

Draft DCC Business Case for DCC activities during the Transitional Phase of the Switching Programme

Sections for EDAG review



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1 Executive Summary

1.1 The Switching Programme

1. Ofgem has established the Switching Programme to improve consumers' experience of switching between energy suppliers, leading to greater engagement in the retail energy market. This will be achieved by designing and implementing a new faster and more reliable switching process, underpinned by a Centralised Registration Service (CRS) to be procured by Smart DCC Ltd (DCC).
2. DCC is a key delivery partner in Ofgem's programme. Conditions have been introduced to the Smart Meter Communication Licence ('the licence') that require DCC to contribute to the design of the CRS and the broader switching arrangements and to procure the CRS.

1.2 DCC Switching Business Case

3. Ofgem also applied an 'ex post plus' price control approach for all of DCC's Switching Programme costs during the period from 1 April 2016 up to the point of contract signature for Fundamental Registration Service Capability to deliver the CRS. This period is referred to as the Transitional Phase of the Switching Programme. Under the ex post plus arrangements, DCC is required to set out its planned activities and costs upfront in a published business case and report its actual and forecast costs to Ofgem on a monthly basis throughout each regulatory year. DCC is also required to justify its expenditure on the Switching Programme through its annual ex post price control reporting.
4. This DCC Switching Business Case for DCC activities during the Transitional Phase of the Switching Programme ('the DCC Switching Business Case') sets out DCC's forecast activities and costs and proposed margin and incentives relating to its role in supporting Ofgem's Switching Programme for the Transitional Phase of the Programme. The DCC Switching Business Case will be baselined in March 2017 following scrutiny by Ofgem and consultation with industry.
5. The DCC Switching Business Case is based on the information available at the time of writing and where information is not yet available in relation to key activities then assumptions have been made, validated where possible, and documented. The DCC Switching Business Case will be revised and updated at key points in the programme to take account of the increasing level of certainty about activities, timelines, resource requirements and costs.
6. Ofgem is developing a wider Business Case for the introduction of new switching arrangements. The content of the DCC Switching Business Case will inform elements of the Ofgem Business Case.

1.3 Requirements

7. During the Transitional Phase, DCC is required to:
 - support development of the Ofgem and DCC Business Cases
 - fully participate in Ofgem-led design teams (Business Process Design, Delivery Strategy, Commercial and Regulatory Design) by leading and contributing to the development of products

- prepare for and deliver the procurement of the CRS.
- 8. DCC has identified defined products and activities to deliver these requirements and traced these to Licence Conditions, decision documents and Ofgem instructions.
- 9. DCC has developed three high level scenarios that illustrate how key areas of scope uncertainty may affect DCC's activities and the associated costs: a baseline scenario, a high scenario and a low scenario. This approach is intended to provide transparency to Ofgem and stakeholders about the potential cost impacts of changes to the baseline assumptions.

1.4 Activity and resourcing plan

10. DCC has planned the activities required to deliver the requirements associated with the baseline scenario, based on the information currently available. DCC has developed an indicative programme timeline that identifies the duration of activities and the effort and capabilities required to deliver them, in order to develop a costed resource plan. DCC's planned activities during the Transitional Phase are summarised in Figure 1.
11. This plan does not reflect Ofgem's currently planned timescales for the Enactment Phase for the following reasons:
 - DCC has reduced the level of overlapping activity, across Blueprint, DLS and Enactment phases, in order to reflect a realistic resourcing profile
 - DCC considers that it would be logical to commence the development of the CRS technical specification and CRS delivery specification once the detailed design and detailed delivery planning are complete at DB4, rather than undertaking both design and specification activities in parallel
 - DCC has reflected the planned review and approval cycles for procurement products as set out in the Procurement Framework in its timescales for the procurement activities.
12. It will only be possible to determine the end date of the Transitional Phase with any certainty once the solution design and delivery strategy have been decided, DCC and Ofgem have undertaken joint planning and this is confirmed to be achievable following external assurance.

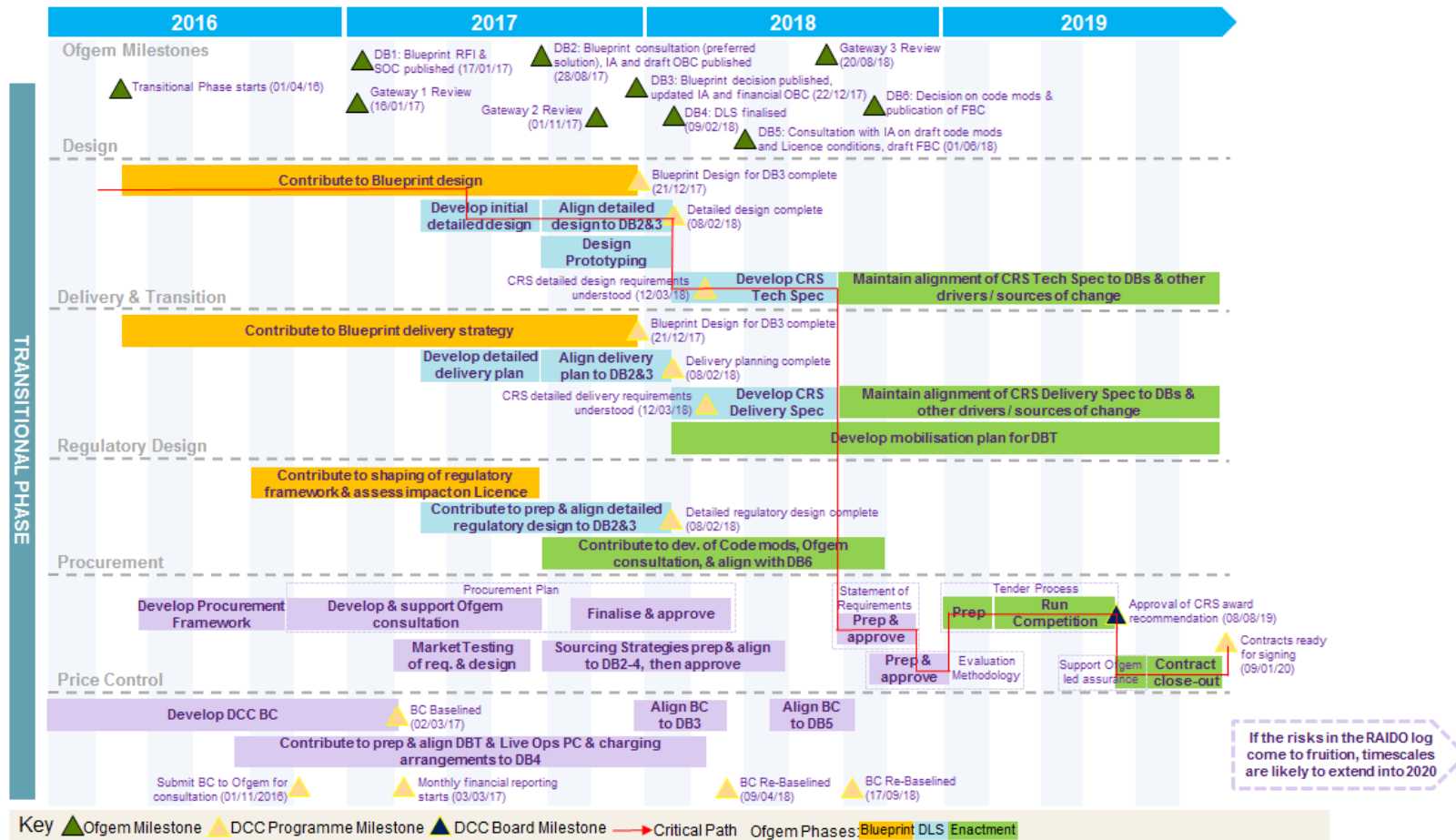


Figure 1 – High level DCC programme timeline

13. The key resource capabilities required are:
 - technical design, including security
 - delivery planning
 - programme management
 - procurement
 - regulation
 - commercial (including price control and charging)
 - support services.

