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Industry participants, consumers
and their representatives and
other interested parties

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Consultation on draft DCC business case for DCC activities during the Transitional Phase of the Switching Programme

The Switching Programme, led by Ofgem, aims to improve customers' experience of switching. We hope it will lead to consumers engaging more in the retail energy market, through a new switching process that is reliable, fast and cost-effective. In turn, this will build consumer confidence and facilitate competition, delivering better outcomes for consumers.

The Data and Communications Company ('DCC') is a central communications body appointed to manage communications and data transfer for smart metering. DCC was granted the Smart Meter Communication Licence ('the licence') by The Department for Business, Energy and Industrial Strategy, formerly the Department for Energy and Climate Change, in September 2013. This was modified in May 2016[1] to give Smart DCC Ltd ('DCC') new obligations and set out the funding arrangements for its role in the Switching Programme. Through its licence, DCC is required to contribute to the design of the Centralised Registration Service ('CRS') and to procure the Relevant Service Capability[2] to deliver the CRS.

The ex post plus price control arrangements agreed between DCC and Ofgem were set out in May 2016[1] to cover DCC's activities during the Transitional Phase of the Switching Programme. Under these, DCC is obliged to publish a plan of activity and justify its forecast costs in an upfront business case which will be used as a baseline for regular reporting and annual price control submissions. Ofgem is then obliged to lead a consultation on the business case so that stakeholders can scrutinise and challenge it before it is baselined.

This letter and the accompanying draft DCC business case for DCC activities during the Transitional Phase of the Switching Programme ('the DCC business case') form that consultation. This letter sets out the status of the DCC business case, the particular areas we are seeking your views on and what happens next. The questions are below and the deadline for responding is 23 December.

Summary

The draft DCC business case sets out DCC's planned approach and costs for its activities in the Switching Programme up to CRS contract signature ('the Transitional Phase'). In March

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

[2] This means the internal and external resources which DCC relies upon in order to provide services to DCC Users

2017, we anticipate DCC will publish a further version which takes into account feedback from this consultation which will form the baselined DCC business case. This business case should also reflect further collaboration between DCC and Ofgem to clarify and agree assumptions on the scale of required activities. This is in order for DCC to align its plan with Ofgem's developing detail of the required activities. The March 2017 version of the business case will form the baseline for applying DCC's price control framework and monitoring DCC's delivery.

The DCC business case presented here represents DCC's view and assumptions based on the information currently available. Ofgem has scrutinised the underlying information and we are now seeking views from industry on the assumptions, approach and transparency of the document.

We anticipate that ongoing work between Ofgem and DCC and the comments received from this consultation may alter the indicative costs, timing and resourcing outlined here. We do not anticipate further consultations on this business case before it is baselined.

We will keep stakeholders informed of the development of the business case through the relevant Switching Programme governance bodies e.g. Commercial User Group, External Design Advisory Group and the Switching Programme Delivery Group. This would include instances where the materiality threshold (the allowance for variance from the baseline scenario) is exceeded and the business case needs to be re-baselined. We may consult again where there is major material change in programme scope or costs.

In parallel, Ofgem is also consulting on our proposal for DCC's margin and incentives during the Transitional Phase. DCC has included its proposal for margin and incentives in appendix E of the DCC business case. The DCC proposal on margin is included for completeness within the draft forecast cost base, and does not represent Ofgem's position.

We ask that comments on margin and incentives are provided in response to the parallel consultation 'Consultation on DCC's margin and incentives during the Transitional Phase of the Switching Programme'.

Context and relationship with Ofgem Programme Plan

Ofgem's high level Programme Plan anticipates that CRS procurement contracts will be signed at the end of December 2018. The DCC business case anticipates signing contracts in mid-October 2019. It is important that stakeholders understand the reasons for that difference and how the plans will be aligned before the DCC business case is baselined in March.

The draft DCC business case has been developed by DCC on a bottom-up basis, with DCC making assumptions on the nature and scale of the various tasks it will be responsible for based on current Ofgem thinking. The business case explains how it will deal with uncertainty in activities where roles are yet to be confirmed. DCC may in places take a prudent approach to the resource requirements for tasks not yet fully specified by the programme. This is particularly evident in the Detailed Level Specification ('DLS') phase, where Ofgem planning is at a very early stage and we believe DCC has therefore used more cautious assumptions than Ofgem about the nature and scale of the work required.

One reason for the difference in contract signature dates is that DCC's plan assumes it is high risk to run the development of CRS technical specifications and other DLS products in parallel due to an unmanageable spike in resource requirements and therefore runs these activities sequentially. The Ofgem plan is based on a different assumption about the nature of these tasks and the resource required delivering them which would allow these activities to run in parallel without the risk of a resource spike.

