Angela Love SEC Panel Chair
Smart Energy Code Company Limited
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For the attention of: Jakub Komarek, DCC Oversight and Regulatory Review (Retail Systems and Processes)
Submitted via email: DCCregulation@ofgem.gov.uk

17 February 2025

Dear Jakub,

Thank you for the opportunity to respond to Ofgem's consultation on the DCC review: Phase 2 – Process for determination of Allowed Revenue.

We broadly agree with the proposals set out in your consultation. DCC ex-ante cost control regime should be robust, transparent and, at the same time, easy to understand and engage with. This will allow a wider participation in the arrangements, which, we believe, will lead to the cross-pollination of best practice developed and deployed by various teams at Ofgem for the different regulated entities operating in the GB energy market.

We provide a summary on our main position below and the detailed answers to the consultation questions in our main response.

Key positions:

1) We support Ofgem's preferred approach (Option B) - the proposal to transition to a multi-annual, ex-ante cost control regulatory regime
2) We believe that a shorter (2-year) initial cost control cycle moving to a longer planning cycle (3+ years) should provide enough flexibility to establish and test the new ex-ante cost control regime. An assessment of pros and cons for a longer planning cycle should be undertaken during the first ex-ante cost control cycle, which should also consider the practical learnings from the new ex-ante regime in operation
3) The Business Planning Guidance needs to be practical and pragmatic so that it can help pinpoint and focus on any materially significant variances that need to be determined more precisely before the business planning commences
4) It is important to balance the granularity and materiality of forecast/ control over the cost line items with the resulting requests on the internal capacity and industry's time to engage with detailed publications
5) The new ex-ante cost control regime should be robust and underpinned by a transparent Business Plan. At the same time, DCC Board and senior management team need to have enough agency and control to act on the customer feedback and deliver what is required of them – with appropriate oversight and engagement from the industry

Across the SECCo team and SEC Panel, there is an in-depth understanding of the central market arrangements and the evolution and recent history of new regulatory initiatives. Should you wish to discuss any aspects of our response further then please either get in touch with myself or with Alina Bakhareva (alina.bakhareva@seccoltd.com), Head of Code and Regulatory Strategy.

Yours Sincerely,

Angela Love

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SEC Panel Chair

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 support Ofgem's preferred approach (Option B) - the proposal to transition to a multi-annual, ex-ante cost control regulatory regime, which will incorporate mechanisms to address uncertainty. Additionally, we support the proposal to mandate a costed Business Plan as part of the cost control submission.

There is precedent for a similar approach in other parts of the energy markets, i.e. the regulated entities operating under a licence (Distribution Network Operators (DNOs)) and currently unregulated central bodies (energy codes and central systems).

In particular, we believe there could be useful lessons learnt from decades of Ofgem's regulating similar scale entities, such as energy networks.

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?

In principle, the approach, outlined in the consultation, a shorter (2-year) initial cycle moving to a longer planning cycle (3+ years) should provide enough flexibility to establish and test the new regime for at least 12-15 months before planning needs to commence for the second ex-ante price control cycle. We believe an assessment of pros and cons for a longer planning cycle should be undertaking at that point, which should also consider the practical learnings from the new ex-ante regime.

We support combining the Business Development Plan (BDP) and the ex-ante costed Business Plan irrespective of how long the price control period will be set for. This is likely to increase efficiency in business planning and forecasting, as well as aid with stakeholder oversight and ease of engaging with the new regulatory regime.

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

We support the general approach outlined in the consultation and welcome the combination of the existing practices and an introduction of the Business Planning Guidance. The Business Planning Guidance needs to be practical and pragmatic so that it can help pinpoint and focus on any materially significant variances that need to be determined more precisely before the business planning commences.

As with other similar regulated entities, Ofgem anticipates and requires industry involvement and participation in discussions regarding the costed Business Plan and specific cost line items. The new regulatory framework will need to strike the right balance between rigour and complexity to allow for a wider involvement from the industry as well as effective knowledge sharing and transfer.

Two new SEC Sub-Committees are anticipated: an Customer Challenge Group and a new Finance Sub-Committee. These new Sub-Committees, as well as the existing SEC bodies (SEC Panel and the existing Sub-Committees) can provide valuable input, insight, wider technical, operational and consumer experience to the debate, as well as constructively challenge and explore any lessons from a collective 'corporate' memory, which will be required to deliver value to the industry and end consumers.

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 we recognise the historical issues with the accuracy of cost projections and cost management under ex-post regime, we believe it is important to adequately empower the new DCC2 Board and management to deliver within the set boundaries and budget, allowing for transparent reporting and avoiding over justification of costs. Otherwise, this may lead to excessive reporting; therefore, placing an unnecessary burden on the DCC internal resources as well as requiring a greater extent of involvement from the industry to engage with the DCC publications. We would like to see a principle of proportionality, and bearing in mind the materiality of costs, we believe there needs to be a comparative assessment of regulatory approach to cost management with other similar bodies, for example, NESO with the annual projected budget of £690m for 2025/2026[1] and Elexon with the annual projected budget of £118.9m for 2025/2026[2].

We recognise that while it may not be possible/desirable to introduce a change for the first ex-ante cost control cycle, a further harmonisation in Ofgem's approach to regulation of the non-for-profit central market bodies could significantly lessen the time/effort required from the industry to engage in the budget comparison and budget approval cycles.