14. DCC has developed a resource model that generates a resourcing profile for delivery of the products and activities. This is based on business conditions within the cost model that automatically determine which roles would be more economically and efficiently fulfilled by permanent resource or by temporary resource. The resource profile is summarised below in Figure 2.

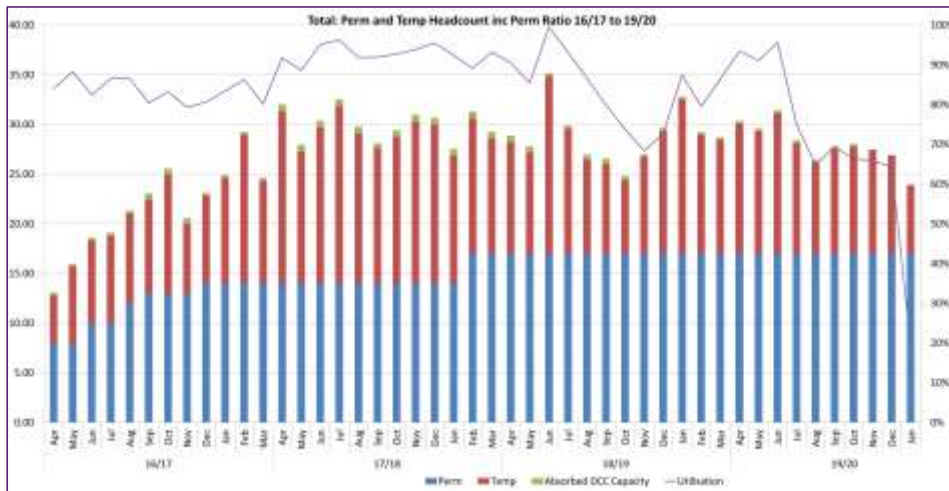


Figure 2 - DCC FTE profile

15. DCC has also identified non-staff resources that are required to deliver its activities. Non-staff resources are driven by the number of staff, such as office space, tools and IT equipment, or by specific delivery activities, for example prototyping and other professional services that may be required.

16. DCC has identified risks, assumptions, issues, dependencies and opportunities associated with the delivery of these activities.

1.5 Costs

1.5.1 Total costs

17. The total forecast cost associated with delivering the baseline scenario is summarised in Table 1.

(£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	RY 20/21	TOTAL
Total costs	5,435	8,580	7,607	6,695	768	29,085
Staff costs	4,319	5,662	4,858	3,880	0	18,719
Non-staff costs	235	608	239	225	0	1,307
Contingency	138	568	830	1,188	702	3,426
Management reserve	271	998	1,019	821	0	3,110
Overhead	472	744	660	581	67	2,523

Table 1 - DCC baseline scenario costs

1.5.2 Staff costs

18. The forecast cost by resource type is summarised in Table 2.

Staff Costs (£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	Total
Total staff costs	4,319	5,662	4,858	3,880	18,719
Support services	483	393	681	704	2,261
Design	1,684	2,159	1,219	764	5,826
Delivery	339	978	1,326	1,167	3,810
Programme	612	643	646	523	2,423
Procurement	252	431	337	384	1,404
Regulation	022	299	088	-	409
Commercial	928	759	562	338	2,586

Table 2 - DCC staff costs

1.5.3 Corporate overhead charge

19. The Capita overhead charge is levied at 9.5% of DCC's Internal Costs. The corporate overhead charge enables Capita to function as a business, covering Group corporate management activity including Head Office and executive oversight. It is also covers the contribution to central Capita services which underpin all Capita contracts including DCC e.g. payroll and insurance.

1.5.4 Materiality threshold

- 20. The materiality threshold sets the tolerance level for variance from the baseline DCC costs. If this materiality threshold is exceeded, DCC will be required to update and publish a revised DCC Switching Business Case. The materiality threshold comprises contingency, which allows for known quantified risks, and management reserve, which allows for unforeseen change.
- 21. The proposed contingency allowance is £3,426k. This is equivalent to 17% of the total cost base associated with the baseline scenario.
- 22. The proposed management reserve is £3,110k, which is equivalent to 16% of the total cost base associated with the baseline scenario.
- 23. The total materiality threshold is £6,535k, which is equivalent to 33% of the total cost base associated with the baseline scenario.

1.5.5 Comparison of scope scenario costs

- 24. The costs associated with the high scenario, baseline scenario and low scenario are summarised in Table 3. Note that this comparison is based on resource and non-staff resource costs only and does not include the corporate overhead charge, contingency, management reserve or margin.

Scenario base costs - staff and non-staff costs) (£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	RY 20/21	Total	Variance from base scenario
Baseline scenario base cost	4,554	6,269	5,097	4,105	-	20,026	0%
Low scenario base cost	3,942	5,427	4,412	3,553	-	17,334	-8%
High scenario base cost	4,973	7,994	7,617	7,713	2,130	30,428	+30%

Table 3 - Scope scenario cost comparison

1.6 Margin and incentives

1.6.1 Proposed margin

- 25. DCC proposes that:
 - the margin is calculated as a fixed rate of return of 15% of all DCC costs in the Transitional Phase¹ (margin=(x/(1-y))-x, where x = cost; y = % rate of return)
 - the fixed rate of return is set ex ante for the entire Transitional Phase (RY 2016/17 – RY 2019/20)²

¹ Calculated as a 'margin' as opposed to a 'mark-up'

- the forecast margin is recovered via DCC charges in effect from April 2017 onwards
 - there is a mechanism for both DCC and Ofgem to apply for an adjustment to the fixed rate of return in the event of a significant change to DCC's role and/or risk profile.
26. DCC considers that this rate of return is commensurate with risk associated with DCC activities during the Transitional Phase of the Switching Programme, represents a reasonable return on the provision of professional services to the Ofgem Switching programme compared to market rates, and reflects the commercial expectations of DCC.
27. Based on the rate of return of 15% and the forecast costs associated with the baseline scope scenario, the forecast value of the margin to be recovered is set out compared to the forecast DCC costs in Table 4.

(£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	RY 20/21	Total
Total costs	5,435	8,580	7,607	6,695	768	29,085
Margin	959	1,514	1,342	1,181	136	5,133

Table 4 - Proposed margin values (based on forecast costs)

1.6.2 Proposed incentives

28. Ofgem's preference is for DCC to operate under a performance incentive regime with incentives relating to timeliness of product delivery and stakeholder satisfaction. As a result, DCC has developed a proposal that seeks to mitigate some of the challenges of implementing incentives during the Transitional Phase and ensure that the incentives can be practically implemented and monitored. Further collaborative work by DCC and Ofgem is required to develop the incentive framework in detail.

Time-based incentive

29. A time-based incentive places DCC margin at risk based on whether DCC delivers specific milestones by agreed dates.
30. The time-based incentive applies only to DCC activities where DCC has a high level of ownership and control. DCC proposes that incentives are applied to the following milestones:
- CRS technical specification complete
 - CRS tender packs complete (for the latest of multiple major procurement projects)
 - Contract award recommendation reports approved (for the latest of multiple major procurement projects).
31. This is a downside-only financial incentive. DCC proposes that the level of margin at risk is proportionate to the percentage of the cost base for DCC activities relating to delivery of the incentivised milestones. Based on the current forecast costs this equates to 25% of DCC margin at risk.

² Except for the margin relating to RY2016/17, which would be set during RY 2016/17 and be recovered during RY 2017/18

32. Milestone achievement should be based on defined and agreed acceptance criteria in order to ensure an appropriate quality level is achieved alongside timely delivery. DCC proposes that milestone achievement is validated by wholly independent assurance, sourced by Ofgem and paid for by DCC.
33. In addition to this milestone assurance, DCC proposes that the incentive mechanism should only be activated following external assurance that the plan is deliverable and that it is possible to achieve the milestones linked to the incentives.

Stakeholder satisfaction incentive

34. DCC proposes that a non-financial, reputational incentive is linked to survey feedback from Switching Programme participants on DCC's performance within the Switching Programme. This incentive could form the baseline for a potential financial incentive in future phases of the Switching Programme.

