Thursday, February 6, 2025

DCC Oversight & Regulatory Review (Retail Systems & Processes)
Ofgem
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Dear Jakub Komarek,
Re: DCC review: Phase 2 – Process for determination of Allowed Revenue

We welcome the opportunity to input into the design of the new DCC licence. A new licence affords Ofgem the opportunity to implement change and shape the way DCC functions going forwards, while also addressing key industry concerns around cost, transparency and control.

It is encouraging that Ofgem recognises improvements must be made. Industry and Ofgem appear broadly aligned as to what the key issues are:

1. DCC Costs – DCC was initially forecast to cost £1,994.2m[1]. We are now in year 12 and costs are 252% above initial estimates[2]. We must reduce DCC costs.
2. Funding Party Control – Funding Parties have voiced concerns about escalating DCC costs since the initial award of the Licence. Parties must have more oversight and control of DCC expenditure. DCC costs are ultimately passed on to energy consumers. Suppliers have been frustrated in their efforts to control DCC spend due to the current Licence and governance arrangements. Ofgem must empower Suppliers to better manage the DCC.

Meaningful change has not been possible due to the terms of the DCC Licence and the conditions of Service Provider Contracts. This is a once in a 15-year opportunity to address these fundamental issues. We look forward to working with Ofgem to develop targeted reforms to improve smart metering services and reduce costs for consumers.

## DCC Costs

It is imperative that the DCC's costs are brought under control, as the overall cost of running has escalated significantly – in Regulatory Year 2023/34 DCCs Internal costs were £143.52m[3], vs the licence application business plan (LABP) forecast £13.5m[4]. External costs (without switching) were £483m[5] vs the LABP forecast of £205.8m[6]. The LABP figures are used here as these were the initial forecasts provided within the application for the current licence, and Ofgem provides differentials between current spend and this forecast within its Price Control reporting. The escalation of costs cannot be allowed to continue, and the structure and mechanisms of the new licence should provide the tools to manage and reduce this going forward.

1: Sum of Total Internal Costs, Table 6 - plus sum of Total External Costs, Table 7 – Final Redacted Licence Application Business Plan, Smart DCC Ltd
2: Variance over remaining Licence period figures taken from paragraphs 4.4 (Internal Costs) and Table 3.2 (External Costs) from DCC Price Control: Regulatory Year 2023/24, Ofgem
3: *"In RY23/24, Internal Costs, excluding Shared Services, were £143.52m"*, Paragraph 4.4, page 66, DCC Price Control: Regulatory Year 2023/24, Ofgem
4: Table 3.37 – page 23, Final Redacted Licence Application Business Plan, Smart DCC Ltd
5: Table 3.2 – page 29, DCC Price Control: Regulatory Year 2023/24, Ofgem
6: Table 7 – page 26, Final Redacted Licence Application Business Plan, Smart DCC Ltd

Funding Party Control
Similarly, giving DCC customers transparency over program and project costs, as well as the means to challenge whether costs are efficient, is a critical ask from Industry and has been a source of frustration for several years. The Customer Challenge Group will provide this control and transparency, giving customers the confidence in DCC's costs and direction that is currently lacking.

Utilita remains committed to working closely with the DCC on these, and other, issues via the existing SEC groups as well as the new Customer Challenge Group once it is established. We also welcome Ofgem's future consultation on Business Planning Guidance, as these guidelines go hand in hand with the allowed revenue model in ensuring that DCC operates efficiently and within agreed costs.

Yours sincerely,

Kevin Clark
Utilita Energy

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 believe that there remains too much uncertainty in costs and forecasting for this process to shift to multi-annual ex ante, especially as the proposed annual re-opener uncertainty mechanism would essentially make this process annual. If the theorised stabilisation of charges can be realised, then we would support a multiannual review.

The move to an ex-ante cost control model would give DCC customers upfront visibility of expected costs. However, we stress that it is the need for an efficient and cost-effective network that should be the key goal. This goal can be achieved either through an ex-ante or an ex-post model. The focus of this review must primarily be in reducing costs and improving efficiency.

We believe that there is still benefit to a multi-annual costed business plan being produced, and we encourage Ofgem to mandate this regardless of other outcomes. This will allow customers of DCC2 greater transparency on upcoming projects and potential costs. In combination with the proposed customer challenge group, we believe this will help fulfil the current need for greater oversight and transparency that DCC1 customers continue to require.

Additionally, as the DCC operates a monopoly with associated monopolistic service contracts, it is vital that these contracts and their management is more transparent under the successor licence, and the production of a costed Business Plan could form a key component of enabling that transparency.

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?

