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By Email Only

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Dear Jakub,

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

Thank you for the opportunity to respond to this consultation. We are broadly supportive of moving to an ex-ante cost control framework, however we have significant concerns on the proposed approach in terms of the timeline for transition from ex-post to ex-ante, and managing the uncertainty and risks of forecasted costs.

Cost control scope & cycle

We understand that commencing the ex-ante price control with an initial two year framework may reduce the inherent risks in the transition from the current ex-post price control. However, there should be set evaluation periods to review and refine this cycle based on the evidence of outcomes and if the cycle duration needs to be re-evaluated.

We note that in setting the price control period to include the ex-post final year with an ex-ante first year, there are set dates that will drive the creation of the first detailed business plan that may result in unintended consequences. These milestones will drive delivery of the first combined business plan and yet these may not result in the desired stability or the certainty of costs that would be allowed. Given this approach, has there been a view developed by Ofgem to decouple the final ex-post price control and to commence ex-ante on a two year cycle? This would allow for additional transition time and preparation for both DCC and the CCG to evaluate a future proposed detailed business plan prior to Ofgem's approval.

In addition, given the timing of the forthcoming Ofgem consultation on Roles and Governance suggests there is an area of risk between the proposed dates for the establishment of the CCG and DCC commencing detailed business planning. We note this particularly applies when there are outstanding critical policy decisions still to be communicated by Ofgem for both this consultation, and the outstanding decisions for the Future DCC framework.

Managing Risk and Uncertainty

There are areas where we seek clarification to further understand how these would be treated by Ofgem in the proposed process lifecycle.

Large new contracts: the business case process will be overseen by Government and requires DCC to seek non-objection from the Secretary of State for procurements with a value over £10m. How will non-objected procurements be incorporated into the cost cycle in the event this occurs post *ex-ante* approval by Ofgem? In particular, where this may include requirements set by Government post the start of the Ofgem price control cycle and the timings may be outside of the proposed re-opener process.

Evidence of customer engagement on the requirements, scope and costs for contractual changes (Change Requests/Project Requests): care must be taken given the cost variance we have seen between SEC Mods that are at the Preliminary Assessment versus Impact Assessment stage. It must also be noted that the DCC requires funding to generate Impact Assessments, that are required to input into the detailed business plan, but may be unavailable at the time of the business plan formulation.

Depending on the stage of the Smart Energy Code Modification process, there may be several mods that require input into a re-opener process to ensure these are not delayed unnecessarily, once approved by the SEC Change Board or as part of an Authority Direction. Therefore, Modifications may need to be considered across Price Control cycles to ensure potential costs can be approved to progress essential industry required changes.

Our detailed responses to the consultation questions are provided in Appendix A. Should you have any questions please contact policy@ovoenergy.com.

Kind regards,

Samantha Cannons
Regulation Manager, OVO

Appendix A: OVO responses to consultation questions

Chapter 2: Scope and cycle

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

OVO has reviewed the proposals and broadly supports the move towards a multiannual, ex-ante cost control with uncertainty mechanisms. However, we have the following comments and these are set out below.

Full *ex-ante* regime - costs will be approved upfront for all of DCC's Allowed Revenue with the introduction of uncertainty mechanisms must be subject to a robust change control process.

Whilst we note that the majority of DCC's costs are now associated with live operations and these costs are less volatile, the significant cost variances occur with new programmes and code modifications. We seek further clarification on how new programmes, that now go through a robust multi-stage business case process, will interact with the proposed Ofgem process. Noting that this business case process will be overseen by the Government and requires DCC to seek non-objection from the Secretary of State for procurements with a value over £10m.

Multiannual cycles

We agree that DCC should be required to prepare a costed Business Plan covering a set period of time (cycle) and provide justifications for cost forecasts over that period. We also support the introduction of a Customer Challenger Group (CCG) that will be able to engage with DCC and receive detailed information on the costs, ahead of the plan being issued to Ofgem for assessment. Given this initial support of CCG, we recommend that further information should be provided to ensure all parties are fully aware of the constituency and terms of reference requirements.

In addition, we believe that in order for customers to be able to assess the performance of DCC, ongoing regular reporting will be essential to understand the status of the budget vs forecast, alongside the progress and outcomes of DCC development through the regulatory cycle. This should form part of the regular engagement by DCC with the proposed CCG.

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

OVO views that a biennial cycle should continue for DCC2 from 2028, this will provide greater predictability and certainty of forecasted costs and reduce the need for re-openers during this period, versus moving to a three year cycle. However, there should be set evaluation periods to review and refine this cycle based on the evidence of outcomes and if the cycle duration needs to be re-evaluated. The link to a long term strategy should be manageable and should help to ensure that developments are competitively managed and deliver benefits within the cost control cycle in a timely manner.

Currently, DCC is required to set out its business development objectives for a five-year period in an annual Business Development Plan (BDP). We agree that both the BDP and the proposed 2 year-detailed costed submission are required and therefore these could be merged, however we are uncertain as to how the annual updates to the BDP would be managed with this approach. There may be a need to refresh the annual BDP and for this to be considered alongside the proposed annual re-opener at the end of year one.