1.7 Monitoring and updating the DCC Switching Business Case

35. DCC is required to justify its expenditure on the Switching Programme through its annual ex post price control reporting.
36. Under the ex post plus arrangement for the Switching Programme, DCC will also:
 - report to Ofgem monthly on its actual and forecast financial performance against the DCC Switching Business Case
 - provide monthly updates to industry stakeholders on its delivery against the DCC Switching Business Case via regular programme governance forums.
37. DCC plans to update the DCC Switching Business Case at key milestones in Ofgem's Switching Programme plan. DCC will also update the DCC Switching Business Case by exception if the materiality threshold has been exceeded and Ofgem subsequently instructs DCC to re-baseline the DCC Switching Business Case.

2 Costs

38. This section explains our approach to calculating costs and provides an overview of the cost model, which is included in full at Appendix D. A diagram of the business view of the cost model is included within the cost model to help navigation between the various worksheets.

2.1 Summary of costs

39. The total estimated cost associated with delivering the baseline scenario is summarised in Table 13.

Costs (£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	RY 20/21	TOTAL
Total costs	5,435	8,580	7,607	6,695	768	29,085
Staff costs	4,319	5,662	4,858	3,880	0	18,719
Non-staff costs	235	608	239	225	0	1,307
Contingency	138	568	830	1,188	702	3,426
Management reserve	271	998	1,019	821	0	3,110
Overhead	472	744	660	581	67	2,523

Table 13 - DCC baseline scenario costs

40. Staff costs are described in Section 9.3, non-staff resource costs are described in Section 201 and corporate overhead is described in Section 9.5. Contingency and management reserve is explained in Section 12 and margin is set out Section 10.

2.2 Cost drivers

41. Staff costs are primarily driven by the duration of activities, the amount of resource effort required to deliver the activities and the cost of resource to deliver the activities. The DCC Switching programme plan generates a monthly FTE resource profile for each resource type, based on the duration, effort and capabilities required to deliver each activity. The cost model applies business conditions to generate a profile of permanent and temporary resource by resource type. The generation of this profile is explained in Section 8.5.2.
42. The permanent rate card is applied to the permanent resource profile, the contractor rate card is applied to the contractor resource profile, and a blended consultancy day rate to the consultancy resource profile, in order to generate a base resource cost for the baseline scenario. This includes recruitment costs and on-costs for all permanent roles recruited. The approach to the cost of resource provided by central DCC functions is explained in Section 9.3 below.
43. Non-staff resource costs are summarised in Section 9.3. Some cost items are driven by the number of staff, such as office space, tools and IT equipment. Other non-staff resource costs relate to delivery activities, for example prototyping services and other professional services that may be required.
44. The contingency element of the materiality threshold is driven by the probability weighted cost associated with the high scenario and with quantified risks not directly related to the

high scenario. The management reserve element of the materiality threshold is driven by the level of uncertainty associated with estimating the costs of activities to be delivered later in the Transitional Phase. This is explained in more detail in Section 12.

45. The rationale for the corporate overhead charge is explained in Section 9.5 below and the rationale for the level of margin is set out in Section 10.

2.3 Staff costs

46. The annual cost of each resource type is summarised in Table 14.

Staff Costs (£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	Total
Total staff costs	4,319	5,662	4,858	3,880	18,719
Support services	483	393	681	704	2,261
Design	1,684	2,159	1,219	764	5,826
Delivery	339	978	1,326	1,167	3,810
Programme	612	643	646	523	2,423
Procurement	252	431	337	384	1,404
Regulation	022	299	088	-	409
Commercial	928	759	562	338	2,586

Table 14 - DCC staff costs

47. The cost by permanent, contractor or consultancy resource for each resource type is summarised in Table 15, Table 16 and Table 17.

Permanent resource costs (£k)	16/17	17/18	18/19	19/20	Total
Total	1,426	1,585	1,794	1,495	6,300
Support services	195	174	174	145	688
Design	379	435	435	362	1,611
Delivery	183	300	510	425	1,418
Programme	521	542	542	452	2,057
Procurement	-	-	-	-	-
Regulation	-	-	-	-	-
Commercial	149	134	134	111	527

Table 15 - Permanent resource costs

Contractor resource costs (£k)	16/17	17/18	18/19	19/20	Total
Total	1,672	1,387	1,478	1,233	5,771
Support services	-	-	-	-	-
Design	1,152	441	437	354	2,385
Delivery	65	293	553	557	1,467
Programme	-	-	-	-	-
Procurement	228	228	228	190	873
Regulation	-	197	33	-	230
Commercial	228	228	228	133	816

Table 16 - Contractor resource costs

Consultancy resource costs (£k)	16/17	17/18	18/19	19/20	Total
Total	1,221	2,689	1,586	1,151	6,648
Support services	288	219	507	559	1,574
Design	153	1,283	347	48	1,831
Delivery	91	384	264	186	924
Programme	90	101	104	71	366
Procurement	25	203	109	194	531
Regulation	22	102	55	-	179
Commercial	552	398	200	94	1,244

Table 17 - Consultancy resource costs

2.3.1 Resource rate card

48. In order to calculate the costs associated with the planned resource profile, DCC has developed a rate card that includes both permanent and contractor rates for each identified role. Permanent rates reflect fully loaded costs³ and permanent recruitment costs are also reflected in the cost model. Agency fees for contractors are not included at present.
49. DCC has benchmarked these rates based on:
 - similar roles in the Hays Paynet database
 - the cost of similar roles previously recruited by DCC
 - the cost of similar roles previously recruited by the DCC Switching Programme team in previous roles.

³ Including National Insurance, pension, bonus, travel/car allowance, expenses, training, phone and health

50. The base salaries included in DCC's budget for permanent resource capabilities are detailed in Table 18. This is supported by benchmarking data from Hays Paynet, which maps similar job roles based on actual payroll data supplied by organisations.
51. A salary range is provided against each role to reflect the spread in the resource market. The forecast for salaries is based on pay levels within the 50th and 90th centile values as they are most aligned to the market in which DCC operates in for the Switching Programme. The programme is based in central London to ensure access to DCC management and central resources and to make use of any existing office space. The programme requires experienced professionals, typically with advanced technical skillsets and energy experience. Recruits also need to possess the ability to deliver in a fast-paced, high pressure programme environment on national scale across a complex multi-party stakeholder landscape.
52. Where 'n/a' is indicated in job role column, it indicates that no comparable role was found in the PayNet database, so DCC has made a judgement on the appropriate level for the role to provide a salary range for benchmarking.
53. Table 18 also details the permanent salaries converted to a fully loaded day rate and the day rate where the same resource type is sourced through a temporary contract. Where consultancy resource is required a blended day rate is applied, based on the average rate for a Level 4 consultant from DCC's framework contract for consultancy services. Legal costs are applied at a competitive rate for all legal requirements.

[Table 18]

Table 18 - Permanent employee salary benchmarking

54. All permanent and temporary DCC roles will be advertised in the open market to ensure an economic and efficient resourcing approach. All consultancy resource will be sourced through DCC's existing consultancy services framework, in line within the DCC procurement strategy.

