Consultation

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DCC Price Control: Regulatory Year 2019/20

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The Data Communications Company (DCC), or Smart DCC Limited, is the central communications body appointed to manage communications and data transfer for smart metering. It holds the Smart Meter Communication Licence[1] (Licence). Price control arrangements restrict DCC's revenues to ensure that costs incurred are economic and efficient. The arrangements also place incentives on DCC to counter its monopoly position to deliver higher quality services and performance levels.

DCC submitted its price control information (based on the published Regulatory Instructions and Guidance (RIGs[2])) for 1 April 2019 to 31 March 2020 on 31 July 2020. On the same day, DCC also submitted proposals for adjustments to its Baseline Margin and External Contract Gain Share values.

[1] The Smart Meter Communication Licences granted pursuant to Sections 7AB(2) and (4) of the Gas Act 1986 and Sections 6(1A) and (1C) of the Electricity Act 1989. This consultation is in respect of both those Licences. Those Licences are together referred to as 'the Licence' throughout this document.
[2] Regulatory Instructions and Guidance RY1920: https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2020

This document includes our review of the DCC's costs for the 2019/20 Regulatory Year and outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations and will publish the non-confidential responses we receive alongside a decision on next steps on our website at www.ofgem.gov.uk/consultations. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential and, if possible, put the confidential material in separate appendices to your response.

Contents

Executive Summary

DCC is the central communications body licenced to provide the communications, data transfer and management required to support smart metering. It has a pivotal role in ensuring the successful rollout and ongoing operation of smart metering in the GB energy market. As a monopoly service provider, it is vital that appropriate controls are in place over its costs and that it is subject to an appropriate incentive regime that focuses it on providing a good quality of service to its customers, which include energy suppliers and network companies. Through the price control, Ofgem is seeking to ensure that DCC continues to be able to make the required investments to deliver a good quality of service, whilst also focusing the organisation on delivering an efficient operation.

DCC's price control submission for the 2018-19 Regulatory Year (RY18/19) described how DCC supported the accelerating rollout of SMETS2 meters; put in place the building blocks to enable migration of SMETS1 meters onto the DCC infrastructure; and progressed the enactment phase of the Switching programme. In this year's submission, DCC continued to scale the live service to support the migration of SMETS2 meters and the enrolment and adoption of SMETS1 meters. In addition, DCC entered the Design, Build and Test (DBT) phase of the Switching programme, and initiated work on its Network Evolution programme.

There has been an increase in costs compared to last year's forecasts. As was the case last year, this is mainly because DCC has not previously been able to forecast the costs associated with the SMETS1 programme with sufficient certainty for them to be allowed through the price control. DCC also incurred additional costs from its RY18/19 forecast in its corporate management cost centre, largely driven by a number of procurements outside of the forecast.

Overall, DCC's total reported costs for RY19/20 are £495m.[3] Excluding pass-through costs, the figure is £463m. This is a 14% increase in total costs incurred in RY19/20 compared to last year's forecasts (or a 15% increase with pass-through costs excluded). Over the Licence term (RY13/14-RY25/26), total costs (excluding pass-through costs) are now forecast to be £4b, 5% greater than last year's forecast.

[3] All Great British Pounds (GBP) figures given in this document are in current year (RY19/20) prices. Inflation adjustments have been calculated using the Consumer Price Inflation including owner occupiers' Housing costs (CPIH) inflation index.

Cost Assessment

DCC's submission for RY19/20 was streamlined compared to previous years, and provided reasonable justification for the majority of costs incurred. However, as in previous submissions, DCC did not include justification for forecast costs beyond RY21/22, signalling the continued uncertainty around DCC's activities and the associated costs. Our assessment of the submission revealed three cross-cutting issues where we have concerns:

- **Payroll efficiencies** - We expect DCC to ensure that all costs incurred are economic and efficient. As DCC continues to grow in terms of both permanent staff and contractors, it is important that DCC applies robust processes to ensure that the pay and benefits package offered is economic and efficient. As such, we welcome the changes DCC made to its approach to contractor benchmarking towards the end of RY19/20, though we remain concerned by DCC's approach throughout much of the year. This will continue to be an area of scrutiny.

