the additional revenue before DCC is allowed to increase its charges.
- Emergency reopener – we agree that this is required and the DCC needs to be able to respond to changes in an agile way. However, the criteria for what constitutes an emergency need to be set in a way that ensures that DCC does not bypass the end-of-year process and the need for proper planning by treating every change as an emergency.

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?

As noted in our response to Question 6, EDF agrees that Uncertainty Mechanisms are necessary within an ex-ante cost control process. However, we expect that the use of these mechanisms, and especially reopeners, should be an exception rather than a routine part of the cost control process. Frequent reopeners would undermine the value of an ex-ante cost control and indicate a deeper issue with DCC costs.

We expect that levels of unforeseen change, and especially Smart Energy Code (SEC) driven change will be reduced by new Code Governance mechanisms, such as the use of the Ofgem Strategic Direction to set a direction of travel for SEC changes. The Strategic Direction should enable better long-term planning of industry changes that align to a strategic goal and reduce the sorts of piecemeal SEC changes that tend to result in 'unexpected' DCC costs.

The key area of uncertainty is the extent to which the Department for Energy Security and Net Zero (DESNZ) will continue to use the powers under Section 88 of the Energy Act 2008 and direct code and licence changes that impact DCC costs outside of the standard code governance mechanisms. These powers are currently only in place until 2028; however they have been extended previously.

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?

No.

EDF is disappointed that Ofgem has not reconsidered its decision to implement a not-for-profit model for core services in the new DCC licence. As detailed in our response to Ofgem's Phase 2 consultation on Governance and Centralised Registration Service arrangements, we do not agree that a not-for-profit model is the right approach. In our view a for-profit model is the best mechanism for delivering high performance at a reasonable cost, by placing commercial incentives on the Licensee to achieve those outcomes. The proposals set out in this consultation seek to replicate the effect of those commercial incentives, but in our view will not achieve the same outcomes.

We urge Ofgem to reconsider proceeding with a for-profit arrangement, or at least considering allowing both approaches as part of the bidding process for the new DCC Licence.

We do, however, agree that in the context of a not-for-profit DCC that all DCC's Authorised Business should be carried out on a not-for-profit basis, not just the core services. We agree that there is very limited scope for DCC to provide non-core services, and that creating incentives to do so would provide a distraction from delivery of the core non-profit service.

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?

EDF agrees that it is not clear what valued added services could be developed by DCC. The mechanisms to enable elective and valued added services have existed since DCC started operation, but none have been identified. Ultimately, DCC should be delivering the same high quality smart metering communications service to all its users, the added value should come from how those Users utilise those common services to provide attractive products and propositions to their customers, not from differentiation in the services themselves.

While the scope for valued added services seems to be very limited, we don't want to close the door where opportunities for synergies and cost reductions exist. We agree that DCC should be able to apply for ringfenced funding, however this cannot be on a speculative basis. DCC would need to have a robust proposition and a clear view of the benefits case before considering development of commercial or innovative services. Some of the work undertaken by the current DCC licensee in this area in the past has been speculative and not agreed with DCC customers, resulting in the costs of that activity being disallowed by Ofgem through the ex-post price control.

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?

This is an example of the drawbacks of a not-for-profit model, as noted in the response to Question 8. The ECGS process places a direct financial incentive on DCC to reduce costs as it receives a share of the benefit, the same effect cannot be replicated in a not-for-profit model.

We agree that the ECGS mechanism has minimal value in a not-for-profit model and should be removed. However, we do challenge the underlying assumption that the Business Plan process will always result in the lowest possible cost in the first place, and that Ofgem will only approve the most efficient costs. We will need to review how well this upfront process works in terms of controlling costs before we can understand whether an additional mechanism is required to incentivise the further reduction of those costs.

We note the potential for perverse incentives in this area; for example, if the expectation is that a 2% cost reduction will be achieved year on year, there could be an incentive for DCC to artificially inflate the Business Plan by that amount to enable these savings to be achieved. As noted above, it is not yet evident that Ofgem would be able to identify and prevent relatively small amounts of costs as not being economic and efficient. Additionally, any measurement of savings or efficiency needs to be set against a firm baseline. If DCC costs increase for reasons that are outside of its control it may not be reasonable to expect the 1-3% saving noted, and to penalise staff for this not being achieved.

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

This is a further example of the drawbacks of a not-for-profit model, as noted in the response to Question 8. The for-profit model places a direct financial incentive on DCC to achieve high performance as its profit margin is placed at risk should it fail to do so.