2.3.2 Central DCC resources

55. Central DCC resources are primarily defined as the support functions required to enable daily operation of DCC activity across all of its programmes and operations. This resource is dedicated to DCC activity. Key central DCC resources include:
 - people resources – IT helpdesk, HR, recruitment, commercial, legal, finance, regulation
 - non-people resources – desk space, meeting rooms, facilities management.
56. In addition to the support functions, central DCC resources also include any pre-existing Smart Metering Implementation Programme (SMIP) design and delivery staff, whose input will be required intermittently in the programme. There will be some impact on existing deliverables that DCC will need to update based on our involvement in the Switching Programme, such as the Business Handover Plan.
57. As a principle, the Switching Programme will use existing DCC resources where either:

Comment [AH1]: This is commercially sensitive information and is not included in this version of the document

- there is a requirement to validate the alignment of proposed switching arrangements with delivery of the smart meter communication service or any other DCC programme, for example Enrolment and Adoption of SMETS1 meters. This will be captured in the product and activity descriptions and reflected in DCC's resource plan
 - it is the most economic and efficient use of resource whilst ensuring that there is no impact on SMIP delivery.
58. DCC proposes that where the additional demands of the Switching Programme cannot be serviced through existing central DCC resource, additional capacity will be sourced as required and will be allocated to the DCC Switching Programme. Where additional resource is required due to new demands on DCC SMIP at the same time as the Switching Programme, the cost apportionment will be set accordingly.
 59. Where any of the new demands of the Switching Programme can be absorbed by existing central DCC resource, no costs will be allocated to the DCC Switching Programme unless over 50% of a specific resource is required. For example, where a resource is forecast to be used for 60% of the time on Switching, 60% of the resource cost will be allocated to Switching and 40% to SMIP. This will ensure that the cost of these resources is not double-counted.
 60. This may mean that the true cost of DCC's involvement in the Switching Programme is slightly underestimated or overestimated. However, DCC considers that this is proportionate approach given the cost required to establish and monitor an internal cross-charging arrangement that does not currently exist across DCC. All material contributions to the Switching programme (i.e. those of more than half day blocks) will be time sheeted, whether the costs meet the cross charging conditions or not. This will allow DCC to monitor the efficiency of its resource and whether the demands on resource is increasing or reducing relative to the baseline plan.
 61. Where a proportion of central DCC resource exceeds this threshold and has the appropriate share of cost allocated to the DCC Switching Programme, it will be fixed for the forecast period for which the resource is required and not adjusted each month. This level can be reviewed periodically for each role depending on the level of variance in actual time spent compared to the original forecast.
 62. 100% of each resource's time will be included in the final annual DCC ex post price control submission regardless of which programme cost centre they are reported under. Resource costs split in this way will be made explicit.

63. The forecast use of DCC central staff is outlined in Table 19.

Absorbed DCC capacity (FTE months)	16/17	17/18	18/19	19/20	Total
Total	5	8	5	2	20
Support services	0	0	0	0	0
Design	0	0	0	0	0
Delivery	0	0	0	0	0
Programme	0	0	0	0	0
Procurement	0	0	0	0	0
Regulation	1	5	1	0	7
Commercial	4	3	3	2	13

Table 19 - Absorbed DCC capacity

2.4 Non-staff resource costs

64. The majority of the DCC costs are staff-related; however, some non-staff costs are included within the programme budget as detailed in Table 20.

[Table 20]

Table 20 - Non-staff resource costs

65. A budget for additional office space has been included where the capacity of current DCC premises is exceeded⁴ (currently any resource requirement above 8 FTE).
66. A budget for software tools is included to ensure that the programme management and design functions can operate to required levels. In addition, costs for establishing a time sheeting solution to underpin the monthly financial reporting process has also been provisioned.
67. At the request of Ofgem, provision as also been made for six-monthly satisfaction surveys to support the stakeholder satisfaction incentive mechanism and independent external assurance of:
- the DCC delivery plan at DB4
 - DCC achievement of incentivised milestones (three milestones in scope)
68. Professional audit and compliance services currently sourced by DCC are not included within the budget for Switching as it is assumed that the switching programme can be delivered within the existing DCC budget for this area.

Comment [AH2]: This is commercially sensitive information and is not included in this version of the document

⁴ DCC continues to regularly assess and analyse its current and longer term requirements for office space. The methodology used seeks to balance: over-investment in capacity, resulting in low utilisation and thus an inefficient ongoing and future accommodation cost; and under-investment in capacity, which would result in accommodation that cannot deliver requirements such as collaboration between DCC and its Service Users and Partners. The review and report provided by Capita's Real Estate business supports the DCC's space management strategy and states that DCC are unable to do anything further to improve its use of the space within the constraints of the headcount and collaborative model.

69. DCC considers prototyping as an essential part of the design phase and has provisioned costs for sourcing a prototyping service.

2.5 Corporate overhead

70. A corporate overhead charge is included within DCC's Switching costs and is defined as DCC's contribution to:
- the central Capita services which underpin all Capita contracts including DCC. Services provided through the overhead charge include:
 - payroll
 - accounts payable/accounts receivable
 - tax and treasury services
 - insurance
 - internal audit
 - public relations
 - HR policy and oversight
 - IT policy and oversight
 - policy monitoring
 - corporate travel portal
 - Group corporate management costs – Head Office and executive oversight.
71. DCC and its parent company do not have a formal cost allocation policy. The overhead charge, defined as 9.5% of cost, was itemised in the successful Capita bid to operate DCC, and as such, has been validated through a competitive tender process.
72. DCC acknowledges that Ofgem would welcome greater insight into the overhead charge, and the benefits that accrue to DCC through being able to access Capita Group services. As a result, DCC has provided a more detailed justification for its corporate overhead charge through its recent annual 2015/16 ex post price control submission. The overhead charge for the Switching Programme is included within this justification.
73. The corporate overhead charge enables Capita to function as a business and all of its businesses are required to make a contribution to its underpinning corporate services and management oversight.
74. Using an overhead charge to recover these costs from each business unit is a common business practice for this type of operation. The nature of an overhead charge is that:
- it simplifies the recovery of costs for providing common services, e.g. payroll, where demand is likely to be variable, and hence cost would be incurred in monitoring and charging for usage.

- it allows central costs to be covered, which due to their intangible nature are difficult to value objectively e.g. executive management oversight.
75. The payment of the overhead charge is included within the intercompany trading agreement between Smart DCC Limited and Capita Business Services Limited (a Capita Group Company that is also DCC's parent company).
 76. Taking account of both the benefits obtained from our parent company and the need to make a contribution to central costs, DCC considers that the overhead charge represents value for money to the consumer. This is further supported when the alternative costs of DCC establishing and operating these functions as a standalone entity are taken into consideration.
 77. Within the annual ex post price control reporting, the corporate overhead charge is allocated against a 'shared services' category, even though it also includes group corporate management costs. This is done for reasons of simplicity and will continue to be the case for reporting the Switching Programme's contribution to the corporate overhead. The Switching Programme's contribution to corporate overhead can be reported separately from the wider DCC contribution, if required.
 78. For the avoidance of doubt, where some functions are listed under both DCC central costs and corporate overhead e.g. IT and HR services, this is complementary resource not a duplication of resource. The DCC services are dedicated to DCC delivery, whereas the corporate overhead resources provide strategic oversight and support.

2.6 Costs of scope scenarios

79. The costs associated with the high scenario, baseline scenario and low scenario are summarised in Table 21. Note that this comparison is based on staff and non-staff resource costs only and does not include the corporate overhead charge, contingency, management reserve or margin.

Scenario base costs - staff and non-staff costs (£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	RY 20/21	Total	Variance from base scenario
Baseline scenario base cost	4,554	6,269	5,097	4,105	-	20,026	0%
Low scenario base cost	3,942	5,427	4,412	3,553	-	17,334	-8%
High scenario base cost	4,973	7,994	7,617	7,713	2,130	30,428	+30%

Table 21 - Scope scenario cost comparison

3 Margin and incentives

3.1 Overview

80. This section sets out DCC's proposals in relation to:
- DCC's expected return for our work in relation to the Transitional Phase of the Switching Programme
 - the incentive framework for DCC's activities during the Transitional Phase.
81. DCC's proposed rate of return is based on proposals or analysis around a number of supporting features which collectively form DCC's margin proposal. These features are shown in Figure 14 below.

