

January 21, 2015

Dear Tricia,

DCC Price Control Consultation

Please find Co-Operative Energy's response to the above consultation below.

Also included separately is an appendix which we would request that Ofgem treat as confidential and not circulate externally.

Question 1: What are your views on our approach to assessing DCC's costs? And do you have any suggestions on where we can improve our approach?

As a general principle, we do not believe that DCC's costs should be agreed on a post-ante basis. Agreeing costs after they have been incurred is unique to DCC and we believe that this does not incentivise suitable focus on keeping costs to an economic and efficient level. We are also of the view that this is exacerbated by the use of DCC's prudent estimate to set charges to obligated parties.

For example, in the 2013-14 regulatory year, DCC recovered £19.3m against £11.7m costs incurred. This represents an over-recovery of 65%. We are of the view that Ofgem should seek to move to ex-ante agreement of costs, in line with the manner in which the transporter price controls operate, at as early a date as possible. The prudent estimate basis for charge setting should also be removed at the earliest possible opportunity.

Question 2: What are your views on our assessment of DCC's performance against the IMs?

We agree with Ofgem's assessment that DCC has failed to meet Implementation Milestone 5 (Submission of DSP Interface Specifications) and therefore also agree that DCC should be subject to a downward margin adjustment in relation to this.

Question 3: Do you have any observations from the current incentive framework which can inform early thinking on developing an enduring framework?

As mentioned in our answer to Question 1 above, we do not believe that a post-ante approach is appropriate as costs are incurred before they are agreed. This may then create a reduced incentive for economic and efficient expenditure by DCC. In our view this could be ameliorated by an ex-ante approach in line with that used for the transporters.

We also have concerns around DCC's use of its prudent estimate in relation to charge setting, particularly as DCC will not now start providing services until significantly later than originally envisaged. This will potentially lead to an even greater level of over-recovery in the current regulatory year than that seen in the previous regulatory year as large external costs which were expected to become live during this regulatory year now will not although they will still be reflected in the prudent estimate.



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It is our view that this has a direct impact on the ability of smaller obligated parties to compete on a level playing field. The cash flow impacts of paying charges based on the prudent estimate, which is based on minimising any cash flow risk for DCC itself and also assumed that DCC would begin providing services at a much earlier date than we now know will be the case, are proportionately more significant for smaller obligated parties and tie up cash which cannot then be used to grow the business.

Question 4: What are your views on our proposal?

We agree with the disallowance of some costs for the 2013/14 regulatory year and the disallowance of the £4 million of cost increase over the remaining term of the licence. However, we would request that the remainder of the 3.8% increase in projected costs over the licence term be carefully scrutinised by Ofgem prior to any approval.

We would like to reiterate that obligated parties mandated to use DCC are already paying significant costs for a service which will now launch considerably later than expected. In our view, DCC's basing of charges on its prudent estimate will lead to even greater over-recovery in the 2014/15 regulatory year than was the case in the previous regulatory year as this year's prudent estimate was based on DCC incurring costs for service provision that will now not be incurred due to the delay. While we accept that any over-recovery is recycled in the form of lower charges in the following regulatory year, this does not cancel out the significant cash-flow impact for smaller obligated parties resulting from paying charges based on full service provision for a service that will not be delivered at the time originally envisaged.

Question 5: Do you have any views on how the RIIO price control approach could be applied to DCC in future?

We see no reason why this could not be applied to DCC in the same manner as used for the transporters. We would support this change being made at the earliest possible date.

Question 6: We are looking for ways to benchmark DCC costs. What other sources of data or potential comparators can you recommend for subsets of DCC costs?

Given DCC's unique function we understand that it may be difficult to find a direct comparator on which to base any analysis. However, despite the lack of direct comparators, we do not believe that the baseline margin provided for in DCC's contract is appropriate given that it is a regulated monopoly service provider facing very minimal levels of risk. We would also appreciate further detail in relation to the shared service charge and the margin that Capita is allowed to add to these invoices charged to its DCC subsidiary.

Question 7: What are your views on DCC's approach to the prudent estimate?

As mentioned above, we have significant concerns in relation to DCC's use of the prudent estimate and basing its charges on this. Co-Operative Energy is of the view that the prudent estimate incentivises DCC to factor an excessive risk premium into this figure. This is inappropriate in light of the fact that DCC is a regulated monopoly which faces a minimal level of risk, particularly when compared to the companies from which it collects its charges. We would like to reiterate our preference for the prudent estimate basis to charging to be removed and for DCC to move from a post-ante to ex-ante regulatory model as soon as possible.

Question 8: Do you agree that our proposals should take effect from April 2015/16?

If this is the earliest possible date on which the changes can take effect, then yes. However, we would prefer to see these changes implemented earlier if possible.

Question 9: Do you agree with our assessment against the criteria in the licence?

We agree that the baseline margin values should not be increased as we share the view that the justification provided by DCC for an increase to these is insufficient.

Question 10: What are your views on our longer term strategy of moving towards a more ex ante price control? How might this be achieved?

We believe that this change should take place at the earliest opportunity and could be achieved by making DCC subject to something akin to the RIIO framework used for the transporters. The prudent estimate basis for DCC charge setting should be removed at the earliest possible opportunity in order to remove the negative competitive impacts that this creates when any delays to DCC's planned functions arise.

I trust that this response proves helpful, please do not hesitate to contact Chris Hill (christian.hill@cooperativeenergy.coop) should you have any questions or require any further information.

Best regards,

Steve

Steve Rowe

Head of Regulation and Compliance