While EDF broadly agrees with the categories of measures set out in the consultation, we do not agree that these should have equal priority. These measures would need to be appropriately weighted to reflect the priorities of DCC Users.

In our view, performance and delivery must be the key criteria for any incentive regime for the DCC. It is the highest value item for DCC Users and their customers and is the key driver for DCC customer satisfaction. The core purpose of DCC is to provide a robust, secure, and efficient communications for smart meters, ensuring as many meters as possible can be connected to that network and can send and receive communications when required. Cost control is the second priority for DCC Users – the weighting of these items in any incentive regime should focus strongly on these two key areas.

We are concerned that Ofgem seems to view customer satisfaction as the primary metric that should be used to measure the success of DCC; for example it is always listed first in the list of measures in this consultation. While it is important that DCC engages with its customers, that should be an intrinsic part of delivering high system performance, not something separate.

The current DCC incentive regime is clearly not working, as demonstrated through the current Operational Performance Regime (OPR). DCC can achieve its operational targets under the current scheme and retain its baseline margin, however the consensus amongst DCC Users is that the DCC is performing poorly, especially in the Northern region. There needs to be a better way of measuring DCC performance that ensures its incentives are aligned to the real-world experience of DCC Users and their customers of DCC services, which is not the case today.

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?

EDF agrees with principle of having input into the Business Planning process from DCC's customers. We do, however, have some concerns about the proposed customer challenge group and its role in the process. If this group is to exist as a separate new group, it must have a substantive role in the process and be able to materially impact the outcome. DCC also needs to be open to the challenges posed by the customer challenge group as part of the engagement process. It is not clear from the consultation that this will be the case, and a risk that this could become simply a 'talking shop' as a result.

While the group will engage with DCC on its business and will produce a report for Ofgem, neither DCC nor Ofgem are bound to specifically address the feedback provided to them by the group. As an example, the consultation notes only that the group and DCC will '*engage*' on the draft plan, and that the group's report will be '*taken into account during Ofgem's assessment of DCC's submission*'. That is not sufficient. Instead, both DCC and Ofgem should be obliged to specifically address the feedback provided by the customer challenge group, and if changes are not made because of that feedback, Ofgem must set out why.

To be able to carry out a substantive role, the customer challenge group needs to have the relevant expertise to understand and challenge DCC's Business Plan. Given the highly technical nature of DCC operations it is not clear that the proposed membership of the group, largely made up of representatives of DCC Users, would have the relevant expertise in areas like IT systems and communications. Without that expertise being part of the group, or accessible by the group, it is unlikely that it will be able to carry out proper scrutiny of the Business Plan. As well as technical expertise, the group will also need access to detailed information about costs. It will need to be able to view the detail behind the Business Plan and the cost forecasts – which might be subject to confidentiality provisions where it is commercially sensitive. We are unsure how this confidential information will be able to be scrutinised by the group.

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

As noted in our response to Question 12, EDF is concerned by the proposed membership model. While we agree with the principle of DCC Users having representation on the group, the members of the group will need to have a detailed technical understanding of DCC's operations to play a substantive role in the Business Planning process and challenge DCC's forecasts. We need clarity on how the core members would be appointed (for example through elections, or a selection panel) and how they will ensure that they have the relevant expertise to be able to carry out their role.

We are also concerned that many of the seats on the group are proposed to operate on a rota basis. This re-enforces our concern that the group could become a 'talking shop', as there is no consideration of the need for continuity and a building of knowledge over time for the group to be effective.

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

EDF agrees with the proposed scope, focus and responsibilities of the group. We also agree that there needs to be a mechanism to escalate to Ofgem where there is a disagreement between DCC and the group during the engagement process.

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

EDF agrees that the output of the group should be a report detailing areas of concern with DCC's Business Plan. This report should be publicly available and should be sent directly to Ofgem rather than being published by DCC alongside its Business Plan. This will help to ensure that the report is viewed as an independent assessment of the Business Plan.

As noted in our response to Question 12, Ofgem should be required to specifically address the points raised in the report and explain any actions taken, and not just '*draw on the Report's findings and recommendation when carrying out its review of DCC's submission*' as noted in the 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?

EDF agrees with the proposed implementation approach and with the requirement for the first Business Plan to be published by the current DCC Licensee. This will facilitate the transition to the new Licensee, it should also make the cost forecasts for the remaining period of the current DCC licence more robust, which will help the current price control process.

We recognise the risks of this approach and the need to progress relatively quickly to achieve the timescales set out in the consultation, especially if the customer challenge group is going to be established with a suitably experienced membership.

EDF
February 2025