British Gas
Ground Floor, Lakeside West
30 The Causeway
Staines
Middlesex
TW18 3BY

Robyn Daniell
Smarter Markets
Ofgem
9 Millbank
London SW1P 3GE

22nd January 2016

Dear Robyn,

British Gas response to Ofgem's DCC Price Control Consultation

We are pleased that Ofgem has completed their second review of DCC's price control and are challenging DCC on costs where it is felt that they should be disallowed under the terms of their licence. We are broadly supportive of the proposals set out in this consultation but have highlighted a small number of concerns, most of which we raised in the last PCR consultation.

1) **The DCC needs strong post live incentives to ensure the scalability and reliability of their systems**

   We believe the current incentive scheme for the DCC, with emphasis on hitting key time bound milestones, must be rebalanced to reflect the shape the industry needs. Now that the DCC's ecosystem will not be fully tested until after go-live as end-to-end testing is due to start with DCC-live in July 2016, the reliability and usability of the system will not be proven until 2017, at the earliest.

   The current incentive scheme does not ensure that the DCC will deliver services that the industry requires or prove they can work at scale. With obligations to start installing SMETS2 meters within 6 months of go-live and curtailment of SMETS1 in October 2017 more risk is passed onto Energy Suppliers without the ability to performance manage the DCC or their Service Providers.

2) **We remain concerned that the industry has not received the full over-recovery from Regulatory Year 2013/14.**

We note that the DCC over-recovered £11m in 2013/14. However only £6.4m appears to be corrected in the 2015/16 charging statement and no further correction is visible for 2013/14. We also note that the prudent estimate offsets the correction factor in every charging statement or indicative budget.

3) **Greater scrutiny and transparency is required on the procurement of services from the DCC's parent company and affiliates**

We remain concerned about the use of Capita group services without clear strategy or procurement processes (e.g. for their service help desk). Although the use of a shared service provision from their parent company or an affiliate may be the most economical option, we do not believe this has been clearly demonstrated by the DCC.

The DCC have spoken about not wanting performance targets for 3rd party contracts. However, where no competitive tender process has been utilised, the DCC should be held accountable for their performance

It is imperative that the incentives are rebalanced to ensure that the DCC delivers the full services the energy industry require post go-live, whilst demonstrating that it is 'cost-conscious' in everything that it does, in providing the expected standard of service and clearly demonstrating value for money.

Our detailed responses to Ofgem's questions are attached in the Appendix. Please do not hesitate to contact me or Rochelle Harrison (Rochelle.Harrison@BritishGas.co.uk) if you require any further detail on our response.

Yours sincerely

(*by email*)

Andrew Pearson
Head of Smart Regulation and Industry Codes
andrew.pearson@britishgas.co.uk

Question 1. What are your views on our approach to assessing DCC's costs?

1.1 The forensic accounting report makes for interesting reading and we welcome Ofgem gaining an independent view on the DCC's policies and procedures. Given that all of the DCC's costs are eventually paid by domestic energy consumers, ensuring value for money is essential.

1.2 We remain convinced that the ex-post price control review, using the LABP (which was competitively-tendered) ensures that the DCC costs are efficiently and effectively managed, as the onus remains with the DCC to explain each new or over tolerance items. We feel that an ex-ante price control process allows monopoly businesses to inflate their costs in the expectation that they will be challenged down. Also, as the DCC has very few direct comparators (except possibly Xoserve, see below), benchmarking in an ex-ante review will be impossible.

Question 2. Do you have any suggestions on where we can improve our approach?

2.1. It appears that Ofgem has run considerable analysis on the salaries of the DCC staff and we agree that the DCC should not increase the scale and scope of their operation beyond what is necessary and efficient. Going forward, we believe that Ofgem could use comparators from within the energy industry, such as Xoserve (with project Nexus), Gemserv and Elexon for comparators, particularly by skill set and relevant grade.

Question 3. What are your views on our assessment of DCC's performance against IM7?

3.1. We agree that the DCC achieved IM7 Approval of the Service Management Design in 2014/15.

3.2. We are happy to support Ofgem in the design of the operational incentives and have started thinking about the performance measures within section D of the DCC's licence.

Question 4. What are your views on our cost proposal?