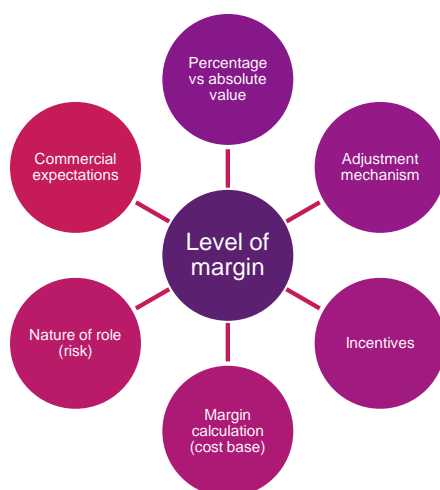


Figure 14 – Features of margin proposal

82. The margin, as discussed in this DCC Switching Business Case, represents a return to Capita (through DCC) for the delivery and management of DCC's role during the Transitional Phase of the Switching Programme. This margin will be recovered through DCC charges in effect from April 2017 onwards.
83. Ofgem has stated that DCC can reasonably expect a margin for its Switching Programme activities which is commensurate with the degree of associated risk⁵ and it anticipated that a margin allowance would be incorporated in DCC's allowed and regulated revenues via a direction which specifies the "Centralised Registration Service Performance Adjustment" (CRSPA) term in the Licence⁶.

⁵ Ofgem, 'Decision: DCC's role in developing a Centralised Registration Service', 17 May 2016, paragraph 1.31: <https://www.ofgem.gov.uk/publications-and-updates/decision-dccs-role-developing-centralised-registration-service>

⁶ Licence condition 36.10

84. DCC expects that the DBT and Live Operations phases will present an opportunity to incorporate a meaningful incentive framework for DCC's activities. DCC's role will be critical to the successful implementation of change to the energy supplier switching process and, as such, DCC anticipates that a performance incentive framework will apply during those programme phases. Margin and incentives for DCC's role during the DBT and Live Operations phases of the Switching Programme will be set separately from this DCC Switching Business Case.

3.2 Agreed principles

85. Working collaboratively through the Price Control Design Team (comprising DCC and Ofgem representatives), DCC and Ofgem developed a set of principles relating to determining the margin proposals. The principles are that the margin should:
- reflect the nature of the activities, the market returns for activities of this type and the level of risk to DCC of the Transitional Phase activities, e.g. specialist skills
 - be calculated by applying DCC's expected marginal rate of return on economic and efficient costs
 - be set ex ante in accordance with Ofgem's direction in early 2017
 - be directed by Ofgem with a mechanism for both DCC and Ofgem to apply for an adjustment.

3.3 Summary of margin proposals

86. DCC's proposals in relation to margin are summarised below. We propose that:
- the margin is calculated as a fixed rate of return of 15% of all DCC costs in the Transitional Phase⁷ ($\text{margin} = (x/(1-y)) - x$, where $x = \text{cost}$; $y = \% \text{ rate of return}$)
 - the fixed rate of return is set ex ante for the entire Transitional Phase (RY 2016/17 – RY 2019/20)⁸
 - the forecast margin is recovered via DCC charges in effect from April 2017 onwards (subject to any ex post adjustments following the ex post price control assessment)
 - there is a mechanism for both DCC and Ofgem to apply for an adjustment to the fixed rate of return in the event of a significant change to DCC's role and/or risk profile.
87. This proposal is based on the incentives framework outlined below and DCC's assessment of the risks we face during the Transitional Phase, which is also included below. Each feature of the proposal is explained below.
88. Based on the rate of return of 15% and the forecast costs associated with the baseline scope scenario, the forecast value of the margin to be recovered is set out compared to the forecast DCC costs in Table 22.

⁷ Calculated as a 'margin' as opposed to a 'mark-up'

⁸ Except for the margin relating to RY2016/17, which would be set during RY 2016/17 and be recovered during RY 2017/18

(£k)	RY 16/17	RY 17/18	RY 18/19	RY 19/20	RY 20/21	Total
Total costs	5,435	8,580	7,607	6,695	768	29,085
Margin	959	1,514	1,342	1,181	136	5,133

Table 22 - Proposed margin values (based on forecast costs)

3.4 Incentives

89. This section sets out the key elements of DCC’s proposed application of performance incentives to its activities during the Transitional Phase of the Switching programme. The proposal seeks to define an incentive framework that is practical to implement and supports the desired outcomes for the Switching programme.

3.4.1 Principles for incentives

90. Through the Price Control Design Team DCC and Ofgem developed a set of design principles against which potential incentives would be assessed. These principles have been designed to ensure that incentives are only applied where they bring genuine benefits to the programme. DCC wholly supports the use of incentive regimes when they are applied in an appropriate context.
91. It was agreed by the Design Team that any incentive should:
- ensure there is no duplication of rewards and penalties with existing incentives⁹ – e.g. under the Operational Performance Regime (OPR)¹⁰
 - encourage behaviour that is aligned with the desired outcomes for the Switching programme i.e. time, quality, cost
 - be proportionate i.e. it would be disproportionate to develop a complex incentive regime for an immaterial financial value
 - be capable of being measured objectively and unambiguously
 - have quantified limits to risk as well as reward
 - feature an upside incentive as well as downside, in order to balance risk and reward (note that this could apply to a package of incentives)
 - not create perverse incentives, that is, incentivising one outcome in a way that creates an unintended consequence of compromising other key outcomes

⁹ These include:

a. Incentives to be economic and efficient, in order to avoid costs being disallowed through DCC’s annual price control regime - downside
b. Incentives not to over-recover costs from SEC Parties, through the penalty interest rate regime - downside
c. Incentives to deliver quality, through potential granting of future contracts - upside

¹⁰ As set out in Schedule 4 of the Smart Meter Communication Licence

- measure performance of activities which are within DCC's reasonable control.

3.4.2 Assessment of potential incentives

92. As part of the Price Control Design Team's planned work on incentives, DCC identified potential areas to which incentives could be applied and assessed these against the principles outlined above. The assessment is included as Appendix E. DCC's analysis concluded that there was no compelling rationale for the application of incentives.
93. However, subsequently, Ofgem has expressed a preference for DCC to operate under a performance incentive regime with incentives relating to timeliness of product delivery and stakeholder satisfaction. DCC has some concerns with incentivising the timely delivery of activity as it may perversely encourage DCC to:
 - prioritise time over quality and lead to missed opportunities to improve quality and reduce time and cost in later phases of the programme.
 - be overly cautious in its planning to reduce the risk of late delivery, which may result in longer delivery timescales
 - make compromises in the procurement approach it plans to adopt such that it prioritises faster delivery over depth or breadth of competition
94. DCC's main concerns for incentivising stakeholder satisfaction are that:
 - the measurement of effectiveness is subjective
 - good programme delivery does not always equate to satisfied stakeholders. For example, it may be in the interests of the programme for DCC to challenge vested interests in relation to the current arrangements or to challenge the quality of the design work carried out by other parties, where doing so results in a more robust design that better meets the objectives of the programme
95. Due to these concerns, DCC considers that it would be preferable not to introduce incentives during the Transitional Phase. However, in order to support Ofgem's preference for performance incentives during the Transitional Phase, DCC has developed a proposal that seeks to:
 - mitigate some of the challenges of implementing incentives during the Transitional Phase
 - ensure that the incentives could be practically implemented and monitored.
96. DCC's proposals for time-based incentives and stakeholder satisfaction incentives are explained below.

