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

Responding Party: Octopus Energy

Date: 6 February 2025

For the attention of: Jakub Komarek, DCC Oversight and Regulatory Review (Retail Systems and Processes)

This response is non-confidential.

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 on moving toward a multi-annual, ex-ante cost control with the introduction of mechanisms to address uncertainty, but with amendments to the specific forms presented here.

We agree with the proposal to require a costed Business Plan as part of 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?

We believe that a two-year cycle is appropriate in the short to medium term while the new regime beds down. We think that consideration of longer cycles should be dependent on the success of these earlier cycles.

We agree with consolidating the Business Development Plan and the costed Business Plan to improve alignment and efficiency.

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

We agree with the general requirements (3.14) but are concerned that, if performed to the letter, these requirements could lead to an expensive 'industry' of information generation, whose costs will exceed the benefit gained. It will be critical to ensure that the amount and content of the information provided is commensurate with the materiality of the decision involved. We hope that the new independent DCC Board can collaborate with Ofgem to ensure a pragmatic approach.

We note the reference to 'customer engagement'. In the past, true customer engagement on costed alternatives has been severely hampered by confidentiality restrictions leading to high levels of stakeholder frustration. We recommend that members of TABASC, the new anticipated SEC finance subcommittee and SEC Panel be specifically included within the same confidentiality 'ring fence' as the DCC Board on matters of cost and contracts. This would help ensure that the larger financial contributors to DCC are able to understand the evolution and result of significant DCC financial commitments. This would accelerate Business Plan approval. It would also ensure that the operational implications for future customer experience were understood as part of any financial economies.

We note (3.8) that 'forecast costs should only contain economic and efficient costs and be ***significantly*** more likely than not to occur'. We note that this approach has led to much misunderstanding in previous price control conversations, whereby projects that were widely expected to occur, but with material cost uncertainty, have been entirely excluded from budgets. Not only has this led to confused comparisons many months later of budgets vs outturn, it has misdirected discussions away from the real need to analyse whether the money was spent efficiently.

We therefore believe that a key component of ensuring the success of ex-ante is how stakeholders are brought together on a project journey: from knowing a project is required; then through the various ***costed*** technical options to agreed choices (and compromises); to project delivery and finally verification. We believe that TABASC and the new anticipated SEC finance subcommittee would be the right parties for this collaboration. As permanent sub-committees they hold the SEC memory for projects which can often span years from conception to delivery.

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

We recognise the past issues with cost management under ex-post and the dissatisfaction expressed by Ofgem and other stakeholders. However, we are concerned that the proposed highly 'codified' rules for cost management will generate overly complex processes, leading to cost and operational inefficiencies. In some circumstances the interplay of the separate control components (as currently written) may lead to unintended consequences such as incentivising unnecessary spend.

We would therefore recommend a regime which takes the principles of the controls presented here, but places them in the hands of existing and planned future governance groups, where rich and deep expertise is concentrated. These groups would include the new

DCC independent Board, the existing SEC subcommittee structure (with TABASC a primary candidate) and the future SEC finance subcommittee. It would then be possible to consider wider latitude for aspects such as fungibility without the need for delays or regulatory involvement. It would also allow such deliberations to be fully informed on both the issue requiring decision and the contemporaneous context.

As part of this re-arrangement we also suggest that approved SEC Mods, accompanied by explicit financial support beyond current practice, would automatically be granted ex ante approval. We would recommend that verified delivery and cost management of such Mods would be part of the ToR for TABASC and the future SEC finance subcommittee.

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?

We think that it is confusing to mix cash flow management and truly contingent items under the same category. We see working capital management as a basic duty of the DCC finance department, including judicious attention to the timing of invoice payment. We would only anticipate regulatory or stakeholder involvement in cash flow management in the event of serious mismanagement or significant debtor default. We see this as separate to the normal course of business processes and more akin to an emergency reopener.

We are confused about the relationship of the term 'contingency' to some other pass-through items such as volume-related charges and would like to see such items defined in a a clearly separate category from contingency.

With these simplifying caveats, we see a 2% contingency, under appropriate controls as explored in Q6, as a necessity to address unforeseen items of spend that will not be automatically restored by the passage of time.

We agree that accruals-based reporting is a more appropriate approach than cash.

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

We recognise the past issues with cost management under ex-post and the dissatisfaction expressed by Ofgem and other stakeholders and we agree with the drivers under-pinning the proposals for these Uncertainty Mechanisms.

However, we are concerned that the proposed highly 'codified' rules for uncertainty management will generate overly complex and lengthy processes, leading to cost and operational inefficiencies. In some circumstances the interplay of the separate control components (as currently written) may lead to unintended consequences such as incentivising unnecessary spend.

We would therefore recommend a regime which takes the principles of the suggested controls (e.g. the concept of fungibility) and delegates the exact approach of their implementation to existing and planned future governance groups (e.g. SEC committees and the future DCC Board), where rich and deep independent expertise is already or will be concentrated. This will allow later cost deliberations (such as evolving projects) to be conducted with full contemporaneous context. Referral to the Authority would only be required in the event of disagreement or for large or unexpected deviations. This will also allow DCC and stakeholders to benefit from the effort expended by Ofgem in establishing more independent governance.