4.1 We agree that the use of contractors on a long-term basis is not economic or efficient. Although a contractor strategy may well be a practical way of quickly gaining specialist knowledge and flexibility, this arrangement should include a timeline for transition to the use of permanent employees. As with the procurement of shared services, there is a risk that contractors may be sourced directly from the DCC's parent company or affiliates without any external benchmarking. This could lead to contractors not being economically-sourced with potentially over-inflated rates.

4.2 We are pleased to see that the accommodation costs associated with being in a prime, central London office have been reviewed by Ofgem. A central London location not only adds to office costs but also staff salaries, i.e. the need to compete with salaries paid to other employees in the area and additional overheads such as help with staff loans for annual travel cards. Whilst we appreciate the need for some DCC personnel to spend time in London this should not automatically mean that the entire company need to be centrally-located.

Question 5. We are interested in feedback from stakeholders and industry parties on the DCC's external engagement. What were your experiences of engaging with the DCC in regulatory year 2015/16?

5.1. The DCC external engagement continues to develop and improve; they are particularly good at seeking and acting on feedback following each stakeholder event. Unfortunately, with the size and breadth of the energy industry, one size does not fit all. However, the DCC are accommodating with bilateral meetings with specialists as well as industry-wide days.

Question 6. We welcome views on DCC's benchmarking methodology, including what you consider the appropriate percentile is that DCC should use when carrying out benchmarking, and approach to benchmarking benefits?

6.1. We agree that benchmarking at 50^{th} and 75^{th} percentiles is too high and should be fully-justified by the DCC for specialist roles or extended responsibility. We believe that a benchmark of the 50^{th} percentile should be the maximum, even for roles that require significant expertise.

Question 7. We are looking for ways to further benchmark DCC costs. What other sources of data or potential comparators can you recommend for subsets of DCC costs?

7.1. Use of Xoserve resource costs and comparison of accommodation costs in a location outside of London, particularly the project Nexus costs, could prove helpful. Project Nexus costs could also be used as a direct comparator for timescale slippage.

Question 8. Do you agree with our approach to RPEs?

8.1 We agree with Ofgem's approach on real price effects; using RIIO as a comparator. However, we do not agree that the generalist roles in effect gain +2.6% versus their RIIO counterparts (from -1.9% to +0.5%). We do not understand Ofgem's rationale for this significant divergence from your approach.

8.2 We would welcome more information on which roles are considered generalist or specialist by both the DCC and Ofgem.

Question 9. What are your views on DCC's approach to the prudent estimate?

9.1 As previously stated we do not agree with the DCC's use of the prudent estimate. It should not be used as a separate term in their allowed revenue and appears to completely outweigh the correction factor each time; see table below. Therefore consumers are not benefiting from the protection of the correction factor term within the Licence.

9.2 The table below shows the correction factor and prudent estimates as published by the DCC within their quarterly updates for regulatory years 2015/16 and 2016/17.

£m 2015/16	Jan-14	Apr-14	Jul-14	Oct-14	Jan-16	Final
Correction factor	0.0	0.0	0.0	-2.4	-8.0	-8.5
Prudent estimate	0.0	9.7	9.7	10.4	9.5	9.5

£m 2016/17	Jan-15	Apr-15	Jul-15	Oct-15	Jan-16
Correction factor	0.0	-4.3	-2.4	-2.4	-9.1
Prudent estimate	0.0	13.1	14.5	12.0	13.1

Question 10. Do you think our proposals should take affect from April 2015/16?

10.1. Yes.

Question 11. Do you agree with our assessment against the criteria in the licence?

11.1. Yes, we agree that the contract value is not the correct basis for evaluating the value of increased risk.

Question 12. What margin do you think should apply, 10% or 15%?

12.1 Whilst we have some sympathy for the DCC expressing the margin should be 15%, we do not believe that 15% is the correct value, as it is clearly higher than any equivalent company or rate of return of a monopoly business.

Question 13. Do you have any views on the rate of return methodology we have developed?

13.1 Perhaps Ofgem could consider weighting the different comparator margins based on the proportions of work the DCC undertakes to the similar companies. The median of the margins could then be multiplied by the DCC proportions

END