- **Innovation** - DCC confirmed that in RY19/20 no Value Added Services, Minimal Services or Elective Communication Services were provided. Nevertheless, DCC increased its resources both in terms of business strategy and technical roles to explore innovation and growth opportunities. Though this activity currently aims at developing new products for existing customers based on DCC's current capabilities, we are concerned that DCC's growth in this area may not be underpinned by demand from its customers. DCC's main priority should as ever remain delivery of its core business.

- **Contract management** – Core to DCC's role is its negotiation and management of service provider contracts. In the RY18/19 price control consultation, we stated our expectation for DCC to provide fuller assurance in future price control submissions on the trade-offs they choose to make in contract negotiations, and how they manage contractual risks to ensure performance and delivery throughout the terms of the contract. Though we acknowledge that DCC has made some improvements in this area, we continue to have concerns over the efficacy of DCC's procurement and contract management. As outlined in our decision on the Operational Performance Regime review, published alongside this document[4], we will be

[4] http://www.ofgem.gov.uk/publications-and-updates/dcc-operational-performance-regime-review-october-2020-decision

trialling a contract management incentive based on an auditor assessment as part of next year's price control.

For the cost assessment itself, subject to further evidence, our position is that £4.385m from DCC's total cost in RY19/20 are unacceptable costs. This comprises expenditure on a retention scheme; inefficiencies in contractor benchmarking; growth of the strategy and product management team in DCC's corporate management cost centre; and accommodation costs from DCC's Preston Brook site.

In addition, we are minded to disallow a total of £4.654m in forecast costs for RY20/21 and 21/22 due to the level of uncertainty connected to activities in innovation and network evolution. We are also minded to disallow a further £172.003m increase in its baseline forecast costs over the period RY22/23 to RY25/26 (the remaining term of the Licence) because DCC has not justified these costs. Any costs that we ultimately decide were not economically and efficiently incurred will either be excluded from the future calculation of Allowed Revenue or be subject to an undertaking about DCC's future management.

Performance Incentives

All of DCC's margin is at risk against its performance. This is the second year in which DCC's performance is being assessed under the Operational Performance Regime (OPR) and a Baseline Margin Project Performance Adjustment Scheme (BMPPAS).

We are proposing that DCC's Baseline Margin should be reduced by up to £1.608m due to its performance under the OPR. In the RY18/19 submission, we stated our concerns that the OPR may not be providing the best incentives to DCC. Following our consultation on the OPR review in May 2020, we have published our decision on the amended OPR alongside this document[5].

The BMPPAS enables the Secretary of State to create incentive regimes for specific projects and, this year, applies to the Release 2.0 (R2.0) project. We are proposing a reduction of £0.482m to its Baseline Margin in RY19/20, and a total of £1.002m across the licence period under the R2.0

[5] Operational Performance Regime Review: Decision October: http://www.ofgem.gov.uk/publications-and-updates/dcc-operational-performance-regime-review-october-2020-decision

BMPPAS. This represents a reduction of 85% of the BM that has been assessed under this regime.

Baseline Margin Adjustment

The Baseline Margin adjustment mechanism was included in the Licence to recognise the uncertainty when the Licence was granted over the nature and risk of DCC's Mandatory Business over time. It is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business under the Licence.

This year DCC has applied for a £10.795m adjustment to its Baseline Margin (BM) for increases in the volume and complexity of work, caused by both new drivers and drivers previously identified by DCC.

We are minded to adjust DCC's application to reflect the price control decisions on unacceptable costs. We are also minded to reject several parts of DCC's application, where we have not seen sufficient evidence of a material change that could not have been foreseen, or for which the driver does not appear to meet the conditions in the Licence, unless we receive further information.

Taking all of these disallowances into account, we are minded to amend DCC's application to an adjustment of £7.521m between RY21/22 and RY23/24, a decrease of £3.275m from the application.

External Contract Gain Share

The formula for the DCC's Allowed Revenue includes an External Contract Gain Share (ECGS) term which allows for an upward adjustment where DCC has secured cost savings in its Fundamental Service Provider (FSP) contracts. This is so that DCC has an incentive to seek and achieve cost savings. This term is zero unless DCC applies for an adjustment.