As part of this re-arrangement we also suggest that approved SEC Mods, accompanied by explicit financial support beyond current practice, would automatically be granted ex ante approval. We would recommend that verified delivery and cost management of such Mods would be part of the TABASC and future SEC finance subcommittee ToR.

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?

We accept the need for reopener mechanisms but believe that this should be the for exceptional events rather than normal business change management.

In particular we note that SEC Mods have their own approval processes and, once approved, should not require inclusion in additional re-opener proposals. We note that SEC Mod processes could be improved by more explicit financial information, more formal prioritisation between TABASC and DCC and more formal delivery verification by TABASC. In our view this would remove the need for separate re-opener discussions.

In addition, where projects have been identified as necessary items in the business plan but carry too much financial/technical uncertainty for formal budget inclusion then a separate reopener process could be delegated for agreement between DCC and TABASC alongside the future SEC finance subcommittee. Only if it was not possible for these groups to reach agreement would there be a need for reference back to the Authority.

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 have previously expressed our concerns with the application of a not-for-profit structure on the management of the technology ecosystem that constitutes 90% of DCC business. In contrast, commercial operators with multiple outsourcing contracts are able to routinely share innovation and cost efficiencies that will not be so easily available to DCC.

However, we note that competitive service providers to DCC are allowed to make profits. It is therefore possible to conceive that significant parts of DCC business might still be subcontracted on a for-profit basis (to create a 'thinner' DCC) with the anticipation of achieving an overall cost saving. We would like such restructuring considerations to be a part of the DCC Board mandate.

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?

We believe that the DCC priority for the next few years should be the delivery of a stable cost-efficient service that demonstrates a glide path of reducing costs. We are not in favour of DCC developing additional services until this goal has been achieved.

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 do not share Ofgem's view that 'robust business planning' is necessarily a mitigant to institutional inertia. We believe that adaptability is a much more critical component of business success. If anything, we believe too great a conviction in the reliability of robust planning can increase inertia as it becomes more difficult to challenge earlier perspectives when institutional and personal 'face' is felt to be at risk.

The challenge with any form of incentive is to find ones that are effective, efficient to administer, avoid gaming and do not have negative unintended consequences. Therefore, if Ofgem believe that ECGS has met these criteria in the past it would seem sensible to include an element of this structure in future management incentives.

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

We agree with the proposed measures but also believe that a significant part of the incentive 'pot' should be available to be used at the discretion of the Board. We note that Ofgem has committed a great deal of thinking to establish a new independent DCC Board. We see one of the primary duties of the Board to be the establishment of the right corporate culture and the Board should have appropriate financial discretion over monies set aside for incentives to achieve this.

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 note from Appendix 3 that there are already a very large number of DCC customer engagement groups. The fact that this Appendix is not complete (for example, no mention of CTG or TBDG) is not surprising as most authors of previous similar lists have equally struggled. We therefore believe that the addition of another engagement group with new individuals needs to be considered against this existing volume and complexity.

We further note that the current smart metering ecosystem continues to show significant operational and technical challenges at a basic functional level. We therefore believe that the requirements for any customer challenge group are very different to many of the other organisations referenced here. Fixing the current range of functional issues is not really 'strategic'. It requires deep experience and expertise in the resolution options and the associated costs.

We note that many of the existing SEC subcommittees contain deep experience of the operational and architectural issues and it is this knowledge that is vital to be incorporated into DCC business plans. We find it difficult to believe that new incoming parties would be able to become equally informed in the proposed 3 month review period. We therefore believe that any customer challenge group needs to draw directly and heavily from the existing SEC stakeholder community, rather than seeking to establish what appears to be an arm's length relationship in terms of structure and participation. We propose that, as a minimum, the Chairs of TABASC, OPSG and the anticipated SEC Finance subcommittee should be key members of any DCC business plan review/customer challenge group.

We also note that DESNZ has expressed a desire to manage the development of VWAN, a critical enabling technology. It is not clear how such projects would integrate with the proposed customer challenge group.

We agree that a meaningful contribution to the DCC Business Plan by non DCC parties can only be achieved by wider sharing of contract and cost information. This would have to go beyond the information currently shared at QFF.

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

As discussed in A12, we are sceptical that any new community of members, both core and non-core, would be able to get up to speed with the detailed operational, technical and architectural components that will be required to properly engage with DCC Business Plans within 3 (or even 6) months if working on a part time basis. This may well change when a high degree of operational and functional stability, alongside financial predictability, has been achieved.

We would much prefer that in the immediate future any customer challenge group is drawn from those members of the SEC community with the relevant deep expertise and experience. This would include the Chairs of TABASC, OPSG and the anticipated SEC Finance subcommittee.

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

We agree with the presented considerations.

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

We agree with the proposed outputs.

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?

It appears that during part of the transition period DCC will exist under both ex-post and ex-ante controls. We are unclear what this will mean for the approvals of spend.

It also appears that the transition will take place in the middle of a regulatory year. We are unclear what this mean with regards to assumptions about phasing of spend as we assume that cost phasing is unlikely to correspond proportionately with calendar phasing.

As noted in A12, we are sceptical that any new community of members in a potential customer challenge group would be able to engage with the detailed operational, technical and cost components of the DCC Business Plan in sufficient depth to provide useful feedback. We think it is additionally unlikely to expect this to be achieved in only 3 months.