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

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

We believe that consumers should be able to switch supplier quickly and reliably, and we support reform that will improve the consumer experience of the switching process. Any reform must deliver a good customer experience at a reasonable cost – consumers must benefit from the investment that is being made on their behalf as part of the Switching Programme.

We are very concerned by the level of cost (£30million) DCC will incur as set out in the draft business case. While we recognise that these costs are subject to change, this represents a very significant investment for the industry. This is especially the case when considered relative to the estimated overall costs set out in Ofgem's decision on Moving to Next Day Switching published in February 2015, which estimated the NPV cost of moving to next day switching to be £143million in total.

If we are to commit to this spend in the Transitional Phase, we need to be sure that consumers will benefit from the reforms that are being developed. At the moment there is still a great deal of uncertainty as to the eventual shape that any reform of the switching process will take. Until the results of the RFI, which is to be issued in January 2017, are analysed and a decision made on the chosen reform package, there is a significant risk of regret spend. Any costs incurred by DCC in the period until this decision is made must be minimised to mitigate this risk, and a final decision should be made at the earliest possible opportunity.

The level of management reserve and contingency included within DCC's business case are a particular concern. While some level of contingency is to be expected, an overall level of 35% is much higher than we would expect for a programme of this nature. This contingency is being driven by a significant amount of uncertainty in Ofgem's programme plan, which DCC are trying to account for in their assessment of risk. A robust plan based on a specific reform option will reduce uncertainty and provide a more accurate forecast of costs with a reduced level of contingency.

We are also concerned by the lack of a formal process to approve use of contingency which is exacerbated by the size of that contingency. Allowing a variance of up to 35%

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before the business case is re-baselined does not demonstrate a clear control of costs, which will ultimately be borne by our customers. This approach might be more acceptable if the level of contingency were lower. Based on the current level of uncertainty, and the level of control that we perceive around how this would be released, we would not be happy to include the management reserve and contingency in the upfront charges.

The business case does provide a detailed and understandable view of how the costs to industry have been estimated by DCC. It also enables those costs incurred to be linked to the specific activities and products that DCC are being asked to lead on, or contribute to. This traceability gives visibility to industry parties, as well as Ofgem, of how the costs have estimated. This should also provide a robust basis for tracing actual costs against those estimates, enabling better forecasting as well as cost control. However, independent assurance is required to verify that the business case represents a reasonable view of the activities required and their associated costs.

The activities that DCC will undertake during the Transitional Phase could create the foundation for a new set of switching arrangements that deliver a good customer experience at a reasonable cost. This will only happen if:

- the detail of the new switching arrangements is agreed by industry
- the plan to implement those arrangements is clear and is accepted by all industry parties, and
- the costs incurred are transparent, reasonable and deliver real value for money.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact me.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

Paul Delamare

Paul Delamare
Head of Customers Policy and Regulation

Attachment

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EDF Energy's response to your questions

Q1. 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?

We welcome the level of detail DCC has provided within the business case. There is a clearly demonstrated link between the requirements, the Product Breakdown Structure, the Requirements Traceability Matrix, the DCC Switching Programme Plan and the Cost Model. All of the costs incurred by DCC must be clearly justified by an activity within the plan that is required to enable the successful completion of the Transitional Phase.

A clear plan setting out the relevant products will be critical to assessing delivery by DCC. Product descriptions will be critical in not only setting out the scope of those products but the quality criteria against which they will be assessed. As much as possible industry stakeholders should be involved in not only setting those quality criteria, but also assessing whether they have been met. Where appropriate some form of assurance, preferably independent, should be used to assess the delivery of critical products. The need for robust assurance must be balanced with ensuring costs are controlled and only incurred where necessary.

While we agree that the documented approach seems to be clear and robust, we are not able to verify that the activities that have been documented, and the estimated effort that has been associated with them, is appropriate. Some form of independent assurance should be applied to these products before the DCC business case can be baselined in March 2017. This will provide confidence to those that will incur DCC charges that these are appropriate. It will also ensure an accurate baseline for applying DCC's price control framework and monitoring DCC's delivery against their plan.

We are concerned about DCC's Corporate Overhead Charge of 9.5%, which is not directly driven by activities it is asked to undertake but is a standard percentage based on other costs. The logic behind the application of this charge needs to be more clearly explained, especially as it is proposed that this charge would be included in the calculation of DCC's margin. It must be ensured that this charge is reasonable, and does not exceed the comparable costs that would be incurred by DCC were it not part of Capita.

Q2. 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?

On balance, we agree that the business case's structure and base assumptions are clear. The business case does set out how the total cost to industry noted in Section 1.5.1 has been calculated in a clear and understandable manner, and we welcome the level of detail and explanation that has been provided.

