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

On 24 November 2016 we issued a consultation to seek stakeholder feedback on the draft DCC business case for DCC activities during the Transitional Phase of the Switching Programme (the DCC business case). This consultation was done in advance of DCC publishing a baselined version of its business case in April 2017[1] against which DCC will report its progress for programme management purposes. The aim of the consultation was to seek views from industry on the assumptions, approach and transparency of the business case. Work between Ofgem and DCC to clarify and agree assumptions on the scope of DCC activities and its role within the programme continued during the consultation period. This ongoing work has resulted in an aligned programme plan for the Transitional Phase which we published on our website[2] (Switching Programme: Transitional Phase High Level Plan) on 21 April 2017.

The aligned plan and the DCC Business Case now reflect reform package (RP) 2 (major reform - a new central switching service)[3] as a planning assumption – this does not pre-empt a decision on the scope and shape of the new switching arrangements, but allows progress to be made towards delivery of either RP2 or RP3. Should the analysis of the options indicate that neither RP2 nor RP3 is likely to be the preferred solution Ofgem will change the planning assumptions accordingly and re-plan.

The main high-level comments in the consultation responses raised concerns around the disparity between the Ofgem and DCC plans, the overall cost of DCC's role in this phase of the programme, the uncertainty around DCC's scope, the high level of contingency and management reserve, and DCC's incentive to manage its spend given the inclusion and level of the materiality threshold. The comments identified some concerns that were relevant for DCC to manage in baselining its business case, while other concerns were raised for us to take into consideration.

Nine responses were received to this consultation including one confidential response. The non-confidential responses are published alongside this letter and a summary is provided in Appendix A.

Summary

1 Published on DCC website on 21st April 2017
2 https://www.ofgem.gov.uk/publications-and-updates/switching-programme-transitional-phase-high-level-plan
3 https://www.ofgem.gov.uk/publications-and-updates/moving-reliable-and-fast-switching-switching-programme-business-case-including-design-baseline-1

DCC have made a number of changes to the version of the DCC business case consulted on in November 2016 and these are summarised along with their impact in Appendix B. These changes have been driven by consultation responses, detailed bottom up planning between Ofgem and DCC aligning plans to reform package 2.

The aligned programme plan now has a date for contract award in February 2019 and contract signature in May 2019. This reflects an ambitious and non-contingent set of planning assumptions. The anticipated cost to industry for DCC's activities during the Transitional Phase is £24.1m based on an assumption of delivering Reform Package 2.

Plan alignment

The main task in finalising this initial baseline of the DCC Business Case was to align the DCC and Ofgem programme plans. This has been achieved through detailed, joint bottom-up planning between DCC and Ofgem with consideration of the responses received to the consultation particularly in relation to DCC's role. The Ofgem and DCC plans are now aligned in terms of timing and underlying assumptions in relation to scope and phasing. We expect to expand and refine the planning in relation to the procurement projects to align with our preferred solution once it is identified.

This joint bottom-up planning has led to the development of an ambitious plan developed without building in time contingency. This joint planning has increased the certainty of DCC's role within the Transitional Phase of the programme and therefore decreased the number of potential scope scenarios. This has narrowed the cost variance between the high and low scenario compared to the base case. However, the ambitious and non-contingent planning has meant that the underlying delivery risk has increased and this is reflected within DCC's budgetary contingency.

Materiality threshold

Consultation responses reflected an unease on the level of materiality threshold and the inclusion of management reserve. Following this DCC have removed the management reserve and are instead accounted for a lower portion of cost within the contingency to account for unforeseen eventualities. Although the risks linked to scope uncertainty have decreased, the ambitious non-contingent planning assumptions have resulted in an increased number of time-based risks. This means that despite the removal of management reserve the contingency remains at a similar proportion of baseline costs however as an absolute figure it has decreased. This represents prudent programme planning accounting for the increased time-based risks.

In response to stakeholder requests for greater clarity on costs and delivery per activity DCC has updated this version of the business case to show the costs relating to each scope scenario and how these are split across workstreams. Further to this pre and post mitigated impact ratings in relation to the identified risks have also been provided.

Ofgem and DCC have also worked to develop a change control process which has been outlined at a high level in this version of the DCC business case and has allowed DCC to provide further detail on the controls in place to draw down contingency funds. This includes Ofgem approval for the unforeseen contingency to be drawn down. These processes are in place to encourage strict cost management. Further change controls, managed by Ofgem, are in place in relation to the incentivised milestones and this is

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outlined in more detail within our direction on DCC's margin and incentives during the Transitional Phase[4].

