

CAPITA

Mr R Salter-Church
Ofgem
10 South Colonnade
London
E14 4PU

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By email to: smartmetering@ofgem.gov.uk

Dear Rob

DCC Price Control consultation 2017/18

Thank you for providing the opportunity to respond to your consultation on the DCC Price Control for the regulatory year 2017/18. This letter represents the views of Capita plc, shareholder of Smart DCC Ltd (DCC).

DCC is providing its own response to your consultation in which it will address the specific questions raised in the Initial Proposals. Capita fully supports DCC's view on these points, most notably in relation to the disallowance of contractor costs which is a cause of concern.

The contents of this letter can be treated as non-confidential and may be published.

A market in transition

Before addressing the specifics of Ofgem's consultation, Capita would like to restate how proud it is to be involved in what has become an exciting and dynamic sector of the economy.

In our original bid for the DCC licence, we envisaged DCC as being an agent of change and, five years on, it is pleasing to see the transformation of the market gathering pace.

As a company, we remain wholly committed to supporting DCC in its important work to digitise the electricity and gas markets. Moreover, we look forward to continuing to partner with Ofgem and Government colleagues as this transformation gathers pace through Faster Switching and on to Half-hourly Settlement.

If Capita or DCC can assist further in this process, or equally, are not delivering to your expectations, please do not hesitate to contact me.

Smart DCC in 2017/18

The period since April 2017 has seen the achievement of several significant milestones for the Smart Metering Implementation Programme and DCC.

Release 1.3 was delivered, and, after a measured start, we understand that the rollout of SMETS2 meters is now gathering pace with the DCC infrastructure performing well.

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Furthermore, releases 1.4 and 2.0 have been successfully implemented and with industry recognition for the successful outcome.

In themselves, these programmes of work would be sufficient to occupy many organisations. However, DCC has also been able to make considerable progress in preparing for the enrolment and adoption of SMETS1 meters, as well as steering the first phase of the vitally important Switching Programme to time and below budget.

In parallel with this, DCC has continued to scale and build the robust and capable organisation that will be required to support Smart Metering going forward, whilst delivering further transformation projects on behalf of the energy industry and consumers.

DCC has achieved a great deal. However, we also recognise the scale of future challenges and rising expectations.

In our response to your 2016/17 consultation, we stated that we believed DCC was facing “*two or three critical years*” and that DCC had done much to “*lay the foundations for the next generation of smart metering*”. Our view on this hasn’t changed and this needs to be taken account of when assessing the actions DCC believes it is necessary to take.

Engaging with customers

In the consultation, Ofgem makes explicit reference to the need for DCC to engage with its customers. We wholly support this and all the evidence we have seen is that DCC staff are very active in working with customers on all manner of topics. It is our observation that this has an increasing focus within DCC, with a number of tangible elements, including its current consultation on Improving Engagement with Customers and Stakeholders.

Having said that, the DCC model was, at least in part, devised such that DCC had a certain independence from Industry which would then allow it to focus on delivering Government’s policy objectives and facilitating competition in the energy market.

This necessary distance has the potential to create some challenges for DCC in walking the fine line between collaborating effectively with customers, whilst being tasked with implementing capabilities which may not be perceived as being to their advantage.

Whilst we would encourage DCC to ensure that it is working as closely with Industry as possible and using the undoubted expertise therein to inform its decisions, DCC management must also be mindful of its obligations under the Licence and SEC.

We recognise that as DCC’s operations move into steady-state, Industry will play a greater leadership role when it comes to setting DCC’s priorities. However, in the interim, we hope Ofgem will be supportive of DCC management in the choices it makes, where it can demonstrate that it is listening to its customers and factoring their views into its decision-making.

Initial Proposals

Our reading of the Initial Proposals is that DCC has been effective in providing the justification and evidence required in support of its expenditure decisions, and Ofgem has been proportionate in making its assessment.

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It is pleasing to see that there appears to be a mature relationship between DCC and Ofgem which is appropriately challenging to DCC, but also broadly realistic in its appraisal.

However, there are two items which we would like to highlight and express Capita's concern, namely the disallowance of c£1.4m of contractor-related costs and the disallowance of c£0.2m of shared service costs related to emulator costs.

DCC is now an increasingly mature organisation and has recruited literally hundreds of permanent and contract staff over its lifetime. It employs professional recruitment staff and makes extensive use of Capita's resourcing expertise to identify potential candidates and manage the recruitment process in a professional manner.