Chapter 3: Managing risk and uncertainty

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

OVO agrees that DCC should continue to set out economic and efficient costs in their upfront forecasts as part of the new *ex-ante* approach. We are broadly supportive of the general requirements that would need to be provided as part of DCC's costed Business Plan submission.

External costs
There are some areas where we seek clarification to further understand how these would be treated by Ofgem in the proposed process lifecycle.

- **Large new contracts:** this business case process will be overseen by Government and requires DCC to seek non-objection from the Secretary of State for procurements with a value over £10m. How will non-objected procurements be incorporated into the cost cycle in the event this occurs post *ex-ante* approval by Ofgem? In particular, where this may be requirements set by Government post the start of the cost cycle and the timings may be outside of the proposed re-opener process.

- **Evidence of customer engagement on the requirements, scope and costs for contractual changes (Change Requests/Project Requests):** care must be taken given the cost variance we have seen between SEC Mods that are at the Preliminary Assessment versus Impact Assessment stage. Dependent on the stage of the Mod process, there may be several Mods that require input into a re-opener process to ensure these are not delayed unnecessarily once approved by the SEC Change Board. In addition, how will costs be treated in the event the development, build and implementation of an approved Mod rolls over into a new cost cycle?

- DCC should also call out where there may be expected milestone invoice payments for external providers.

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

Whilst OVO recognises there may be a need for a degree of flexibility within DCC's Allowed Revenue, we believe this needs to be controlled to ensure that there is transparency and ensures focus by DCC to actively manage the costs of each approved programme.

External Costs
OVO agrees with Ofgem's proposal that there should be no fungibility in External Costs. Our view is that DCC should be efficiently managing each contract and should seek to drive the reduction of costs.

Internal Costs
OVO agrees that DCC should be able to have flexibility in terms of resource costs and costs correlated with resourcing (including Payroll, Accommodation, and IT Services). In terms of non-resource internal costs, we agree that these should be ringfenced where they are not directly linked to workforce deployment.

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

OVO views that having a contingency set at 2% of DCC's annual Allowed Revenue would seem reasonable based on historical monthly incoming and outgoings. This should enable DCC to successfully manage any potential shortfall, whilst reducing the existing amount of over-recovery and accrual of customer funds, subject to a reconciliation within the process.

We would like further clarification on how this contingency would be utilised for SEC Modifications, given the variance in costs that occur from PA to IA and what will be included within the detailed cost submission by DCC. Will there be a level of materiality applied to what can be covered by this contingency, and what will be part of the re-opener process? We believe this requires specific direction for DCC to ensure there is consistency and transparency, and to manage expectations for customers.

There must be a mechanism to ensure there are controls applied to mitigate the risk of DCC spending the surplus in full, and to encourage prudent financial management. We agree with the proposal to require DCC to justify the use of the surplus at the time of a re-opener, with at risk a reduced re-opener allowance where DCC is unable to provide a satisfactory justification. We also recommend that the use of the surplus must be monitored to ensure this is based on exceptions rather than becoming a standard undertaking by DCC.

We are supportive of a move to providing accruals-based reporting of Price Control information as it will provide a more accurate reflection of costs incurred and forecasted which provides more meaningful basis on which to evaluate DCC's business plan. This should also be monitored to ensure that reporting provides a better view of programme costs aligning to activities.

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

Our views on the proposed Uncertainty Mechanisms are set out below.

Automatic Adjustment
OVO is in agreement with the proposal that all costs subject to automatic adjustment should be pre-approved at the Business Plan stage. It seems reasonable that DCC would reflect these changes in their Charging Statement, noting this could happen within year 1 if the Charging Statement is reopened, or in preparation for year 2. We would expect these changes to be advised to and scrutinised by the Customer Challenger Group.

It seems reasonable to apply this mechanism for agreed existing passthrough costs that relate directly to Alt HAN costs and SECCo costs, where DCC must recover the full costs.
OVO broadly supports volume-sensitive costs like CH charges, where the unit cost is predictable however the volume during the price control period is uncertain.

End-of-year re-opener
We note that this re-opener would only apply to year 1 of the proposed biennial cost control cycle; any relevant changes that need to be accounted for during year 2 would be applied to the DCC Business Plan for the next 2-year cost control cycle. OVO agrees that the re-opener process should be included to account for potential in-cycle changes to costs.

Our assessment of the relevant trigger factors has raised the following queries that we seek clarification on, to understand the process that is being proposed:

Implementation of industry code changes - it is not clear how SEC Mods will fit within the process, noting that there will likely be uncertainty of costs at the outset of the cycle and these will often change within cycle.

- Will a materiality level be applied to what will result in a Mod being included in the re-opener vs what will be part of the 2% of AR contingency?
- How will Mods that have approvals during year be treated if the approved costs exceed those included within the original costed Business Plan? Particularly, if those increased costs may result in needing to suspend DCC work until the funding is subsequently approved - whether this is through a re-opener in year 1, or being included within a subsequent biennial cost control cycle.