Baseline costs and price control

As there are still aspects of the programme to be confirmed, primarily in relation to the chosen solution, there is not enough certainty over DCC's costs to use the business case as a baseline for price control purposes. This means that DCC will have to justify all Incurred Costs within its annual price control rather than just those above the baselined amount. Any incurred Internal Costs that are not justified and/or are deemed uneconomic and inefficient in the annual price control review will be disallowed. This determines the Centralised Registration Service Internal Cost (CRSIC) term per regulatory year. Margin will be applied to this term and therefore margin will not be earned on disallowed Internal Costs. This should address concerns raised about DCC's motivation to manage costs and the level of justification presented to date.

Our decision on DCC's price control, 5 published on 28 February 2017, states that for new scope activities which were not included in the DCC's licence bid, DCC must provide justification to demonstrate any shared services cost relating to these activities are economic and efficient. The decision further states that we consider the methodology used by DCC in their 2015/16 price control submission for estimating the tangible benefits of the services provided by Capita as reasonable. As such, the 9.5% shared service charge will not be automatically applied to Switching Programme costs, but we encourage DCC to monitor and improve their processes and methodology for estimating the intangible benefits.

Although this version of the DCC Business Case will not be used as a baseline for price control purposes it will be used by DCC to report on progress to the Switching Programme. This reporting will cover delivery, quality and financial performance. We will share a summary of this detailed reporting with the appropriate governance forums.

Re-baselining

DCC aims to re-baseline the DCC business case following our identification of a proposed preferred solution to be consulted on. We anticipate this will be in the third quarter of this year and is shown as design baseline 2 in the DCC business case. This should increase certainty on the chosen solution and allow for a more robust planning of the enactment phase of the programme. DCC's subsequent programme reporting will then be against that updated version of the DCC Business Case and programme plan. The aligned programme plan as part of this re-baselining will be independently and externally assured and will be used for setting the incentivised milestone dates.

We further anticipate that the DCC business case will be re-baselined in the event of any major scope changes, significant programme changes or if the materiality threshold is exceeded. These changes would be communicated and discussed through programme governance forums.

Next steps

Ofgem do not anticipate further consultations on this version of the DCC business case which is now baselined for programme management purposes. Our intention is to keep stakeholders informed of progress towards the plan, changes to milestones and through the established governance groups and design forums. We do not believe there is sufficient

[4] https://www.ofgem.gov.uk/publications-and-updates/decision-margin-and-incentives-dccs-role-within-transitional-phase-switching-programme

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programme and budgetary certainty at this stage for the business case to be used as a baseline for price control purposes. Our intention is to keep relevant governance groups informed of any updates made to the business case before it is re-baselined in autumn this year.

There was also a parallel consultation running on our proposal for DCC's margin and incentives during the Transitional Phase. Our direction[5] on this was published 16th March 2017.

If you have any questions regarding this document or the associated annexes please contact Natasha Sheel (Natasha.sheel@ofgem.gov.uk).

Yours faithfully

Rachel Clark
Programme Director

[5] https://www.ofgem.gov.uk/system/files/docs/2017/03/direction_on_the_value_of_crspa_under_the_smart_meter_communication_lice_1.pdf

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APPENDIX A – Summary of responses received

Stakeholders have been engaged with DCC's business case since its early development and the questions in this consultation were based on the main discussion points in establishing this iteration of the draft. These questions were considered among stakeholders at an additional SPDG meeting[6] after the publication of the consultation, and before responses were due, in order for stakeholders to ask any specific questions that they had at that time. These questions were discussed in addition to the questions asked in the parallel consultation on DCC's margin and incentives, and we see these talking points reflected in the responses to both consultations.

We received nine responses to this consultation, with the eight non-confidential responses published on our website. The non-confidential respondents to the consultation were:

- British Gas
- Citizens Advice
- EDF Energy
- Energy UK
- E.ON
- First Utility
- Scottish Power
- SSE

All responses are summarised below, with calls for actions from both DCC and Ofgem.

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?

The view expressed by eight of the respondents to the first part of this question was that the approach was as clear as it could be given the level of uncertainty. One respondent noted that it was "as clear as can realistically be expected, given the levels of uncertainty involved at this stage" with others expressing similar thoughts. There is the expectation that as planning and scope become clearer the business case will correspondingly mature and a reduction in the materiality threshold is anticipated.

There was support for the regular reporting and stakeholder participation, with calls for weight to be given to stakeholder views and engagement throughout the programme. It was felt that the Requirements Traceability Matrix and Product Breakdown Structure were comprehensive, though a lack of detail around how activities will be accounted for and progress will be assessed. This has been expanded on and will be addressed though DCC's monthly programme reporting on quality and delivery. One respondent requested that more detail be given on governance and the reporting structure used to manage procurement and this has been provided through the Procurement Framework[7] published in January 2017.

Concerns were raised around the structure of the business case not aligning incentives correctly, with one respondent noting that it does not mitigate enough of the "risk arising from the incentive to overspend due to the margin arrangements coupled with the ability to overspend due to the significant contingency reserves".

