3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

**21 December 2017**

**DCC Price Control Consultation: Regulatory Year 2016/17**

Dear Robyn,

We are pleased to be invited to respond to this consultation. Citizens Advice has statutory responsibilities to represent the interests of energy consumers in Great Britain. This document is entirely non-confidential and may be published on your website. If you would like to discuss any matter raised in more detail please do not hesitate to get in contact.

We broadly agree with the proposals Ofgem is making in this consultation to push down on the costs requested by DCC. The underlying dynamic of this price control is potentially skewed against consumers. DCC clearly have a strong incentive to argue for a higher allowance, and since these costs would affect all users equally and be passed on to consumers, they will have a minimal effect on those users' competitiveness. This removes any clear counterweight of advocacy within industry to offset DCC's position. With this in mind, we would hope that Ofgem's attitude would always be to give consumers the benefit of the doubt where any doubt in this price control exists.

However we are concerned by the increase in external and internal costs which consumers ultimately pay. Costs have risen significantly fixed internal and external costs for 2018-19 are almost £180m more than initially expected in the DCC licensing competition. Cornwall insight reported[1] that in July the DCC forecast its

[1] https://www.cornwall-insight.com/newsroom/all-news/smart-dcc-costs-a-rollercoaster-ride?utm_medium=email&utm_campaign=Blog%20%20Smart%20DCC%20costs%20A%20rollercoaster%20ride&utm_content=Blog%20%20Smart%20DCC%20costs%20A%20rollercoaster%20ride+

3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

fixed revenues for the 2018-19 charging year at £344.9m. In October, just three months later, forecast revenues had increased 12.8% to £389.1m. Cornwall estimate that although these costs equate to around 2% of the domestic bill, they provide an upward influence alongside other rising drivers on the electricity bills such as higher Capacity Market, Contracts-for-Difference, and Renewables Obligation costs for 2018-19.

We continue to have concerns over the margin that the DCC is permitted to make, particularly in the context of tougher price controls for monopoly network companies which Ofgem has recently signalled. This tougher stance is related to the high returns that these companies are making.

We recognise that the unique function of the DCC made an ex post approach to the price control the best option at the outset. At the same time, we are keen to see a transition to a fully ex ante control as soon as possible. Continued revised forecasts of revenue upwards, does not bode well for consumers getting a good deal from an ex post arrangement. Although we recognise this is partly for reasons beyond DCC's control, an ex ante approach would give more certainty for stakeholders and a stronger mechanism for keeping costs under control.

Ofgem should also consider DCC's past performance in relation to stakeholder satisfaction. Stakeholder engagement by DCC during SMIP has not been optimal, despite improvements over time. We would want DCC to develop a business plan in consultation with stakeholders, and Ofgem should consider whether this should be scrutinised by a Stakeholder Panel. Similar parallels can be drawn with the framework for price control of monopoly energy networks where stakeholder engagement is being considered as a key part of the next set of price controls, and has been successfully used in the water industry. This would ensure transparency and help both Users and other stakeholders to hold DCC to account. This could be financially incentivised either as part of the Value for Money measure, or through a discretionary reward for stakeholder engagement. As set out by Ofgem, a further benefit of setting a robust business plan is that it could expedite the transition to an

CID_b3016ea2df8c4f9ff0b9398cb95e1534&utm_source=email%20marketing&utm_term=Read%20the%20full%20article

3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

ex ante price control system. We support this transition as rapidly as possible to ensure that the DCC focuses on long term costs.

We have outlined answers to the questions in your consultation below.

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

We support your proposal to consider the External Costs as economic and efficient, whilst noting that these are a major driver of overall cost increases and therefore contribute to the costs that consumers pay.

We recognise the challenges faced in regulating these costs, and restrictions that the licence places, particularly the requirement to ensure FSPs are no better or worse off, have on the negotiations for these costs. We support Ofgem in encouraging the DCC to explore all the options available to them to ensure costs remain economic and efficient. We agree that it is vitally important that all cost variations meeting the DCC's materiality threshold are explained and evidenced in the submission, and we encourage Ofgem to consider how this can be improved.

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

We support Ofgem's position on contract management. We recognise that there has been good progress in a number of areas. We would expect DCC to demonstrably improve on those areas Ofgem have highlighted:

- The late delivery against plans of release 1.2 (and release 1.3 which took place in RY17/18)
- Industry feedback that even when release 1.2 was delivered, stakeholders couldn't use the service effectively and proceed with their plans.
- Instances where DCC decided to deviate from established procedures to enable work to continue at the pace required by their timelines,

3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

- Concerns about the risk of DCC incurring additional Internal Cost related to fundamental service capability.

These areas signal the importance of stakeholder engagement at highlighting areas where performance needs to be improved, and indicates the benefits that would be gained for consumers by greater engagement by the DCC with its stakeholders.

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

Internal Costs comprise the part of DCC's allowed revenue for the purposes of provision of the DCC service (excluding External Costs and pass-through costs). These include internal payroll and associated costs, accommodation, external and internal services, IT costs and service management costs. As a monopoly provider the DCC is not subject to market pressures to drive efficiencies, so it is essential that the price control pushes down on costs that are unnecessary and uses benchmarking to determine what the appropriate cost would have been. It is vital that any additional revenue that is requested is evidenced and substantiated.

Consumers ultimately bear these costs. Therefore we support Ofgem's proposals to find costs unacceptable for:

- £0.451m for contractors expenditure
- £5.397m of forecast payroll costs
- £38.956m all proposed increases in payroll, related non-payroll costs and recruitment costs to be unacceptable.
- £1.216m forecast cost for new premises
- £2.733m the entire variation in accommodation costs
- £1.167m of CGI contract
- £6.980m DCC external forecasts linked to ATG and SMKI contracts
- £4.435m service management forecast variencies.
- £0.091m shared services charge associated with the switching programme.

3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

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

We agree with Ofgem's assessment of performance against IM9 and IM10.

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

We support Ofgem's proposal to adjust the DCC's margin proposal downwards, especially considering that the DCC have not provided Ofgem with appropriate justification.

But we do not consider 15% to be a reasonable margin.  This decision is being made in a context where Ofgem is also considering the framework of the next set of price controls for energy networks. It is already signalling a tougher regime after networks were show to be making an average 10% return. The DCC return is higher still, and we'd encourage Ofgem to be tougher in this price control, as well as considering moving to an ex-ante model as soon as possible in order to better control costs.

We encourage Ofgem to further consider how this margin could be managed downwards, whilst recognising the need to avoid perverse incentives relating to delivery of the switching programme.  If profit margin is determined in part by risk, and Ofgem accepts that the DCC faces no significant risks (and low risk overall), then the acceptable margin range for the DCC must necessarily be lower than the range for companies that do face real market risks. We would therefore suggest Ofgem revisits its reasoning in this area and downwardly adjusts the DCC's margin range accordingly.

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

We support Ofgem's assessment.

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

3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

We agree with Ofgem's assessment and share concerns over the size of the correction factor, and look forward to the DCC providing details of their discussion and engagement with customers on this issue.

Yours sincerely

Stew Horne

Principal Policy Manager, Energy Regulation