3.4.3 Time-based incentive

Application of incentive

97. A time-based incentive places DCC margin at risk based on whether DCC delivers specific milestones by agreed dates.

98. In line with the principles agreed by the Price Control Design Team, the incentives should apply only to DCC activities where DCC has a high level of ownership and control. The incentive should therefore be applied to the activities underpinning DCC's specification and procurement of the CRS solution, and not to DCC's professional advisory activity supporting Ofgem in designing and planning for the delivery of end-to-end switching arrangements.
99. The overarching period in which incentives could be applied to DCC milestones is therefore from:
 - receipt of detailed switching design and delivery specification from Ofgem; to
 - award of major CRS contract(s).
100. DCC has considered which milestones are likely to be on the critical path, in order to identify where there may be benefit in incentivising delivery, and which programme products are already planned to be subject to assurance, in order to minimise the additional oversight required. DCC therefore proposes that incentives are applied to the following milestones:
 - CRS technical specification complete
 - CRS tender packs complete
 - Contract award recommendation reports approved
101. DCC's current planning assumption is that DCC will run three procurement projects, which will likely include major and minor projects. An example of a major procurement project could be to source core software provision, whereas a minor procurement project could be to source professional services support e.g. systems integration.
102. DCC considers that applying incentives to milestones for each of the individual procurement projects would be disproportionately arduous to set up and monitor and would not provide any substantial additional benefit in terms of ensuring overall timely delivery of DCC's activities. DCC therefore proposes that the incentive should be applied only to the milestone that represents the cumulative end point of all major procurement projects, i.e. the point at which the final major procurement tender pack is complete and the point at which the final major procurement contract award recommendation report is approved.
103. DCC considers that it would be counterproductive to introduce a time-based incentive relating to the milestone for 'CRS contracts signed', as this is beyond DCC's reasonable control and quality should not be compromised for time for this activity. A time-based incentive relating to this milestone may also give the potential Service Providers disproportionate negotiating power.
104. Dates for milestones can only be agreed once:
 - Ofgem and DCC have undertaken a joint planning activity in order to develop a detailed baselined programme plan

- DCC's Switching programme plan is integrated with Ofgem's overall Switching programme plan via an agreed series of inbound and outbound dependency milestones
 - DCC has commissioned expert assurance of the plan and deliverables to advise on its deliverability and has subsequently confirmed to Ofgem that the plan is deliverable and that it is possible to achieve the milestones linked to the incentives. DCC has assumed that an external provider will carry out this assurance.
105. DCC proposes that the incentive mechanism and the milestones to be incentivised should be defined within DCC's licence. However, to ensure that timely programme delivery is not hindered by disproportionate governance of incentives, DCC proposes that the detail underpinning the milestones, such as the due dates, acceptance criteria, and inbound dependencies, should be defined and managed outside of the licence.

Risk/reward of incentive

106. The time-based incentive is financial, that is, it places a proportion of DCC margin at risk based on whether specific DCC milestones are delivered by the agreed date. In line with DCC's overarching concern relating to the unintended consequences of incentivising time at the expense of quality, DCC does not propose that there should be an upside financial incentive if the milestone is delivered before the agreed date. The financial incentive therefore only has downside, i.e. DCC margin is at risk if milestones are delivered late.
107. In line with the principle that incentives should only apply to activities where DCC has a high level of ownership and control, DCC proposes that the margin placed at risk is proportionate to the percentage of the cost base for DCC activities relating to delivery of the incentivised milestones, i.e. the cost of the CRS specification and procurement activities, and not the cost of DCC's advisory services to Ofgem's design and delivery planning for the end-to-end switching arrangements. The activities that DCC considers are directly related to delivery of the incentivised milestones are highlighted in the DCC Switching programme plan under the flag 'Activities relating to incentivised milestones'. Based on the current forecast costs associated with the baseline scenario, around 25% of the cost base relates to activities to deliver the incentivised milestones.
108. DCC proposes that 100% of the margin associated with these activities is placed at risk. For example, where the cost of the activities leading to delivery of the incentivised milestones represents 25% of total DCC costs within the Transitional Phase, 25% of total DCC margin is placed at risk against the milestones.
109. DCC considers the amount of margin placed at risk should be distributed equally across all three milestones. That is, of the total amount of margin at risk, 33% of the margin would be at risk based on delivery of each of the three milestones. This provides simplicity and is supported by a recovery mechanism (outlined below) that ensures that DCC is incentivised to deliver the final milestone by the agreed date even if earlier incentivised milestones are delivered late.
110. In addition, DCC proposes that the level of margin lost once a milestone is missed should be profiled as a reverse s-curve at each agreed milestone, as illustrated in Figure 15. This profile should mean that, if a milestone is missed by a short period of time, DCC is still incentivised to deliver the milestone in a timely manner. For example, if DCC was one day late in delivering a milestone, a high proportion of the margin would still be available to DCC and DCC would be incentivised to deliver as soon as possible as the amount of margin

available would reduce if milestone delivery were to be further delayed. The exact profile of the reverse s-curve will be agreed between Ofgem and DCC before the incentive is implemented.

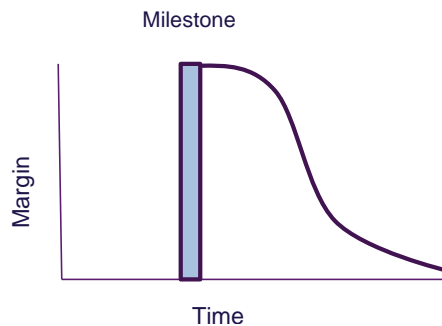


Figure 15 – Reverse s-curve margin profile

111. DCC proposes that a recovery mechanism is deployed which enables DCC to recover margin lost on a previous milestone if subsequent milestones are achieved on time. This would be similar to the recovery mechanism that applies to DCC's SMIP Implementation Milestones. The three proposed milestones are sequential and lead to the award of the CRS contract(s), which represents the end of the Transitional Phase (except for the contract negotiations with providers), therefore a recovery mechanism would be well suited to these activities and would incentivise DCC to minimise delay to the Transitional Phase as a whole.
112. DCC proposes that the forecast margin is recovered through DCC charges. The final margin value would be calculated based on the Allowed Revenue as determined by Ofgem as part of its ex post price control assessment. Where there is a difference, this will result in a corresponding adjustment to the CRSPA term within Ofgem's direction on margin and incentives. Similarly, where there is an adjustment to the costs associated with the activity being measured under an incentives framework, this will also result in an adjustment to the margin placed at risk.
113. In addition to financial downside, there would be a negative reputational impact should DCC deliver its milestones late.

Measurement of incentive

Acceptance criteria

114. Milestone achievement would be based on whether the acceptance criteria defined in the product description have been met for the related product(s). This is intended to mitigate the impact of potential compromises on quality by ensuring a minimum quality level is defined.
115. DCC suggests that acceptance criteria should be unambiguously defined in each product description and the acceptance criteria are approved by both Ofgem and DCC in advance of the incentive arrangement coming into effect.
116. The acceptance criteria in the product description should comprise:

- Time – date for product completion
- Quality – objective criteria that the product must meet.

117. Existing relevant product descriptions should be revisited by DCC and Ofgem to ensure that they are sufficiently unambiguous such that they are capable of supporting the incentive mechanism. Where products cannot be defined in detail now, the product descriptions and acceptance criteria must be agreed by both parties before the incentive mechanism is finalised.
118. Approval of programme strategy and planning products is inherently subjective. However, Ofgem and DCC will jointly need to ensure that acceptance criteria are defined in as objective a manner as possible. Where there is disagreement on whether acceptance criteria have been met, it should be the responsibility of the reviewer to demonstrate why the product does not meet its acceptance criteria and provide a clear written explanation of the remedial action required.
119. All Ofgem or third party products on which incentivised DCC activities are dependent must also have unambiguously defined product descriptions with clear acceptance criteria.

Inbound third party dependencies

120. Any third party activities on which DCC milestone completion is dependent must be specified for each incentivised milestone. The inbound dependencies must be agreed by both Ofgem and DCC in advance of the incentive arrangement that relates to a specific milestone coming into effect. Inbound dependencies should be identified as milestones (with a clear definition, unique reference, and delivery date) in both the Ofgem programme plan and the DCC Switching programme plan once the dependencies have been agreed.

Governance

121. DCC considers that transparent governance of the product review process, that includes both identified reviewers and defined timescales for review, is an important element of the incentive mechanism. This should be tied into existing assurance points to reduce the programme overhead involved. Applicable comments will only be incorporated from reviewers named on the product description.
122. DCC proposes that wholly independent assurance is sourced by Ofgem (either technical or professional depending on the product to assure) to validate whether DCC has met the product acceptance criteria associated with the milestone. This would avoid any conflict of interest in situations arising where DCC considers it has been delayed from meeting its milestone due to delays to Ofgem-owned activity. The independent assurance body must not have been involved in the development of the products or in the Switching programme in any capacity that may prejudice its independence. The terms of reference for the assurance body should be agreed by both DCC and Ofgem in advance of the incentive arrangement coming into effect. Additional activity would be incorporated into DCC's programme plan to support this additional assurance activity. The independent assurance would be paid for by DCC and would be similar to the performance auditor role that assures delivery of DCC's incentivised Implementation Milestones under the SMIP.