We are unclear how Ofgem feels able to judge that a recruitment decision, which may have been made many months ago, can be deemed to be inefficient. In the case of a contractor, it seems even more unlikely that a day rate can be judged to be 'too high', given the range of factors that might influence a rate at any moment in time.

We do appreciate that the approach used by both DCC and Ofgem to justify staff costs has evolved over time and Ofgem has acknowledged the difficulties in benchmarking of contractors. However, given that Capita is expected to absorb any disallowances that result, we believe that assessment processes should be fair, objective and not merely the outcome of an arithmetical calculation.

As an alternative, we would cite the example of procurement where observance of DCC's processes is deemed adequate to deliver efficient procurement outcomes. We would favour a similar approach for contractor recruitment which trusts well-defined processes to source the right capabilities for the organisation at a market price.

We would urge DCC and Ofgem to work together to rethink how all staff costs are assessed for efficiency and to consider the kind of approach we suggest.

Shared Services

There are two points we would like to make in relation to Shared Services charges: one specific and the other, more general.

Firstly, in the consultation, Ofgem has made an explicit disallowance of the shared service charge on the purchase of emulators. Ofgem is correct to challenge DCC over ensuring that a full cost benefit analysis has been undertaken when procuring products or services. However, we understand that DCC's decision can be shown to be the most economic approach for customers, and that the sourcing strategy was also adopted to provide greater assurance and independence of supply.

In light of this, we would expect DCC to take on-board Ofgem's comments in relation to cost benefit analyses, however we believe that the proposed disallowance is unreasonable given the positive outcome for customers and the underlying rationale.

Secondly, we note Ofgem's comments in relation to the overhead charge which is made on DCC and which provides access to a range of services provided by Capita Group functions to all of Capita's business units.

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We firmly believe that this is an efficient way of delivering a core range of services – given the nature of the large long-term contracts which Capita is often engaged in, it cannot make sense for each to set up, for example, its own payroll or accounts payable function. Equally, if contracts start to opt-out from making such a contribution, it undermines the collective basis upon which they operate.

However, we do acknowledge Ofgem's concerns and recognise its primary duty to protect consumers. We would like to reassure you that DCC is not a passive customer and there are regular and robust communications about the scope and quality of service being provided to DCC.

In addition, we would be willing to engage further with Ofgem to discuss alternative arrangements for the levy of overhead, in relation to new services, not covered by the original licence award. We would welcome the opportunity to agree a long-term arrangement through which DCC makes an appropriate contribution to the provision of central shared services, such that this issue can be settled on a sustainable basis.

Long-term resource efficiency

In the consultation document, you have made the reasonable point that you expect DCC to focus on long-term resource efficiency and emphasised that this was a point made last year also.

Considering that, we believe it is worth restating some of the arguments we presented to you last year.

Like Ofgem and Industry, we expect DCC to bear down on the overall cost base, but this can take a number of forms. It is appropriate to point out the good work that has been done in refinancing of service provider contracts, yielding tens of million pounds of savings for customers. On top of that, DCC has operated a voluntary cost savings programme internally focusing on delivering day-to-day efficiency in its activities.

DCC is committed to continue with both initiatives and we are active in our encouragement of this approach.

However, we also detect an impatience that DCC's headcount, and associated costs, does not seem to be following the profile that was anticipated at the time of licence award.

It seems to us that DCC has two primary aims over the next couple of years; firstly, to support the industry through an exponential increase in roll-out volumes and secondly, to deliver successfully the major programmes of work it is currently tasked with, where the scale and complexity is at a much higher level than anticipated or understood at the initial Licence Award. These are huge demands and we do not believe it would be prudent to expect any significant reduction in headcount in these timeframes.

We view DCC's activities as an investment in the modernisation of the GB energy system. Therefore, the true benefits will only be measured over a longer time frame and today's costs should be seen in that context.

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To be clear, this does not mean that DCC should neglect resource efficiency but the timing of reductions in headcount needs to be appropriate and, ultimately, will be dictated by the demands which continue to be placed on the organisation.

In DCC's recent consultation on *Improving Engagement with Customers and Stakeholders*, DCC has proposed opening up both its annual business planning and budgeting processes, as well as its in-year decision-making to customers. We believe that this is a very positive step which we hope will be embraced by customers and will have the benefit of giving customers a real stake in the future shape and direction of DCC.

If you wish to discuss any points in this letter, or indeed any other aspects of the Price Control, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in blue ink that reads "P. Elliott". The signature is written in a cursive style with a large initial "P" and a long, sweeping underline.

Patrick Elliott
Executive Officer, Government Services