Ofgem and DCC will work to agree the specific products to be delivered during DLS and arrive at a more granular understanding of the requirements to deliver the stated outcomes

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of the phase. This will also allow Ofgem and DCC to assess whether parallel working is possible whilst managing the associated costs and risks. We expect that any change in the timeline within the DCC plan will have a resultant effect on the forecast costs.

The DCC business case that is baselined in March 2017 should reflect Ofgem and DCC's agreement on the extent to which it is practical to run phases in parallel, or reduce the need for additional work in later phases following DLS. This means that in March 2017 a revised DCC business case (including plan) and a revised Ofgem Programme Plan will show the same milestones. We will continue to look critically at the Switching Programme to ensure that we can deliver benefits to consumers as early as possible.

In January 2017, Ofgem will issue a Request for Information (RFI) based on three potential reform packages and a counterfactual for delivering the Switching Programme. Options will cover: doing nothing; optimising existing systems to deliver the programme objectives; major reform focussed on the development of a new central switching system; and fuller reform package including both a new central switching system and market intelligence service. This version of the DCC business case is not based on a particular package and has been developed on high-level assumptions which may apply to the major or fuller reform packages.

As part of the RFI we will ask DCC to estimate the costs for DCC's involvement and for potential service providers for the major and full reform packages as part of the RFI. DCC has indicated in the draft business case that in the first baselined version of the DCC business case to be published in March 2017, it will align the scope scenarios more closely to the reform packages in Ofgem's Strategic Outline business case and RFI. DCC will update and re-baseline the business case after we have consulted on a preferred reform package, expected August 2017.

How the DCC business case was developed

DCC's business case has been developed with input from Ofgem and industry, with key sections developed iteratively based on feedback from the Commercial Design Team, Commercial User Group and External Design Advisory Group.

The full draft DCC business case was submitted to Ofgem for scrutiny in September 2016, and included a detailed cost breakdown and comprehensive cost model. DCC updated the business case and cost model based on Ofgem's initial comments. The version of the cost model as part of the baselined business case will be used as the baseline for monthly reporting as part of the ex post plus price control regime.

Charges and changes

The total charge to industry over the lifetime of the programme (to regulatory year 2019/20) as currently proposed are approximately £25.6m (excluding margin) made up of £15.3m staff costs, £1.9m non-staff costs, £3.5m contingency, £2.7m management reserve and £2.2m overhead[3].

We expect that the biggest changes between the current version and the baselined version published in March will result from the ongoing work between DCC and Ofgem to further develop the activities within the DLS phase and clarifying the scope of DCC's role within this.

Ofgem anticipates that clarifying and streamlining the proposed governance processes will reduce timelines further. Considerable joint working is required to agree a programme

[3] Where possible this will be aligned with the position adopted within the DCC price control. The proposed position is outlined in: DCC Price Control Consultation: Regulatory Year 2015/16 - https://www.ofgem.gov.uk/system/files/docs/2016/11/dcc_1516_price_control_consultation_2.pdf

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timeline and plan which both Ofgem and DCC believe are realistic and achievable. This is ongoing and should be finalised before the business case is baselined in March 2017.

Some of these potential changes in scope are incorporated within the contingency as outlined in Section 7 of the Business Case, where DCC have quantified the risk of scope change and weighted the cost by probability. DCC further proposes a management reserve be incorporated into forecast costs which account for activities that DCC could not have reasonably foreseen (Section 11.4.2). The contingency and management reserve collectively make up the materiality threshold which, when breached, triggers a re-baselining of the DCC business case.

When stakeholders were presented the draft DCC business case, they asked how the contingency and management reserve would be incorporated into the forecast charges to industry (jointly equating to 35% of the cost base). They also debated whether the inclusion of both would encourage good budget management. Ofgem is considering whether the management reserve should be included within the forecast charge as we believe that any major changes in the programme and DCC's role within it would be likely to require Ofgem to communicate with industry (potentially through consultation) and a re-baselining of the business case.

DCC anticipates the contingency will be spent as it is based on weighted costs of defined scenarios occurring. It therefore believes that incorporating both contingency and management reserve in upfront costs will more accurately represent actual costs faced by industry. Any use of the management reserve should be justified to Ofgem in the regular reporting as part of the ex post plus price control regime, and would therefore sit as a separate pot of funds. We will consider all comments received in this consultation before recommending to DCC whether to include both the contingency and management reserve in forecast charges to industry.