Emergency re-opener
OVO recognises that there may be a need for DCC to require a fast-tracked access to additional funding, and to enable DCC to submit an application at any point throughout the cost control period. We agree that this should be limited to a *force majeure* in relation to DCC's operations or supply chains to ensure business continuity.

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

OVO's views on the re-opener process have been partially addressed in our response to question 6.

We consider that there may be a need to assess the materiality levels, to ensure if a proposed adjustment exceeds a certain threshold then this should trigger the re-opener process independent of the proposed end of year 1. Based on prior experience, there are examples that will occur within cycle which are usually accompanied by significant costs requiring implementation to be delivered within specific timescales:

- Full impact assessments on costs for SEC modifications that are approved by the SEC Change Board and subsequently Authority determination
- DESNZ-initiated changes that require DCC to comply and deliver changes that are not previously known about by DCC or industry

Chapter 4: Financial incentives

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

OVO continues to be concerned about the 'not-for-profit' basis of these proposals, and this has not been assuaged by the potential expansion of scope given what is now included within this latest consultation. We note that the proposals now include non-core service provision and Permitted Business, in addition to the previously concluded DCC Core Mandatory Business. There continues to remain a degree of uncertainty as to how the proposed incentives and penalties will drive the required performance improvements where there is a lack of competitive tension.

We firmly believe that any future incentive regime for DCC2 needs to drive strong performance at an optimal cost, and deliver the required outcomes for core services. We agree that there must be concrete measures to assess performance, however we view these measures as being co-operative and interlocked rather than being scored as discrete and hierarchical assessments.

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

OVO's focus remains on requiring DCC to deliver core services for Smart at an optimal cost (value for money) delivering strong levels of performance, with the desired outcomes. We view this ringfenced funding as being a potential distraction that is unlikely to deliver any realised cost savings to customers or end consumers.

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

OVO refers to our earlier responses to this consultation on cost efficiencies, and we are neutral on the External Contract Gain Share (ECGS) - an upward adjustment to the Allowed Revenue where DCC is able to secure cost savings in the FSP contracts.

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

OVO evaluated the proposals by Ofgem with this consultation. We remain concerned that there are insufficient controls in place to ensure that the proposed 'not-for-profit' model of DCC will be able to drive strong performance at an optimal cost, and deliver the required outcomes for core services. We do not see the conclusive evidence that the proposed remuneration principles, targets and policies will deliver the required outcomes.

Chapter 5: Customer engagement

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

Whilst we broadly agree with the proposal to set up CCG, we seek further clarification for all parties engaging with this consultation on the existing framework that is in place to evaluate, assess and contribute to the decision making in DCC's business planning process. There are several groups that interlock and feed into current decision-making, with complex linkages - this results in a lack of clarity and oversight of this view of DCC planning.

The introduction of a new industry group needs to have clear terms of reference and understanding of how it will operate within the existing landscape. We welcome further information of how this new group will interface with existing SEC and DCC aligned groups and forums, and how improvements will be achieved by this group that inputs into the DCC and its performance.

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

OVO has the following comments on the CCG's membership (proposed to be administered by SECAS) and its breakdown:

- We agree that representative nominations and appointments should be independent of SEC Panel and managed by SECAS - this future proofs potential changes introduced by Energy Code Reform, and the transition of activities from Code Panels to Code Managers

- We agree that there should be an independent Chair
- There should be representation, for as long as these SEC Sub-Committees exist (noting the disbandment of Panels and transition to Code Managers proposed under the Energy Code Reform workstream), of the Chairs for SEC Panel, SEC Ops and TABASC
- Corporate memory is important to understand in terms of what has been discussed previously and over the period of a price control review, therefore a rota basis for membership may not be the most suitable for Small Suppliers, Network Operators, Consumer Members and Other SEC Parties

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

OVO agrees with the presented considerations for the scope, focus and responsibilities of the Group. In addition, we recommend that this group should have ongoing engagement not only with DCC throughout the initial development of DCC's costed Business Plan and subsequent discussions to ensure there is an assessment of potential adjustments, re-openers and potential candidates for the next cost control cycle.

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

OVO agrees that the primary output of the Group should be an independent report on DCC's costed Business Plan. As we note in response to Q14, we see this group persisting throughout the price control period and beyond. We consider this needs to remain established for the foreseeable future as this process develops and progresses. There should be evaluation points to understand the ongoing benefit of the CCG for each price control period.

Chapter 6: Implementation considerations

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

Given the transition from an ex-post to an ex-ante price control process, it seems appropriate to ensure the first detailed cost business plan prepared by DCC1 will cover the period April 2026 to March 2028.

Whilst we are broadly supportive of this approach, we would like to understand if there has been planning to decouple the ex-post to ex-ante and to explore an approach that sees the first two year period of ex-ante price control being of specific focus and reporting. This could still result in DCC2 being not unduly impacted by having to provide a plan at the same time as they establish themselves in the first year of their responsibility.