DCC has applied for a Relevant Adjustment of £3.812m across RY19/20 to RY25/26, reflecting a reduction in External Costs resulting from the continuation of re-financing arrangements and the financing of Communication Hubs (CHs). We propose to accept DCC's ECGS Adjustment application of £3.062m related to the continuation of re-financing arrangements and reject £0.751m ECGS Adjustment related to CHs financing.

Between RY15/16 and RY19/20, DCC has secured cost reductions of £112.6m in the FSP contracts and CHs financing (RY19/20 application) based on DCC's ECGS applications, and brought benefits of £67.0m (60% of total cost reductions) to DCC's customers through lower charges.

Switching Programme

DCC plays a central role in delivering the Switching Programme, established to improve consumer's experience of switching between energy suppliers. The costs and performance of the Switching Programme are dealt with separately from the rest of DCC's business.

We are minded to find DCC's costs associated with the Switching Programme in RY19/20 as economic and efficient, but propose disallowing DCC's forecasts for RY22/23 onwards (£20.615m) where DCC has not provided any justification.

In addition, the first of the delivery milestones under the Design, Build and Test Phase of the Switching Programme occurred in RY19/20. We propose that DCC should lose 100% of margin associated with this milestone, as the amount of delay that was within DCC's control extends beyond the four-week margin loss period of the milestone.

Next steps

We welcome your views, and will consider them when we make our decision. Please send responses to smartmetering@ofgem.gov.uk by 23 December 2020. We will publish our decision in February 2021.

1. Introduction

What are we consulting on?

1.1. We are consulting on our proposed positions for DCC's costs, revenues and margin application for the Regulatory Year 2019/20 (RY19/20) under the price control mechanism. As required by the Licence, our assessment of DCC's costs is based on comparing DCC's incurred costs and revised forecast with the previous year's forecast and with DCC's Licence Application Business Plan (LABP).[6] Our guidance document, published in July 2019, sets out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient[7].

1.2. We are restricted as to the detail we can include in this document due to the commercially sensitive nature of much of the evidence we consider. We know that some stakeholders find it difficult to provide meaningful input to the price control consultation process given limited detail of cost information provided within our consultation document.

1.3. DCC provides additional transparency on costs direct to its customers through its quarterly finance forums under suitable confidentiality arrangements. Further, alongside this consultation, DCC has published parts of its price control submission for RY19/20.[8] This additional information should be helpful to stakeholders in responding to this consultation.

1.4. A stakeholder meeting will also be held in December to provide DCC's customers and other key stakeholders an opportunity to explore the issues highlighted in this consultation with both Ofgem and DCC.

1.5. The content of each section of this document is summarised below, along with the questions to which we are seeking your response.

[6] https://www.smartdcc.co.uk/media/1439/redacted_licence_application_business_plan_-_30_april_2014_2_.pdf
[7] https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures-2019
[8] https://www.smartdcc.co.uk/about/price-control/

Section 1: Introduction

1.6. This section includes a short summary of the other sections in this document, a summary of DCC's activities during RY19/20, and an overview of DCC's costs during the year. It also sets out the stages in the consultation process, specifies how you should respond, and explains how we will treat your response.

Section 2: External Costs

1.7. This section summarises the costs incurred by DCC's Fundamental Service Providers (FSPs) and SMETS1 service providers, for RY19/20, and the updated forecasts for the remainder of the Licence term. It sets out DCC's justification for any changes in those costs and our response.

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

Section 3: Internal Costs

1.8. This section examines DCC's Internal Costs, namely the costs that are incurred by DCC for the purposes of the provision of the DCC service (these exclude External Costs and pass-through costs). It examines Internal Costs incurred in RY19/20 and the DCC's updated forecasts for the remainder of the Licence term, focussing on changes in those costs compared with last year's forecast and the LABP. It sets out DCC's justification for any changes in those costs and our response, specifically considering payroll and external services. This section also investigates the DCC's approach to and the results of the benchmarking of permanent staff and contractor remuneration.

Question 2: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 3: What are your views on our proposals to disallow the cost of DCC's retention scheme?