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?

Suitable contingency will be required for unexpected events, as is the case with other similar non-for-profit bodies operating in the central market services space where contingency is planned for as a separate business plan cost item and is normally returned or carried over as a reserve for next financial year, therefore, offsetting the charges. Contingency percentage may need to be set based on historical evidence of any required cashflow interventions by the DCC's parent company in the past.

There needs to be clarity between contingency and payment/cashflow management as a standard practice for any organisation.

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

We understand the rationale for Ofgem to propose three types of Uncertainty Mechanisms. However, there needs to be recognition that there may be operational and contractual constraints on fungibility - 70% of DCC costs are external and are likely to be managed under the existing contracts, especially during the first ex-ante cost control period. Therefore, there will be limited internal management ability to change/tighten contractual arrangements.

Furthermore, there needs to be a certain degree of flexibility/fungibility on external services as it may be difficult/ineffective to provide detailed forecasts for these costs for a two-year period or longer. It may also constrain the organisation's ability to address any emerging issue promptly, leading to a greater overall spend as a result.

There needs to be a careful consideration where the decision for specific proposed control mechanisms should sit – internally at the DCC Board level, external governance groups such as DCC Finance Sub-Committee, or Ofgem as the industry regulator. Although we note that there appears a general view in industry that the DCC Finance Forum is not fit for purpose.

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?

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[1] https://www.neso.energy/document/348266/download
[2] https://www.elexon.com/documents/about/finances-report-policies/business-plan/2025-26/elexon-2025-26-business-plan/

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We agree that there needs to be a mechanism or a reopener, in addition to the contingency, reserved for any unforeseen, exceptional events. Similar arrangements exist for other regulated entities, such as DNOs. We understand that the need for a re-opener may be higher during an initial period of new cost control arrangements being put in place.

There are several existing arrangements under other codes/central bodies that introduced robust, controlled, and transparent mechanisms to allow a non-for-profit industry-funded entity to develop non-core business. As a minimum requirement, under all existing arrangements, there is a need to maintain industry engagement through consultations, as well as any decision being approved by Ofgem/ Government. It is important to highlight that in all recent cases of new arrangements being assigned to existing bodies, any generated income is being used to offset the charges on the industry parties. Some central bodies do not have the right to retain any surplus (in case of budget underspend) and will return the funds back to the funding parties. Other bodies have the right to retain funds and will offset the charges against any underspend from a previous year.

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?

In line with all other central bodies delivering their services to the industry on a non-for-profit basis, we are of the view that the DCC should be run on a not-for-profit basis which would include all of its Authorised Business both permitted and mandatory. Whilst the DCC business will be run as not-for-profit the Service Providers the DCC manages are profit making organisations.

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?

Under the ex-ante cost control, DCC will be expected to engage with the industry through two additional forums: Customer Challenge Group and Finance Sub-Committee. Subject to the core business objectives being delivered to the satisfaction of the industry stakeholders, we believe 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. The energy industry continues to evolve with the new policy and regulatory proposals being assessed and evaluated by Government and Ofgem. Flexibility, especially domestic flexibility, is expected to increase significantly, in fact, according to NESO's Clean Power by 2030 report, flexibility needs to increase five-fold. In this rapidly changing industry environment, if smart metering infrastructure isn't allowed to develop and evolve, it could become a stranded asset. Therefore, we believe there needs to be a mechanism to allow for testing various new services and income generation that will offset the charges levied upon the funding parties. To be clear we do not believe any profits should be accrued but instead returned to funding parties.

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?

The new ex-ante cost control regime should be robust and underpinned by a transparent Business Plan. At the same time, the DCC Board and senior management team need to have enough agency and control to act on the customer feedback and deliver what is required of them – with appropriate oversight and engagement from the industry. Corporate culture and any changes required to it may provide a good litmus test as to the appropriate mechanism to introduce even greater focus on costs efficiency, in addition to the rigorous testing of any proposed costs during the ex-ante costed Business Plan development process. It will be important to bear culture and employee retention considerations in mind when setting any additional mechanisms for stretch targets.

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. We believe that a new DCC Board should be responsible for designing the details of the incentive measures in order to drive the required operational performance, and to establish the robust corporate culture focussed on delivering value to industry and end consumers.

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?

The membership and the remit of the new group will have to be carefully assessed within the existing eco-system of various engagement forums, including SEC Panel and SEC Sub-Committees to determine where the required level of expertise and technical and operational experience may be readily found given the expected short turnaround on this new group set-up.

SEC Panel and Sub-Committee Chairs could provide the required in-depth expertise in order to start driving practical outcomes and share their experience with a wider group of DCC customers.

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

We believe the membership needs to be carefully assessed against the required outcome and the existing expertise and experience. At the same time, it will be important to supplement the core expertise in smart metering with perspectives/experience from other industries on the evolution of customer services and digital business transformation.

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

We understand that terms of reference for the group will be further consulted upon. The initial outline provided in the consultation appears a reasonable start.

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?

During part of the transition period DCC will exist under both ex-post and ex-ante controls with the transition taking place in the middle of regulatory year. There needs to be careful and details planning of the DCC budget and cashflow during that time.

There also may need to be a need to weight the benefits of transitioning six months earlier vs costs involved in planning a transition during a regulatory year, along with the associated risks.