

Regulatory framework
DCC commercial workshop

Laura Nell, Head of Smarter Metering
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ofgem

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- Economic and efficient
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Ofgem's role

- DCC is a new monopoly licensee regulated by Ofgem.
- We monitor DCC's compliance with its licence obligations
 - Price control
 - Non price control (regulatory reporting and Licence obligations).
- Price control arrangements restrict DCC's revenues, and require DCC to incur costs economically and efficiently.
 - We will monitor and assess the costs incurred running DCC.
 - Determine whether DCC incurred costs economically and efficiently.
 - We may disallow costs or impose special measures on DCC to better manage its costs.

Price control formula

Allowed Revenue

Internal Costs: The internal costs incurred by DCC. Subject to ex-post review. They will be compared to the estimate in the Licence Application Business Plan .

Baseline Margin Performance Adjustment: Revenue will vary to reflect Licensee's performance against incentives. It will be the function of the Baseline Margin Implementation Performance Adjustment (BMIPA) and Baseline Margin Operational Performance Adjustment (BMOPA) Term

Value Added Services Contribution : Revenue from non energy services. The net benefit will be agreed by the Authority when approving the provision of the service.

$$AR_t = EC_t + IC_t + PTC_t + BM_t + BMIPA_t + ECGS_t - VASC_t + K_t$$

External Costs: Costs from Service Providers. Should have a basis in contracts and subject to ex-post review. They will be compared to the estimate in the Licence Application Business Plan.

Pass-Through Costs: Authority fee, and SECCo costs (admin & governance costs).

Baseline Margin: Agreed as part of Licence Application process.

External Contract Gain Share: An adjustment to revenue reflecting some part of the reduction in External Costs that DCC has proposed to effect or has effected. Will be zero until Authority determines.

Correction Factor: Adjusts revenue for under/over spend and bad debt in previous year.

Comparison with other regimes

	Networks	System Operator	Offshore Transmission Operators	DCC
Licence obligations and commitments	Monitored compliance.	Monitored compliance.	Monitored compliance.	Monitored compliance.
Nature of business	Asset based.	Asset light (but backed by asset based business).	Asset based.	Asset light.
Grant of Licence	Historic.	Historic.	Competitive tender.	Competitive tender.
Uncertainty	Strategy for output delivery against long term trends set out in well-justified Business Plans. Some mechanisms to deal with uncertainty.	Uncertainty and variability resulted from the increased contribution from renewable resources. SO's costs will be driven by weather related actions.	Limited uncertainty. Revenue is per licence and includes a cap on annual bonuses and penalties.	Uncertainties could result in changes to the scope agreed in the Licence Application Business Plan. Any changes will be subject to ex post review.
Efficiency of incurred costs	Approved ex-ante. Also an efficiency incentive to drive efficiencies through the period, where companies share benefits of savings with consumers	Modelling methodologies are in place to hedge some of the risk by introducing ex-post an ex-ante data. Also a sharing factors of 25% is used to minimise any windfall gains and losses.	Competitive tender should ensure costs are efficient, the 20 year revenue is fixed, with limited scope for pass through costs.	Competitive tender should ensure the Licence Application Business Plan costs are efficient. Costs are reviewed ex-post. DCC charges are not approved in advance. Costs are passed on then reviewed at the end of the regulatory year.

Objectives of regulatory reporting

Consistency

Consistent Price Control Information for every regulatory year of the Licence, to enable comparisons.

Compliance

Allow us to monitor DCC's compliance with obligations under the Licence

Monitoring

Record and monitor performance of the DCC against the milestones and outputs.

Building Knowledge

Enable us to acquire experience and knowledge of the costs and outputs, and help understanding of impacts from future changes.