Roles and responsibilities

Under its licence, DCC must contribute to designing the CRS and switching arrangements, and procure Relevant Service Capability to deliver the CRS through competitive tender. The licence obligations for DCC to support the Switching Programme were set out in the May 2016 modification and are outlined in detail within Appendix A to the DCC Business Case: Requirements Traceability Matrix. As a brief overview:

- LC15: contribute to the design of the CRS and to procure Relevant Service Capability to deliver the CRS
- LC16: the Relevant Service Capability (Fundamental Registration Service Capability) must be procured through competitive tender

Ofgem has broadly outlined roles and responsibilities for the Transitional Phase of the Switching Programme:

- Ofgem is responsible for, sponsor of, and accountable for benefits of the programme through all phases.
- Ofgem may choose to make industry partners accountable for delivering certain activities.
- Activities we believe are better delivered by DCC include technical specification of CRS, and CRS procurement and implementation. There is ongoing work between DCC and Ofgem to outline clearly the scope of DCC's role pursuant to their regulatory obligations in this regard. This includes clarification of the extent of DCC's role in security activities, service management, data improvement, delivery and technical activities.

DCC is required under the licence to adopt a leading role within procurement. We expect DCC to play a significant role in developing the CRS technical specification as this feeds directly into procurement products. These activities account for approximately 25% of the

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currently forecast cost base, this is the same as the cost base for which margin is placed at risk under the three proposed incentivised milestones (as outlined in Appendix 13.8).

There are also significant staff costs relating to activities that DCC would carry out regardless of the scope of its role beyond procurement and developing the technical specification. This includes support to the Switching Programme across a range of issues and managing DCC activities in relation to the wider Switching Programme (£2.8m), commercial and price control activities (£1.9m), and stakeholder engagement.

Funding DCC and assigning activities

Ofgem's decision on DCC's role in developing a Centralised Registration Service showed that we expect DCC to be funded so that it can participate in Ofgem-led workstreams to establish the high level design of the new switching arrangements. This has been successful, and we now consider that DCC should continue to be funded to participate in the Switching Programme in a broader set of activities than just procurement.

These activities are identified in the business case and could be carried out by DCC under the licence obligation, or could be provided by other parties and funded by industry as viewed appropriate. DCC's role will be further developed as part of the ongoing work on the DLS phase. We would appreciate any input from stakeholders on whether it is right to assign these activities to DCC as proposed, or whether other industry partners are better placed to deliver them and why this may be case.

At this stage we do not anticipate changing the commercial licence conditions as outlined within DCC's licence[4] relating to Intellectual Property Rights (LC44), business continuity (LC16.12) and contract novation (LC43). We are interested in hearing from you if you feel we should consider any of these areas further.

Your views

We would like to know what you think about the draft DCC Business Case for DCC activities during the Transitional Phase of the Switching Programme. In particular, we would like your answers to the following se questions:

Question 1 – Is DCC's approach, as outlined in the business case, clear enough about how DCC will account for activities it is asked to undertake and how delivery can be assessed? If not how could this be improved?

Question 2 – Are the business case's structure and base assumptions clear enough to use in setting a realistic programme budget and forecast charges as part of the ex post plus regime? What can be done to address any concerns?

Question 3 – For those activities that Ofgem is proposing to should be carried out by DCC but could be carried out by other parties (i.e non-core activities not relating to procurement and development of the technical specification) have the correct activities been assigned to DCC or would other industry partners be better placed to take these on? If so, which activities, which industry partners and why would they be better placed?

Question 4 - Should the management reserve and contingency (Section 11.4) be included within the upfront charges on industry and what is the justification for this? Does the level of management reserve feel appropriate for the Switching Programme, taking into account the type, scale and actuality of potential unknowns?

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[4] Smart Meter Communication Licence: https://epr.ofgem.gov.uk/Document

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Next steps

We will consider all comments and answers we receive. Please submit comments relating to margin and incentives as part of the parallel consultation.

We will compile comments and use this to suggest changes for DCC before it baselines its business case in March 2017. Ofgem and DCC will continue to develop the Ofgem and DCC Programme Plan and aim to reach a jointly-agreed plan before DCC publishes its baselined business case in March 2017.

How to respond

Please submit your views by email by close of business on 23 December 2016.

Send them to switchingprogramme@ofgem.gov.uk

Unless responses are marked confidential, we will publish them in our library and on our website, www.ofgem.gov.uk. If you have any questions about this consultation letter, please contact Natasha Sheel (020 7901 7206, natasha.sheel@ofgem.gov.uk).

Yours faithfully,

Rachel Clark
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