The change to an ex-ante cost control model is a significant one, and we believe it is unrealistic to expect a new licence holder to be able to provide an accurate forecast across multiple regulatory years. Ofgem has presented concerns within the consultation document that the DCCs forecasting is “historically inconsistent” and “lacking in supporting evidence” which reinforces the difficulty of this process.

We therefore cannot support the cost control cycle being longer than 1 year in the initial stages of the new licence.

We believe that both the Business Development Plan and a costed Business Plan are critical elements to feed into the Customer Challenge group to allow for open and holistic conversations around DCCs plans and costs.

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

We believe that part of the scope of the customer challenge group should be the determination of what is deemed efficient. This can involve producing guidelines for submissions or as part of examining the evidence provided as part of DCC Price Control reporting. As the DCC is a monopoly service with multiple service contracts that are also monopolies, the DCC should be required to provide evidence proving that the rates paid as part of these contracts are comparable to other rates on the market.
Further, we note that in the past the DCC has heavily relied on temporary and contractors rather than internal staffing to provide expertise they do not already have. This is not the most cost-

effective way to manage the level of expertise required, so we would expect these arrangements to be heavily evidenced to provide confidence they provide value for money.

### 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 believe that allowing these flexibility mechanisms risks encouraging negative behaviour when applying for allowed funds. By allowing items to be balanced against each other, it allows the DCC to recover against a total target. There is no benefit to the end consumer by allowing this.

If the way DCC's revenue were allocated changed to a 'top-down' system, where an annual target is set and the costed Business Plan set out how the DCC plans to meet that target, we would support a review of the allowed flexibility mechanisms.

### 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?

The proposed 2% contingency is a reasonable one, as the new licensee should be focusing on delivering an efficient and cost-effective networking service.

The proposed emergency reopener mechanism provides means for funds to be requested, though this should be carefully managed.

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

#### Automatic Adjustment

We note that Ofgem considers the DCC's forecasting "historically inconsistent" and "lacking in supporting evidence", while at the same time noting that this Uncertainty Mechanism relies on transparent reporting. Therefore, we do not feel comfortable allowing the DCC to automatically pass through costs without any oversight – whether this oversight be via Ofgem or the new Customer Challenge Group.

#### End-of-year reopener

An end-of-year reopener reduces a multi-annual cost control cycle to an annual one, but with additional administrative overhead. As outlined in our answer to Q1, we do not believe that a multi-annual cost control cycle is the best way forward at this time, therefore, we also do not see a need for this mechanism.

#### Emergency reopener

Regardless of whether the cost control cycle is an annual or multi-annual one, we believe that this mechanism is one that should be implemented to tackle unexpected cost overruns or entirely unforeseen costs. The new Customer Challenge group should have a prominent position in evaluating these requests before they continue onward to Ofgem for final determination.

To summarise, we believe that under an annual cost control cycle, the only required uncertainty mechanism allowed should be the emergency reopener. If the proposed multi-annual cost control cycle is implemented, we would support the introduction of the end-of-year reopener in addition, so long as it were carefully managed by the Customer Challenge group and Ofgem.

### 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 our preference is for an annual cost control cycle as opposed to the multi-annual proposed here, the proposed Q3 re-opener is no longer required. The inclusion of this reopener in a multi-annual cycle effectively reduces that cycle to an annual process with an unnecessary administrative and regulatory overhead burden.

In either cost control model, we believe that the proposed emergency reopener should be included, however, this should be subject to strict controls and reviews by those paying for the services. Additionally, we believe that this should only be applicable to costs incurred as part of providing core services and not any additional non-mandatory or value-added services.

The Customer Challenge group should be heavily involved in any reopener process, for the sake of transparency, to provide a means for industry to challenge these additional costs and to scrutinise the evidence and justification provided by the DCC.

### 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?

The focus of the successor licence should be on providing value for money and cost efficiency rather than simply restricting contracts to not for profit. If a for profit model provides a better cost benefit realisation, this is a fully acceptable outcome, as the contract and regulatory framework should be driving the desired behaviours rather than the profit model.

### 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?

There has been no Value Added Services. We are yet to see solid proposals for any services. Defining such a process encourages DCC to continue to speculate on value added services, which we do not want.

Moving to an ex-ante process potentially removes the incentive for the DCC to speculate on business opportunities outside of the Core services and the associated risks, therefore the cost control model may dissuade DCC2 from exploring these services. Any application for funding should be fully supported by those responsible for funding the DCC – potentially via the new Customer Challenge group – and included within an annual cost control Business Plan, with outlined costs.

### 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 believe that the best way to ensure cost efficiency in this area is through competition rather than through single contract monopolies, especially as these large single contracts have not been cost effective.