Changes to incentive

123. Once the milestone dates have been agreed, DCC suggests that there should be a mechanism whereby both parties are able to request a change to an incentivised milestone

(e.g. date, acceptance criteria or inbound dependencies), for consideration by the other party. The dates of incentivised milestone may need to be changed following implementation of the incentive mechanism as a result of factors including:

- need for change identified by Ofgem:
 - a top-down re-plan stemming from its overarching Switching business case
 - a change to DCC's role within the Switching Programme
 - notification of delay to an inbound dependency to a DCC milestone
- need for change identified by DCC:
 - identify an opportunity to increase quality or reduce the risk of error, resulting in a net benefit to the overall programme timeliness (including DBT and Live Operations), which is quantifiable (at least as a ROM)
 - identify that another party is likely to miss a milestone which is an inbound dependency to a DCC milestone, with a subsequent impact on DCC's milestone date that is beyond DCC's control.

[The definition of conditions for change are to be further developed by Ofgem and DCC.]

124. The incentive change mechanism must be responsive to the needs of the programme, therefore DCC proposes that changes to the dates and acceptance criteria of incentivised milestones should be managed within the wider programme change process (which is not yet defined). This should reduce the management overhead and minimise duplication. This approach will also ensure that any impacts on incentives are considered as part of the assessment of all change by decision makers.
125. DCC expects that a change process should follow the logical process outlined in Figure 16. This process will be further developed by Ofgem and DCC in the Programme workstream.



Figure 16 - Logical change process

126. The process must deliver decisions on requests for incentive changes within a maximum of one month from submission of the formal request, as it is critical that all parties are working from an accurate and authoritative programme plan.
127. There must be clearly defined Switching Programme roles that have the authority to approve changes, including those that impact incentive milestones.
128. DCC considers that industry engagement on changes to the detail contained within product descriptions associated with incentive milestones should only be through programme governance. A requirement for formal industry consultation would likely lead to significant programme delays and therefore be counter to the rationale for deploying a time-based

incentive. However, where it is proposed to change the milestones to be incentivised or how the incentive mechanism operates, consultation would be appropriate.

129. Regular programme reporting by both Ofgem and DCC should identify where there is a risk that either the inbound dependency or the DCC product itself is at risk of not achieving an incentivised milestone.

Assumptions

- Ofgem and DCC will undertake joint planning activity to ensure that both Ofgem and DCC plans are integrated via an agreed series of inbound and outbound dependency milestones
- The incentive mechanism will be activated following confirmation by expert external assurance that the plan is deliverable and that it is possible to achieve the milestones linked to the incentives. DCC has assumed that this assurance will take place towards the end of the design phase
- The milestones proposed for incentivisation are on the critical path of the programme. Where this is not the case the milestones should be removed from the scope of the incentive arrangement as it is unlikely to be beneficial to the programme to incentivise accelerated delivery of milestones that are not on the critical path
- Ofgem and DCC are accountable for any third parties working under their respective control in the products they own, and for any delays these parties may cause.

3.4.4 Stakeholder satisfaction incentive

Application of incentive

130. DCC proposes that a reputational incentive is linked to feedback from participants in the Switching Programme on DCC's performance on the Switching Programme. Participants should include other design team members and industry participants at user groups and EDAG. The expected sample size is 50-100 and feedback will not include that of Ofgem as it may introduce a conflict of interests.
131. DCC proposes that a six-monthly survey is conducted to record feedback, comprising both quantitative scoring and qualitative explanations. DCC considers this frequency should allow a reliable baseline to be established and trends to be captured.
132. The survey should be designed and implemented by a third party who specialise in survey design with input from DCC and Ofgem.

Risk/reward of incentive

133. DCC proposes that the incentive has a reputational impact only and that no DCC margin is at risk. Where DCC achieves positive feedback it will support its aim of securing additional work on other energy programmes in future. The incentive could also form the baseline for a potential financial incentive in future phases of the Switching Programme.
134. The non-financial nature of this mitigates some of DCC's concern that there is the potential for vested interest amongst survey participants and that good programme delivery does not always equate to satisfied stakeholders.

Measurement of incentive

135. DCC proposes that the analysis of the results should be conducted by the third party survey organisation, as this ensures independence from any parties involved in the programme. An allowance for carrying out the survey has been included in DCC's non-staff costs.
136. Communication of the satisfaction results with industry should be conducted on an annual basis, aggregating survey results to date into a consolidated report. Both DCC and Ofgem should have the opportunity to discuss and challenge the analysis prior to the results being shared with industry.

Changes to incentive

137. Proposed changes to this incentive by either Ofgem or DCC should be submitted into the wider programme change process, in line with the arrangements outlined for the time-based incentive.

Assumptions

138. DCC has not identified any further assumptions in addition to those relating to the time-based incentive.

3.5 Margin calculation (cost base)

139. DCC proposes that the margin should be calculated as a fixed rate of return (%) of the total costs (CRS Internal Cost¹¹ plus CRS External Costs¹²)¹³. This means that DCC would apply the rate of return to any external subcontractors, e.g. external consultancy, which under the term in the licence would be defined as CRS Internal Costs.
140. This approach ensures that DCC is rewarded for the delivery of activity for which it is commercially accountable and is not incentivised to provide all required services in-house.

3.6 Fixed percentage rate of return

141. DCC proposes that the margin is calculated as a fixed percentage rate of return rather than a fixed absolute figure, as this allows the margin to flex with cost changes, reducing the need to reopen the margin. This approach is suitable for changes to costs relating to activities of a similar nature to those already anticipated, and to which the same rate of return is therefore applicable. This approach is particularly suitable given the uncertainty in relation to programme scope at this stage and it achieves the principles of simplicity and proportionality, given the relatively low cost base.
142. Under this approach, the forecast margin would be recovered through DCC charges. The final value would be calculated based on the Allowed Revenue as determined by Ofgem as part of its ex post price control assessment. Where there was a difference, this would result in a corresponding adjustment to the CRSPA term within Ofgem's direction on margin and incentives.
143. It is important to note that Ofgem would retain its power to disallow any costs that it deems to be inefficient, therefore neutralising any potential perverse incentive for DCC to increase costs in order to secure additional margin. Furthermore, under the ex post plus arrangement, Ofgem will be able to further scrutinise any changes to DCC's costs on a monthly basis.

3.7 Adjustment mechanism

144. Notwithstanding the proposal for a fixed rate of return, DCC proposes that there should be a mechanism to reopen the rate of return itself in the event of a significant change. There may be events where there is a material change to the factors outlined in Section 10.1, such as:
 - a significant change to DCC's role within the Switching Programme, leading to a change in DCC's risk profile in relation to the Transitional Phase
 - a change to the incentive framework.
145. DCC considers that an adjustment mechanism is appropriate as it would ensure that the rate of return remains appropriate in relation to the nature of DCC's activities during the

¹¹ means in relation to each Regulatory Year the sum of the costs (excluding Internal Costs, External Costs, Pass-through Costs, Centralised Registration Service External Costs and Centralised Registration Service Pre-Agreed Costs) that were economically and efficiently incurred by the Licensee for the purposes of the provision of Mandatory Business Services

¹² means in relation to each Regulatory Year the actual amount of the costs that were economically and efficiently incurred by the Licensee in procuring Fundamental Registration Service Capability during that period.

¹³ There will be no CRS External Costs in the Transitional Phase

Transitional Phase. The mechanism could be initiated by either Ofgem or DCC and could result in an increase or decrease in the rate of return, where justified.

3.8 Nature of role (risk)

146. In setting the proposed rate of return, DCC has considered the risk associated with DCC activities during the Transitional Phase of the Switching Programme, based on DCC's currently defined scope.
147. The risks that DCC faces are described under five categories. These are consistent with the risk categories set out in the DCC Risk Management Strategy¹⁴ which are:
- Programme risk
 - Economic risk
 - Regulatory risk
 - Reputational risk
 - Operational risk.
148. The risks that DCC faces are described in Table 23.

