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Robyn Daniell
Ofgem
9 Millbank
LONDON
SW1P 3GE

21 December 2017

Sent by email only to: smartmetering@ofgem.gov.uk

Dear Robyn,

DCC Price Control Consultation: Regulatory Year 2016/17

Dear Robyn,

British Gas key concerns to DCC's price control review are in the main body of our response, with answers to Ofgem's questions are included within the appendix. This is a non-confidential response and may be published on Ofgem's website.

We remain concerned that DCC continues to over recover their allowed revenue and are not feeling the weight of Ofgem's regulatory powers to control their expenditure, resulting in consumers being over charged for DCC services. We strongly believe that the best way for DCC's revenue to be controlled is to incentivise them not to over recover in the first place, as the K factor mechanism within the allowed revenue formula takes up to two years to unwind. If DCC felt Ofgem use their regulatory powers, particularly by charging the DCC penalty interest for the over recovery in 2016/17, we would be more confident DCC would reduce their charges quicker and limit the use of a prudent estimate variable in future years.

Although DCC were created using a competitive tender, Ofgem must regulate as the competitive process no longer persists and monopoly behaviours could take hold. We believe that DCC charge more than they should and they are charging us for services we have already paid for, Readiness to Scale / Delivery Hub are examples. We are concerned that Ofgem lack proximity to the procurement process and the technical detail to stop them; this is highlighted by the number of times DCC have pointed to a change in the UK specification, however they either caused the change or did not adequately mitigate the flagged risk.

We share Ofgem's concern at the significant and sustained increase in Full Time Equivalents (FTEs) employed by DCC and the use and cost of consultants. We believe DCC do not have a tangible plan to reduce the FTE and consultant numbers and cost; solely relying on attrition.

We will continue to challenge the DCC to be more transparent with their costs, particularly their internal initiatives such as Delivery Hub / Readiness to Scale. However, we will rely on Ofgem to scrutinise new costs versus the DCC's tender and any potential underbidding of the Licence Application Business Plan (LABP).

We agree that DCC did not achieve the IP9 and IP10 milestones and should not receive the margin payments for these. We remain concerned that the net £360m additional external cost of achieving R1.x, along with the subsequent time delay and lower quality (as shown by the defects and major incidents raised in 2016/17) has been viewed as economic and efficient.

Please do not hesitate to contact me, or Simon Trivella (simon.trivella@centrica.com), if you require any further detail on our response.

Yours sincerely,

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Appendix

Question 1: What are your views on our proposal to consider External Costs as economic and efficient?

Unfortunately, it is difficult for stakeholders, other than Ofgem, to gain an opinion on whether the external costs are economic or efficient, particularly as the DCC does not publish individual Service Provider costs, due to 'commercial confidentiality'.

We also find it difficult to reconcile the delays, defects and increasing costs with organisations that are acting in an economic and efficient manner. The lack of support for SEC modifications and the significant cost for initial assessments remains unaddressed.

Question 2: Do you have any views on DCC's contract management performance?

We have seen little evidence of DCC changing the FSP's contracts nor managing these effectively.

Question 3: What are your views on our proposals on DCC's Internal Costs?

The ratio of 40:60 contractors to permanent employees continues to be too high and cannot be described as economic and efficient, when a contractor costs on average 3 times the amount of a permanent employee. We also feel that an average cost of £99k per FTE is too high given the spread of roles across the DCC.

We believe that Readiness to Scale and Delivery Hub would not have added significant cost to DCC's internal costs in 2016/17 as these initiatives were first discussed at SMDG on 6th July 2017 and 18 of 22 remain ungrounded in the recent SMDG call on October 2017.

Question 4: What are your views on our assessment of DCC's performance against IM9 and 10?

We agree that DCC failed to meet Implementation Milestones 9 and 10. Therefore the DCC cannot recover the previous missed milestones too.

Question 5: What are your views on our assessment of DCC's application to adjust their baseline margin?

Whilst we have sympathy for the additional work and resources that DCC have taken on, Ofgem and the industry needs to be mindful of the decisions DCC have made and risks unmitigated that have driven considerable extra cost. DCC should not be rewarded for these decisions and mismanaged risks by earning extra margin. For example, under scoping their Licence Application Business Plan.

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Question 6: What are your views on our assessment of DCC's application for External Cost Contract Gainshare?

We do not have enough information to make a confident judgement about the ECCGS.

Question 7: What are your views on DCC's reporting which explains its reasons for over recovery of revenue in RY16/17?

We do not find the DCC's explanation acceptable in recovering 122% of their allowed revenue. We strongly believe the DCC is incorrect in their explanation of the over recovery, they have control over:

- Timing and size of the correction factor;
    - DCC already had £15m in deferred revenue on their balance sheet from previous regulatory years, see DCC's annual report ending 31st March 2016. DCC should have returned some if not all the £15m to consumers in 2016/17 via the Kt factor. Particularly as their prudent estimate (used to cover cash flow concerns) was £13.1m in 2016/17;
    - For 2016/17, DCC now have just under £43m in deferred revenue, however have only chosen to return £27m to customers via the correction factor. Therefore, this flawed reason for over recovery is likely to resurface in PCR 2017/18.
- DSP financing savings;
    - DCC claim to have lead the discussions on the refinancing of the DSP's interest charges, earning themselves several million pounds in external contact gainshare. The claim that the they could not have reasonably anticipated the savings from this initiative are therefore counter intuitive to this.
- Non-payment of milestones;
    - DCC as the contract manager with overall programme delivery responsibility are in the ideal position to be able to predict whether milestones would be achievable, then plan and charge appropriately.
- The over-use of the prudent estimate.
    - DCC also had £25m cash at the end of 2015/16 (page 37 DCC annual report 2105/16), more than enough to cover any immediately payable liabilities. Yet the DCC still included a prudent estimate for cashflow purposes.
    - DCC continue to include a prudent estimate within their charging statement even though this is not a variable within their revenue formula. The inclusion remains for several years into the future, whilst their cash flow remains healthy and have very small bad debt risk. Using the prudent estimate variable ensures that DCC will continue to over recover their allowed revenue, which is unfair to consumers and must be stopped.
- The increase in pass through costs helped the DCC in slightly offsetting their over recovery position and is therefore not a reasonable explanation.

We believe Ofgem needs to take a firm stance against DCC's over recovery, which is impacting consumers and undermining the Smart Metering Implementation Programme by applying the penalty interest to DCC for over recovering their revenue in 2016/17.

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