Additionally, the obligation to produce a multi-annual costed Business Plan should see greater realisation of the desired behaviours in relation to contract management, especially if the Customer Challenge group is given the scope to review and challenge these contracts and their management.

Ultimately, we see the Customer Challenge group as critical in ensuring that these contracts both provide cost effectiveness and are managed to an appropriately high standard. We agree that the new costed business plan process should provide a level of detail to allow this group to provide the oversight from industry to prevent any future mishandling of these types of contract.

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

The Renumeration Committee should have due regard to the DCCs key performance indicators when setting renumeration packages for DCC staff, however, these must be set at a reasonable level.

We support adequate pay and bonuses, however, there is a risk of reputational damage to the energy sector that excessive renumeration packages like these would cause at a time where the industry faces intense scrutiny over costs and rising bills.

In terms of focus areas, we agree with those proposed and have no further areas to add. However, we would encourage Ofgem to utilise this change window as an opportunity to review and update some of the targets the DCC is being measured against, particularly those around system performance.

### 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 formation of a customer challenge group is vital to ensuring both industry engagement and the cost effectiveness of the DCC. There is currently no way for DCC customers to effectively challenge any of DCCs costs, yet are expected to pay for them, often without full knowledge of what is being paid for.

This group also offers the ability to have critical oversight of many areas discussed in this consultation for example: required evidence for allowed revenue, renumeration programmes, funding applications for commercial developments. This would also reduce the administrative burden on Ofgem and allow those responsible for paying the final bill the ability to shape outcomes and products.

Additionally, as the DCC is a monopoly service, there is no way for DCC customers to change to an alternative service provider if they feel the current provider is not providing value for money. Having the Customer Challenge group in place and empowered to see and challenge all of the costs of DCC2 would help to mitigate the cycle of rising costs that customers around bound to pay that is currently being experienced.

We also believe that the Customer Challenge group should play a key role in any reopener process, providing oversight and challenge on the evidence presented to justify the request. Providing oversight on DCCs external service provider contracts is another area that this group should be tasked with, this is an area that DCCs customers have historically had little sight or input into, therefore enabling this would help ensure the effectiveness and economic efficiency.

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

We agree with the proposed core and non-core membership model, however, we believe that this group should be open to all Large Supplier and Network parties. These parties pay the majority of the DCCs costs and should be offered the opportunity to provide oversight and input to the costs they are being expected to pay.

We agree with the proposals that external experts should be invited to provide expertise to the group, however, it must be recognised that the core of the group be made up of funding parties, as ultimately these are the parties who will be paying the majority of the costs incurred and should therefore be afforded a greater input into the monitoring and evaluation of those costs.

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

We support the proposed scope, focus and responsibilities of the Group. The ability to provide meaningful input to DCCs business plan and cost decisions is a welcome and has long been requested by Industry.

It is vital that this group be empowered by Ofgem and supported in providing the appropriate level of oversight and challenge, otherwise the group will be unable to adequately fulfil their duties.  The group should be afforded access to the commercial information that is currently withheld from DCC customers. Without this access, the group cannot properly provide the confidence and security on costs that many DCC customers require.

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

We support the production of a report on the DCCs proposed plans and believe that it should be submitted independently of any submission by the DCC themselves. The group should be seen as independent and unbiased of the DCC, seeking only that operations are cost effective and properly justified, and any potential confusion on this independence should be studiously avoided.

### 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 are supportive of the requirement on DCC to deliver a costed Business Plan ahead of the new licence being introduced, however, we have concerns around the timescale Ofgem are proposing.

The proposed requirement for a costed Business Plan to cover from April 2026 to March 2028 presents significant hurdles. If the Customer Challenge Group is targeted to be formed in June, and the DCCs submission date the 30th of September, this leaves approximately 2 months for the CCG to familiarise themselves with the new commercially sensitive data available, analyst the draft business plan and provide meaningful feedback to the DCC with enough lead time for the DCC to be able to incorporate it into the submission. This is an unrealistic timeline and one we cannot support.

A more sensible approach would be Option B, to have DCC1 develop a business plan from Business Handover Date to March 2028. This gives the Customer Challenge Group sufficient time to be formed and familiarise themselves with the volume of new data and be in a position to support and challenge the development of the business plan.

We also note that the revised Regulatory Instructions and Guidance (RIGS) and Business Planning Guidance including revised Price Control Processes guidance have yet to be consulted upon and published. If significant changes to these documents are made in the middle of the business plan being developed those changes could potentially result in the business plan requiring major changes or a complete rewrite, further reducing the available time for challenge and feedback from the CCG.