Risk category	Description	Mitigation
Programme	<ul style="list-style-type: none"> ▪ Risk that scope and / or delivery complexity is greater than anticipated resulting in DCC failing to meet stakeholder expectations for delivery against baselined plan and budget ▪ Risk of losing margin if DCC misses incentivised milestones; this risk increases where DCC is responsible for more activities during the Transitional Phase 	<ul style="list-style-type: none"> ▪ Continued engagement with Ofgem Switching Programme workstreams ▪ Proposal for adjustment mechanism
Economic	<ul style="list-style-type: none"> ▪ Risk of losing margin if DCC misses incentivised milestones ▪ Risk of cost disallowance through annual ex post price control 	<ul style="list-style-type: none"> ▪ We will continue to work closely with Ofgem to develop the detail underpinning a challenging but achievable incentive regime ▪ Ofgem and DCC to manage milestones and dependencies

¹⁴ DCC, 'DCC Risk Management Strategy', 19 December 2013:
https://www.smartdcc.co.uk/media/91857/risk_management_strategy_december_2013.pdf

Risk category	Description	Mitigation
		against a jointly agreed programme plan <ul style="list-style-type: none"> Monthly regulatory reporting required by ex post plus price control arrangement should mitigate the risk of unjustified cost escalation and subsequent disallowance as this provides an opportunity for Ofgem to raise any concerns as they arise
Regulatory	<ul style="list-style-type: none"> Risk of enforcement proceedings due to DCC failing to meet Ofgem's delivery expectations; this risk increases where there is increasing complexity and interdependency between various parties and workstreams and where Licence obligations are open to interpretation 	<ul style="list-style-type: none"> The likelihood of DCC not meeting its obligations is slim. We have mitigated this risk through ensuring traceability of requirements within the DCC Switching Business Case and regular dialogue with Ofgem to validate our interpretation of deliverables and plan
Reputational	<ul style="list-style-type: none"> Risk of negative stakeholder perception alongside the increased accountability; this risk increases where DCC is responsible for more activities during the Transitional Phase 	<ul style="list-style-type: none"> Continued engagement with programme workstreams
Operational	n/a	n/a

Table 23 – DCC risk profile of the Transitional Phase of the Switching Programme

3.9 Commercial expectations

149. There is a clear precedent for the parent company's expected rate of return for DCC activity. For example at the time of the application for the Smart Meter Communication Licence, the rate of return was set at 15% of Internal Costs and was established through competition. Therefore this is the closest example of the competitively set commercial expectations of the parent company.
150. This also reflects the commercial decisions relating to the viability of this project compared to similar work elsewhere, that is, the opportunity cost to Capita for undertaking this activity.
151. The rate of return should be comparable to that expected by professional services firms, should Ofgem have sourced these programme management, design, delivery and procurement services from the open market.

152. Switching is a complex national transformation programme, and it will become increasingly challenging as we progress through the Transitional phases. DCC's commercial expectations reflect the skills, effort and commitment that we invest in ensuring successful programme delivery.

3.10 Rate of return

153. Based on consideration of each of the factors outlined above, DCC proposes a rate of return of **15%** to set the margin for the Transitional Phase of the Switching Programme. We consider that this rate of return is commensurate with the risk associated with DCC activities during the Transitional Phase of the Switching Programme and the commercial expectations of the parent company. This margin proposal is conditional on the factors described above.

4 Description of cost model

4.1 Identifying permanent and temporary resource [from Section 8.5.2]

154. The activities and associated resource effort set out in the DCC Switching programme plan generate a monthly FTE resource profile for each role in MS Excel format, which is imported to the cost model.
155. In order to identify which roles should be filled by permanent staff and which by temporary staff (contractors or consultants), the cost model applies a set of business conditions. These conditions drive calculations that automatically determine which roles would be more economically and efficiently fulfilled by permanent resource or by temporary resource, and whether that temporary resource is through direct contractors or a consultancy service. These conditions are outlined in Figure 11 (points 1, 3 and 4).

Rules to Allocate Resource to Temporary or Permanent Headcount and Rates

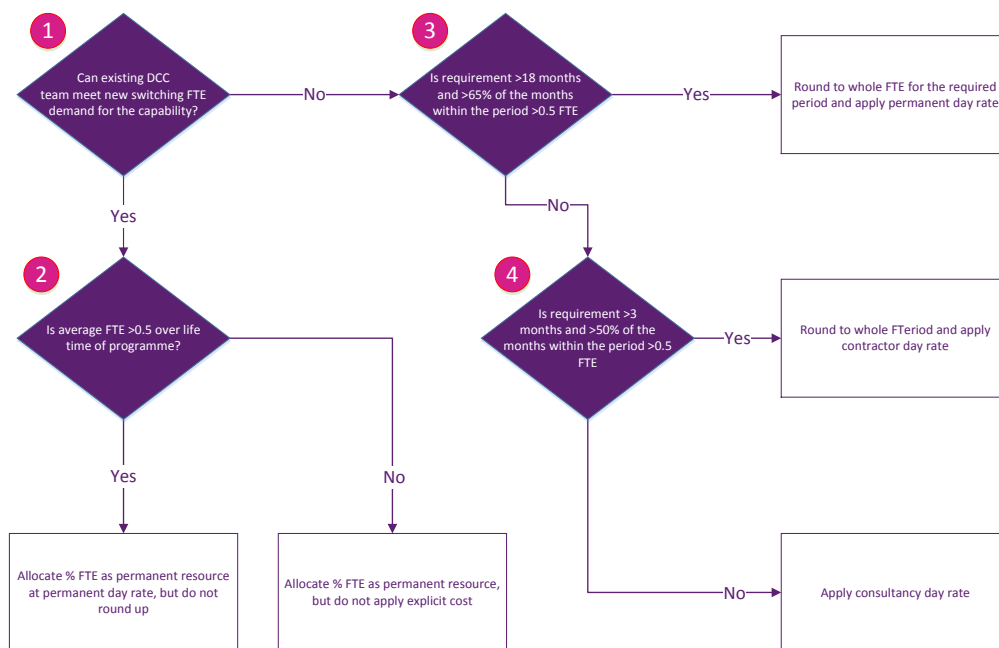


Figure 11 - Rules to allocate resource to temporary or permanent headcount

156. The business conditions are primarily based on whether there is a consistent resource requirement. Within the model this takes the form of a calculation that checks whether the FTE profile for each resource type meets both of the two following conditions:
 - the resource type is required for at least 18 months

- the resource type is required for at least 65% of the months within the required period at a level equal to or greater than 0.5 FTE.
157. If both of these conditions are true, the resource requirement will be rounded to the nearest whole number and treated as permanent resource. Any remaining resource requirement will be treated as temporary resource.
158. To determine whether the temporary resource requirement should be fulfilled through direct contractors or consultancy services, the model checks whether the role is required for at least 3 months at a level equal to or greater than 0.5 FTE for at least 50% of the required period.
159. This approach provides transparency and consistency across the calculation of the programme budget. Automating the calculation of FTE requirements reduces the need for DCC to manually review the resource budget every time an element of the plan changes. Given the uncertainty surrounding the programme plan, DCC considers this to be an economic and efficient approach to modelling the anticipated resource profile during the Transitional Phase.

4.2 Purpose of the model [from cost model]

- To generate a programme budget for the transitional phase of switching to support the first submission of the business case to Ofgem at the end of the month
- To reflect our current DCC switching programme plan, so we can concentrate on getting the plan right with Ofgem over the coming months and reduce the need for manual reconciliation between the plan and the model
- To generate a staffing requirement, considering the mix of perm vs contract vs consultancy – again to minimise manual intervention between plan and model
- To recognise practicalities of recruitments e.g. fees, churn, ramp up periods where unproductive etc
- To capture non-staff costs
- To facilitate the quantifying of risks and opportunities
- To generate the costs of products and activities, which we can later use as a basis to report against
- To provide graphical FTE profiling to accommodate business review on the deliverability of the plan
- To provide key numerical summary outputs to support internal sign off process