Question 4: What are your views on our proposal to disallow the incurred and forecast costs associated with the product management team?

Question 5: What are your views on our proposal to disallow the forecast variance of the Commercial Operations and Vendor Management teams?

Question 6: What are your views on our proposal to disallow the incurred cost variance associated with Preston Brook?

Question 7: What are your views on our proposal to disallow all variance in forecast internal costs?

Section 4: Performance Incentives

1.9. This section covers DCC's performance under the Operational Performance Regime (OPR), any relevant Baseline Margin Project Performance Adjustment Schemes. It sets out DCC's submission of its performance under these regimes and our response (which includes our proposed adjustments to DCC's submission).

Question 8: What are your views on our proposed position on DCC's operational performance?

Question 9: What are your views regarding DCC's failure to ensure all CSPs met their contractual milestones and its wider performance in the North region?

Question 10: What are your views on our proposed position on DCC's project performance?

Section 5: Baseline Margin adjustment and External Contract Gain Share

1.10. This section summarises DCC's application for adjustments to its Baseline Margin and ECGS, and sets out our response.

Question 11: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

Question 12: What are your views on our assessment of DCC's application to adjust its ECGS?

Section 6: Switching

1.11. This section examines DCC's costs associated with the switching programme, and our assessment of the first incentivised milestone for the Design, Build and Test phase of the programme.

Question 13: What are your views on our assessment of Delivery Milestone 1?

Related Publications

1.12. DCC's Licence is at: https://epr.ofgem.gov.uk/Content/Documents/Smart%20DCC%20Limited%20-%20Smart%20Meter%20Communication%20Consolidated%20Licence%20Conditions%20-%20Current%20Version.pdf

1.13. The DCC Regulatory Instructions and Guidance 2020 is at: https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2020

1.14. The DCC Price Control Guidance: Processes and Procedures is at: https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures-2019

1.15. Last year's Consultation Document is at: https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201819

1.16. Last year's Decision Document is at: https://www.ofgem.gov.uk/system/files/docs/2020/02/2020.01_price_control_decision_document_ry1819_0.pdf

1.17. The Price Control element of the DCC's website is at: https://www.smartdcc.co.uk/about/price-control/

DCC's summary of RY19/20

1.18. In its submission, DCC provided an overview of its key activities during RY19/20 and the factors which drove the overall level of activity and spending across the organisation.

1.19. In RY19/20 DCC continued to progress in delivering on its core programmes, including SMETS2, SMETS1 and switching. DCC highlighted the following achievements during RY19/20:

- Migrating more than 4m SMETS2 meters and enrolling and adopting more than 127,100 SMETS1 meters onto DCC's network.
- Entering the DBT phase of the switching programme, and successfully on boarding all four fundamental service providers that will help deliver the service.
- Delivering the November 2019 SEC release, which was the first enduring SEC release to contain DCC system-impacting changes.
- Initiating the Network Evolution programme to support simplified network design with greater resilience, automated testing at a lower cost and to avoid service disruption from the sunsetting of 2G technology.
- Refitting the Brabazon House and Ruddington offices to ensure a more secure working environment and to build the capability of DCC's test labs.

1.20. DCC identified a number of key themes in its submission that summarise its work through the year:

- **Developing a track record of delivery:** DCC states that the rollout of SMETS2 meters is progressing steadily, and expects the enrolment of SMETS1 meters to continue to ramp up. DCC also made progress towards the manufacture of new Dual Band Communication Hubs as part of the Release 2.0 delivery plan, although DCC states progress against this final phase of testing was slower than planned due to delays in the availability of compatible meters, which DCC are continuing to resolve.

- **Looking ahead – future plans and priorities:** Over the coming years, DCC's priorities will remain scaling the live service to support the smart meter rollout, while maintaining a stable, reliable and secure service for its customers. In addition, DCC will continue to support key initiatives underpinning the transformation of the energy market, such as the introduction of Half-Hourly Settlement (HHS) and Enduring

Change of Supplier (ECOS) programmes. DCC have also started work on their Network Evolution programme, which involves: designing and procuring data services that are secure and sustainable; designing and procuring future-proof comms hubs and networks; procuring a replacement/extension to the Smart Metering Key Infrastructure security Trusted Service Provider; and designing and implementing automated testing of SEC releases.