One respondent felt that assessing the cost scenario was difficult as although the business case's "structure is clear, the cost and delivery per activity are not". Others noted a lack of justification for costs (in particular the overhead charge) as well as resourcing numbers.

[6] https://www.ofgem.gov.uk/system/files/docs/2017/03/spdg_meeting_5_meeting_note.pdf
[7] https://www.ofgem.gov.uk/publications-and-updates/switching-programme-procurement-framework

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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?

Out of the seven responses to this question four respondents felt that the structure and assumptions were clear while three did not. However, all respondents raised concerns or suggestions for ways to improve transparency, with a number of similar concerns across both groups of respondents.

Respondents' main concerns were around the reconciliation of Ofgem and DCC's programme timelines, certainty of DCC's role, and the overall level of the proposed charges, specifically around margin and materiality threshold exceeding expectations. As noted by one respondent these costs "will ultimately be recovered from our customers", with Ofgem tasked by a further respondent for ensuring value for money. With regards to the proposed costs it was acknowledged by one respondent that it would be "difficult to set a realistic programme budget given the level of given uncertainty over the scope of the DCC's role" while another requested that it would be helpful to be able to see the relative costs of the high and low scenarios compared to the baseline.

There were requests for explanations of the level of complexity of the registration service justifying the allocated costs, as well as a request to explain how risks will be mitigated. Respondents also expressed a desire for sight of the cost differences between the low, baseline and high scenarios along with less subjective phrasing in DCC's scope descriptions. One respondent also asked that if there should be "a material increase in costs Ofgem should engage with industry again, either through formal consultation or the Switching Programme Delivery Group or other fora".

Question 3. For those activities that Ofgem proposes 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?

There were largely mixed views on this question. There was an appeal from a few respondents for Ofgem to ensure cost effectiveness in delivery of the programme, notably through price control.

The advantages that were noted of DCC taking on the proposed non-core activities were summarised by one respondent who said that "there are advantages in having all activities undertaken by a single service provider. These include less management overhead from Ofgem in managing multiple contractors and there being less chance for conflict and disagreement between parties tasked with delivering aspects of the programme. Ultimately there should also be economies that can be realised from having one service provider." It was noted by a further respondent that stakeholders would normally expect non-core activities to be subject to competitive tension, but given that the costs of the activities here are still of relatively low materiality, it was thought that there might be cost efficiencies in allowing DCC to perform them.

On the other hand, it was noted that having the potential for other parties to take on work that would be able to provide more specific services more efficiently than DCC. It was felt by one respondent that it would "engender transparency through independence of activity ownership, and therefore improve the quality of output through focussed tasking and responsibility for each activity". One respondent also noted that funding mechanisms

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shouldn't drive inefficient and inappropriate arrangements for delivery of key elements of this programme, with the expansion of DCC's role only appropriate for select activities.

Two respondents made specific mention of the tasks that they felt DCC would be best placed to undertake. These included security design, support services, regulation (in collaboration with industry participants) and technical design. It was raised that DCC should use the community of experts available to them through the programme to carry out activities that require co-operation and would allow for DCC to make the most of intelligence, particularly in security design.

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?

All nine respondents answered this question, with seven opposing the inclusion of the full materiality threshold in the upfront charges.

The main reservation around the inclusion of the materiality threshold in the upfront charges was the level of the contingency and management reserve. Respondents acknowledged that including an element of contingency upfront was reasonable although it was difficult to justify such a high level given the nature of the programme. Given the high level of the materiality threshold it was raised that its inclusion in the determination of overhead and margin seemed inappropriate. There was also a common concern that the inclusion of these charges gave the impression that these costs were a certainty rather than being a provision for a maximum tolerance, with DCC incentivised to reach this threshold if it's charged for upfront.

It was raised by a respondent that "DCC should be adequately incentivised to mitigate any risks of overrun / overspend rather than being paid upfront for known risks", with further respondents in agreement with this and another noting that the provision for this in the upfront charges provides the wrong incentives for the tight management of scope and delivery, with accountability for costs taking place afterwards.

The split between the contingency and management reserve components were not necessarily clear, with a call for new requirements to the programme to go through a change control process which should be clarified to stakeholders. There were also requests among respondents for transparency on the process to draw down on the materiality threshold and for the development of the programme governance process around the handling of the charges to be outlined.

It was felt that the high level of unknown unknowns that were included should be managed through uncertainty mechanisms or re-baselined business plans to evaluate cost escalations (such as in network price where there's no allowance for working capital). It was suggested that the business case should be revisited when major changes are made, even if these fall below the materiality threshold, and that a notification and review process should occur before these costs are incurred as they should be seen as a maximum tolerance rather than accepted.

Respondents in favour of the inclusion of the materiality threshold in the upfront charges felt that if it more accurately represented the costs faced by industry, although it was felt to be high. There were further requests for clarity on how unspent moneys will be paid back.

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