Financial Health

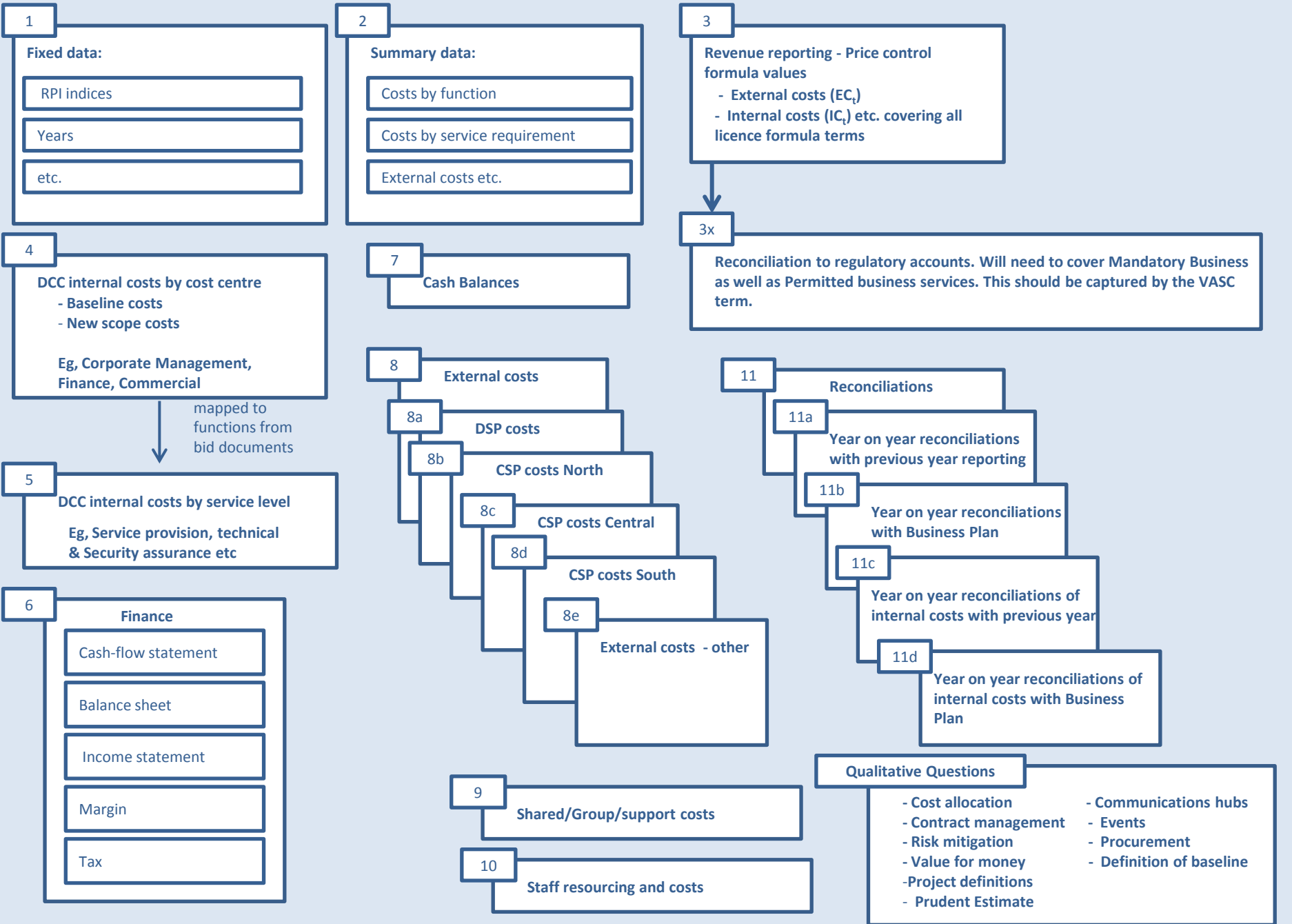
Enable us to respond as early as possible in the event there is any change to DCC's financial health.

Economic and Efficient

Allow us to determine whether costs were economically and efficiently incurred.

- We have no role in approving DCC's Service Charges in advance, which are set out in the DCC's charging statement. We approve the form of the charging statement.
- The RIGs provide a framework which enables us to collect data from DCC in a consistent format. They have been specially designed specifically for the DCC.
- They consist of:
 - Microsoft Excel Workbook for reporting.
 - Instructions and guidance on how to report the data.
- There are four main parts:
 - Reporting incurred and forecast revenue and costs
 - Reconciling reported information with previous forecasts and Licence Application business plan
 - Business structure
 - Questions requiring qualitative explanations

Overview of Reporting under the RIGs



Economic and efficient

Information from the RIGs and other performance information will allow us to monitor and assess whether costs were economically and efficiently incurred.

Cost Reporting

- Look at how DCC's own internal costs and external service provider costs were incurred.
- Compare actual costs levels with those previously forecast.
- DCC will be required to explain and justify deviations from the forecast costs in the business plan or any updated forecast.

Qualitative questions

- Monitor and understand cost drivers, allocations, and facilitate comparison or benchmarking.
- Additional information & evidence on:
 - value for money (vfm) & performance from service providers.
 - assessment of risks
 - cost allocation & group charges
 - baseline & new scope
 - approach to Prudent Estimate
 - minimal & Value Added Services, and any events (eg, implementation milestones.)

Changes & Longer term

- New scope should only be undertaken by DCC, if it is allowed under the Licence.
- New scope costs must be supported by evidence they provide vfm.
- DCC must demonstrate on going vfm of overheads.
- Expect DCC to establish a strategy to ensure that costs remain efficient over time.

Indicative price control timing

	2014												2015			
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	
Price control RIGS consultation (10 weeks)	★															
RIGS decision document				★												
DCC reports for 2013/14						▲										
Review of information							↔									
Consultation ex post review findings										★						
Final Decision*													↔			
DCC publish charges for 2015/16												▲				
2015/16 charges apply from 1 st April															▲	

* LC 19 allows the Authority to direct an amendment to charges as a consequence of the ex-post review, to exclude costs from any future calculations of revenue.



DCC milestones that relate to price control reporting



Ofgem milestones

RIGs consultation

- The first price control information is to be submitted by DCC by 31 July 2014. It will then report annually.
- We published our consultation on the draft Regulatory Instructions and Guidance (RIGs), and reporting templates on 12 February. It closes on 23 April 2014.
- DCC must at all times act in accordance with the RIGs, and these will apply to each year of price control reporting.
- We are seeking views on:

1

Do the RIGs and templates capture the significant cost and expenditure items?

2

Do you have any comments on the definitions used in the RIGs?

3

Given the evolving role of the DCC, do you think the templates are flexible enough?

4

Sufficient to enable a determination of whether costs have been economically and efficiently incurred, while maintaining an appropriate level of regulatory burden on DCC?

New Steps

- Testing the templates during the consultation period.
- We will review responses and intend to publish final RIGs in May.

Future Developments

- A new price control and the RIGs may be modified in future years.
- Consider whether more regular reporting of some aspects of the price control information might be appropriate.
- Implementation phase of licence, RIGs do not include reporting quality of service information and operational incentives need to be developed.

Publication of ex post information

- A large proportion of the price control information that DCC will report to us is likely to be covered by our legal duty to not disclose information.
- We may decide to publish some information in an aggregated format if we consider that it is in consumers' interests.

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