The voice of the energy industry

Energy UK Response to Ofgem's DCC Price Control Consultation: Regulatory Year 2016/17

12 January 2018

About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs with many of our members providing lifelong employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HMT.

Energy UK Response

We welcome the opportunity to respond to this consultation, and confirm that this response is not confidential. Our response is intentionally high-level capturing overarching key points on behalf of our members.

Whilst we appreciate the effort DCC is putting into delivering the key Programme milestones, we remain concerned about DCC's sharply rising costs, its limited transparency and lack of direct engagement with the industry in understanding the drivers for these rising costs that would allow for comprehensive industry scrutiny to ensure DCC is delivering real value for money for consumers. Whilst the DCC has communicated that it has an appetite to drive efficiencies were possible, we are yet to see this commitment translate into action. We believe that Energy UK's members are in the position where they have limited ability to influence these costs, and this clearly needs to be addressed.

We believe that it is essential for a mechanism to be introduced which to enable suppliers to work with the DCC to understand and challenge its predicted or expected costs before they are incurred. We believe the current framework does not allow this and would therefore urge greater DCC transparency and industry engagement to support independent assurance, challenge and review in a timely and meaningful way.

We are equally concerned that DCC's total proposed cost increases would represent an additional £560m[1] over the term of its licence. These costs are ultimately borne by customers through their energy bills, therefore it is essential that costs are kept to an absolute minimum wherever possible. As well as increasing customers' bills, DCC cost increases will further erode the overall SMIP benefits case. Energy UK also notes the risk that negative publicity about cost increases may undermine positive messaging to customers around the rollout, leading to knock-on impacts on rollout efficiency.

We note that there are significant increases in the DCC's forecast of internal costs over the licence term (58% higher than forecast in Regulatory Year 2015/16) as well as increases in its external costs (20% higher than forecast in Regulatory Year 2015/16). The significance and rationale of these increases is concerning. For example, we believe that the increase in project complexity caused by

[1] Variance between the full licence term costs forecast by DCC last year and this year (as per Table 1.1 in the consultation).

changes to the initial SMETS2 solution, and the general maturing of the DCC in 2017, could reasonably be foreseen and so do not satisfy the increase in the payroll forecast compared to the previous year, as ascribed by the DCC.

It appears that DCC's internal costs, in particular, would merit further control to ensure DCC delivers better value. We suggest that Ofgem considers the disparity in costs increases between DCC internal and external costs, with particular focus on DCC's head count and approach to remuneration. DCC's licence was granted following a competitive tendering process, and we would expect its outturn costs to closely mirror those outlined in its tender. However, this seems to be far from the case, as exemplified by internal costs which are nearly three times higher for RY16/17 than forecast in the License Application Business Plan. The extent of DCC's cost overruns call into question the value of the original tendering process.

We support Ofgem's proposals in relation to amendments to DCC's performance, baseline margin and external contract gain share.

Whilst not specifically highlighted in this consultation, we would like to express the significance of concerns previously highlighted to BEIS and Ofgem around DCC's proposed costs for implementing SEC Modification Proposals (that impact DCC systems), as identified in DCC's impact assessments of SEC Mods going through the Change Process. These costs are clearly becoming a barrier to raising changes to enhance the SEC, and therefore negatively affect the programme as a whole. We believe that this failure to facilitate anticipated modifications to ensure the SEC is effective and fit-for-purpose suggests the appropriate commercial arrangements are not in place.

Our concerns also extend to the DCC's timely provision of its impact assessments of SEC Mods, the lack of which continue to delay and frustrate the modifications process. Whilst these issues have been raised directly with DCC via SEC Panel and BEIS' Transition Governance forums, we would suggest Ofgem consideration (in collaboration with BEIS) is required as part of the Price Control arrangements to drive improvements to DCC's performance in the modifications process, with the ultimate aim of ensuring that the SEC change process remains fit for purpose.

We believe that Ofgem should take a rigorous approach to future scrutiny of DCC's costs, actively seeking and considering wider industry views before formal consultation on any proposals. Energy UK and its members would welcome further engagement with Ofgem and DCC on this to ensure a fit for purpose framework. We would also be happy to support DCC (and Ofgem) in looking at possible ways to seek better control of these rising costs.

We believe that the suitability of DCC's current price control has been called into question by the continuously rising DCC costs. The current, ex-post, form of the price control seems increasingly inappropriate for some of the tasks faced by DCC, and a move towards an ex-ante approach for specific projects/ undertakings has been mooted. We would welcome wider examination of this idea by Ofgem in collaboration with industry to help identify the most appropriate form of Price Control placed upon the DCC going forward.

Energy UK's members would expect to be closely involved in any review of the form of DCC's price control. We would expect any change to be conditional on the ability of the price control to subject DCC's future costs to stronger scrutiny, to provide greater certainty about future costs, and to feature better incentives for efficiency.

I hope that these overarching key points are helpful. Please let me know if we can provide any further clarity or assistance. We would welcome further engagement with Ofgem on these key matters alongside our members.

Yours sincerely,

Daisy Cross
Head of Smart Metering – Energy UK

For further information or to discuss our response in more detail please contact Daisy Cross on 020 7747 2963 or at daisy.cross@energy-uk.org.uk.