- **Customer Engagement:** Following customer and Ofgem feedback, DCC have developed a new approach to customer engagement. The key principles of this approach include: enabling customers to help shape DCC's annual business and development plan; increasing transparency around in-flight activities; and seeking views from customers to shape new activities. In addition, an important part of this new approach involves DCC's customer engagement portal that went live during the first quarter of 2020.

Summary of DCC costs

DCC RY19/20 Costs

1.21. Overall, DCC's total reported costs for RY19/20 are £495m. Excluding pass-through costs[9], the figure is £463m.

1.22. This is a 14% increase in total costs incurred in RY19/20 compared to last year's forecasts (or a 15% increase with pass-through costs excluded). Table 1.1 shows how the main cost categories in RY19/20 compare to the forecasts of DCC's RY18/19 submission.

[9] Pass-through costs include the fee paid by the Licensee to the Authority and the payments to SECCo Ltd for purposes associated with the governance and administration of the Smart Energy Code (SEC).

Table 1.1: RY19/20 reported costs compared to RY18/19 forecast in current year prices[10]

	RY18/19 forecast (£m)	RY19/20 (£m)	Variance (£m)	Variance (%)
Total External Costs	317	343	26	8%
Total Internal Costs (excl. SS)	70	99	29	42%
CRS total costs (excl. SS)	9	14	5	58%
Total Shared Services cost (for internal costs and CRS)	6	8	1	22%
Total Costs excl. Pass-Through Costs	401	463	61	15%
Pass-Through Costs	31	32	1	2%
Total Costs	**433**	**495**	**62**	**14%**

1.23. The greatest percentage change in the variance comes from the Centralised Registration Service (CRS) – the switching programme. The switching programme increased by 58% between the reported costs in RY19/20 and RY18/19 forecast, though the Design, Build and Test phase of the switching programme remains under budget compared to the business case. Notably, total internal costs also increased by 42% between the reported costs in RY19/20 and RY18/19 forecast.

[10] Some numbers may not sum to total due to rounding.

DCC costs over the Licence period

1.24. Figure 1.1 reports the trends in DCC's costs over the Licence period as reported in its latest submission. DCC's forecast costs increase with total costs peaking at £516m in RY20/21 with the completion of SMETS1 enrolment and adoption, before decreasing in RY22/23 and rising again towards the end of the Licence term as the SMETS2 rollout nears completion.

