

Draft DCC Business Case

To give EDAG sight of and opportunity to comment on the overview and high level costs presented within the Draft DCC Business Case for DCC activities during the Transitional Phase of the Switching Programme.	From	Natasha Sheel
	To	External Design Advisory Group
	cc	
	Date	6 October 2016

1 Summary

- 1.1 At the EDAG meeting on 18 August 2016, DCC presented an overview of its Draft DCC Business Case for DCC activities during the Transitional Phase of the Switching Programme. DCC have now provided high level costs for these activities during the Transitional Phase as well as its proposals for margin and incentives for EDAG review.
- 1.2 The full draft DCC Business Case was submitted to Ofgem for scrutiny in September 2016 this included a detailed cost breakdown. The Business Case will be consulted on by Ofgem at the end of 2016 before being baselined by DCC in March 2017. Ofgem is developing its proposal on margin and incentives and DCC's justification for its proposal will be taken into consideration. Ofgem will consult on a proposed Direction on margin and incentives in parallel with the consultation on DCC's Business Case.
- 1.3 The DCC Business Case will form the baseline for the application of an ex post plus price control approach. It will also form the baseline for monitoring DCC's delivery against its plans.
- 1.4 The key areas of focus for joint working between Ofgem and DCC is on aligning the planned time for overall delivery which is materially longer than outlined within the Ofgem plan for the Transitional Phase and the impact this is having on the forecast costs. As currently outlined within the DCC Business Case the total charge to industry over the lifetime of the programme (to regulatory year 2019/20) will be approx. GBP 29m (excluding margin) made up of GBP 18.7m staff costs, GBP 1.3m non-staff costs, GBP 3.4m contingency, GBP 3.1m management reserve and GBP 2.5m overhead.
 - 1.4.1 DCC and Ofgem are jointly working to agree a programme timeline and plan which both Ofgem and DCC believe to be realistic and achievable.
- 1.5 DCC has proposed a margin of 15% within the Draft DCC Business Case. Ofgem has asked for further justification for this proposal. Ofgem is also separately developing its own proposal on margin which industry will have a chance to feedback on during consultation at the end of 2016. Ofgem is developing this by assessing the risk on DCC in relation to this programme with the aim of identifying appropriate comparators.
 - 1.5.1 In advance of the Ofgem consultation on margin we would welcome the opinion of EDAG members on how we can assess the appropriate type and level of risk faced by DCC in delivering the Switching Programme and how this should be reflected in the value of DCC's margin. We would also welcome thoughts on what industry commercial expectations for a programme of this nature would be.
- 1.6 Taking on board feedback from User Group and EDAG and acknowledging the challenges in implementing incentives during the Transitional Phase, DCC and Ofgem have worked to jointly develop an incentives package. The proposed package includes a financial downside incentive based on the timely delivery of critical path products to a specified quality and a reputational incentive based on stakeholder satisfaction. The stakeholder satisfaction incentive is expected to be used to develop a baseline for use as a financially linked

incentive for later phases.

- 1.7 **Annex 1** provides an overview of the sections of the DCC Business Case that will be presented at EDAG including costs and DCC's proposal for margin & incentives.
 - 1.8 **Annex 2** provides the link to the overview of the DCC Business Case presented at EDAG in August. This is provided as reference.
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2 Questions and considerations

- 2.1 Does industry support the inclusion of the management reserve and contingency within the annual charging statement (Table 1 section 1.5)?
 - 2.2 Is the rationale for the cost drivers (section 2.2) within the DCC Business Case, for example on resource sourcing (permanent, contractor and consultant) set out in a suitably clear and transparent manner?
 - 2.3 Does EDAG have views on suitable comparators which Ofgem can use to support its work in setting out an appropriate margin?
 - 2.4 Does EDAG have views on the proposed incentives (section 3.4.3), for example, do they allow for a sensible balance between time and quality?
 - 2.5 Is the rationale for the proposed recovery mechanism (in relation to the time-based incentive section 3.4.3 paragraph 111) clear?
 - 2.5.1 Are there thoughts on the appropriate level of margin which can be recovered through this mechanism by DCC for successfully achieving the final milestone?
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3 Feedback from User Group

- 3.1 User Group questioned the inclusion of the management reserve and contingency, which make up the materiality threshold, within the upfront charges. It was asked as to whether these would better placed outside of the price control to act as an extra layer of governance where DCC would have to reclaim charges from industry in the following price controls. DCC felt that the inclusion of these charges upfront gave industry greater certainty but are considering the views from User Group.
 - 3.1.1 Separately Ofgem is considering how appropriate the management reserve is as this pot mainly accounts for scenarios which would require Ofgem to consult with industry on wider programme impacts and would therefore lead to a re-baselining of the Business Case.
- 3.2 DCC confirmed to User Group that there is an overriding objective to identify permanent resource as early as possible although it was noted that given the specialist skill sets required this was a key risk.
- 3.3 It was questioned if the margin and incentives package for the Switching Programme had to align with SMIP. It was confirmed that these are separate and therefore a different margin level could be assigned.
- 3.4 In relation to the financial incentive on timely delivery User Group asked that further consideration was given as to whether any milestone was of greater importance and therefore should be assigned a greater level of margin at risk.
- 3.5 User Group felt that the recovery mechanism, allowing for earlier margin lost to be recovered if the final milestone was achieved, needed further consideration as to the level of margin that could be recovered. It was noted that this was a careful balance between motivating delivery of the overall programme whilst not negating the purpose of the earlier

checkpoint milestones.

4 Next Steps

- 4.1 We welcome comments on the Draft DCC Business Case for DCC activities during the Transitional Phase of the Switching Programme during the EDAG meeting and will also take on board any further thoughts provided outside of the meeting. To ensure that comments can be incorporated into the version of the DCC Business Case issued for consultation we ask that any further comments are received by October 17th.
 - 4.2 These comments will be shared with DCC and DCC will consider whether to update the draft DCC Business Case to reflect these comments.
 - 4.3 Ofgem will consult on the full draft DCC Business Case towards the end of 2016. Feedback from the consultation will be reviewed and taken in to consideration by DCC in its update of the Business Case which it will baseline and publish in March 2017.
 - 4.4 Ofgem will consult on its proposed direction for margin & incentives in parallel to the DCC Business Case allowing for the price control decision to be made and enacted for regulatory year 2017/18.
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List of annexes

Annex 1 – Draft DCC Business Case for DCC activities during the Transitional Phase of the Switching Programme - sections for EDAG review

Annex 2 – DCC Business Case presentation from August EDAG

https://www.ofgem.gov.uk/system/files/docs/2016/08/cws_edag_business_case_review.pdf