This does not prevent us from being very concerned about the overall level of the proposed charges to be paid by industry parties, and which will ultimately be recovered from our customers. As noted in our response to Question 1, independent assurance should be applied to the business case before it is baselined. This will ensure that the programme budget is realistic and that the charges we are being asked to pay upfront are reasonable.

We note that Section 7.3 of the business case sets out a number of assumptions that DCC have made about the scope of their involvement in design, delivery, procurement and regulation. These assumptions are key drivers of costs, and of the uncertainty accounted for by the proposed contingency. In general, these assumptions seem reasonable; many of them relate to decisions to be made by Ofgem about DCC's role. Ofgem could reduce the level of uncertainty and improve the accuracy of the baseline scenario by providing additional clarity to DCC on the scope of their role as soon as possible.

Q3. 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?

Ofgem must ensure that the Switching Programme is delivered in the most cost-effective manner possible. If parties other than the DCC would be better placed to deliver components of the Transitional Phase, then this opportunity should be taken wherever possible.

In the time allowed for this consultation, it has not been possible to scrutinise the activities in enough detail to determine which could be carried out by other parties. From discussion with Ofgem, we understand that the key areas that are considered to be non-core activities are security design, and design proving for the proposed new switching arrangements.

In regards to security design, the criticality of security necessitates that this is embedded as an integral component of the design of any new switching arrangements. Our view is that it would therefore be best managed by DCC. Separating this function to be delivered by another party creates potential risk for the design of the new arrangements. Even if this were separated out as a distinct design function, the need for close collaborative working with DCC might increase costs and negate the benefits to be gained by using a third party, which are likely to be marginal in this Transitional Phase.

While DCC should remain responsible for security design, we would highlight the importance of co-operation and intelligence in this space. DCC's security design must be informed by a community of experts, possibly from different sectors. DCC should also look to engage the Security Sub-Committee (SSC), established to support the Smart Energy Code (SEC). The SSC has good industry and regulator representation, and can draw on expertise from the National Cyber Security Centre. We do not believe that there is any clear benefit to be gained by having the security design carried out by another party.

We welcome the proposal to conduct design proving as part of the development of the detailed design of the new switching arrangements. We can see that here may be some value in having an independent review of the proposed design that provides a critical analysis that highlights any issues with the design that need to be addressed. However, the business case indicates that the design proving capability is something that DCC might look to procure externally. If so, they should ensure the independence of any party they contract to perform this function on their behalf.

We also perceive that there could be a small risk that having design proving undertaken by another party could lead DCC to take short cuts, in the knowledge that someone else will analyse and improve their design. We do not see that there is a clear argument for having design proving performed by another party, and we are not aware of any specific party that might be better placed to carry out this activity.

The additional benefit of DCC carrying out any activity is that this means that the costs for that activity will be covered by the DCC Licence and subject to relevant price control arrangements, including those related to over-recovery. It is not clear how Ofgem might procure activities from other parties and manage the costs of those activities outside of the DCC Licence.

Q4. 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?

We do not agree with DCC's view that the management reserve and contingency should be included within the upfront charges, based on the current level of costs attributed to these categories. While we would expect some level of contingency to be accounted for in the business case, an overall level of 35% is much higher than we would expect for a programme of this nature. We would expect this figure to be closer to 10-15% based on our experience of programmes of this scale and complexity. This is especially the case in the Transitional Phase, as opposed to the Enactment Phase which would usually have a higher level of associated risk and uncertainty.

The key driver for the current level of management reserve and contingency is the lack of certainty in the overall Ofgem plan for the Transition Phase of the Switching Programme. Management reserve is being included to account for a change in the scope of the role of DCC in this phase. Contingency is being included to account for uncertainty about the products and activities that DCC is being asked to lead on, or contribute to.

Ofgem should be looking to provide certainty at the earliest possible opportunity. We recognise that this might not reduce the overall level of costs, as what is currently regarded as contingency might become actual forecast spend if some risks materialise. However, this would improve the perceived level of accuracy of the current costs, and provide confidence that DCC's costs are realistic and based on robust forecasting. The current view is that the contingency allowed for could mask a level of inaccurate forecasting of costs by DCC. The current level of contingency, and the request for this to form part of the upfront charges, creates the perception that industry is being asked to fund DCC's inability to forecast their costs accurately.

We are also concerned by the lack of a formal process to approve use of contingency, which is exacerbated by the current scale of that contingency. Control of costs during every phase of the Switching Programme will be critical to delivering value for money to consumers. We would prefer to see a more robust mechanism for requesting and releasing contingency implemented. This should not be onerous or unnecessarily hamper the progress of the Programme, but it must provide assurance that cost is only being incurred outside of the original budget where agreed. It is much easier to prevent money from being spent unnecessarily than to try and disallow costs that have been incorrectly incurred, after the event.

EDF Energy
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