Figure 1.1: Trends in DCC's costs (£m, 19/20 prices) in current year prices

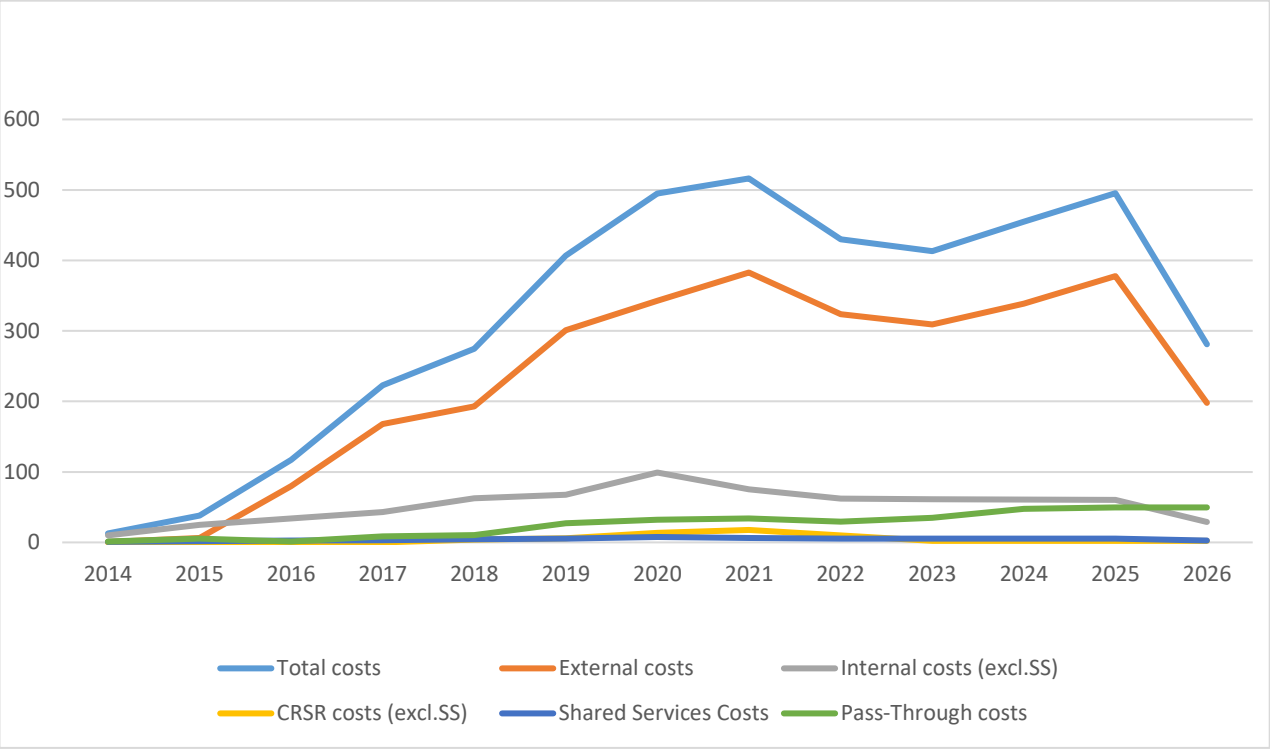


Figure 1.1: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Total costs	**12.7**	**38.2**	**117.3**	**222.8**	**274.5**	**406.8**	**495.1**	**516.3**	**430.1**	**413.3**	**454.9**	**495.2**	**281.2**
External costs	0.6	6.4	79.6	167.8	192.8	300.8	342.7	382.8	323.5	309.4	338.7	377.6	197.8
Internal costs	10.0	24.7	33.8	43.2	62.7	67.5	99.1	75.3	61.9	61.3	60.8	60.3	29.0
CRSR costs (excl.SS)	0.0	0.0	0.0	0.0	4.1	5.6	13.6	17.7	9.8	2.2	2.3	2.3	2.3
Shared Services costs	0.8	1.9	2.7	3.3	4.7	5.5	7.7	6.5	5.5	5.5	5.4	5.4	2.6
Pass-Through costs	1.3	5.2	1.2	8.5	10.2	27.4	32.0	34.0	29.4	35.0	47.6	49.6	49.6

1.25. DCC's latest forecast for total costs over the Licence period (RY13/14-RY25/26), as contained in its submission, is £4.158b. Excluding pass-through costs, its forecast for costs over the Licence period is £3.827b.

1.26. This is a 5% increase in total costs compared to last year's forecasts (and a 5% increase with pass-through costs excluded) over the Licence period. Table 1.2 breaks this down by type of cost, and shows how costs reported in the RY19/20 submission have changed compared to last year's forecast over the Licence period.

Table 1.2: RY19/20 forecast and variation compared to RY18/19 forecast over the Licence period (RY13/14-RY25/26) in current year prices

	RY18/19 forecast (£m)	RY19/20 forecast (£m)	Variance (£m)	Variance (%)
External - Baseline	1,990	1,756	-233	-12%
External – New Scope	1,148	1,264	116	10%
Total External Costs	**3,138**	**3,021**	**-117**	**-4%**
Internal – Baseline (excl. SS)	426	634	207	49%
Internal – New Scope (excl. SS)	0	56	56	N/A
Total Internal Costs	**426**	**690**	**264**	**62%**
CRS (excl. SS)	33	60	27	N/A
Total Shared Services cost (for internal costs and CRS)	35	57	22	64%
Total Costs excl. Pass-Through Costs	**3,632**	**3,827**	**196**	**5%**
Pass-Through Costs	338	331	-7	-2%
Total Costs	**3,969**	**4,158**	**189**	**5%**

1.27. External Costs over the Licence term have decreased by -4% compared to the RY18/19 forecast to £3.021b. This decrease is primarily due to DCC incorporating BEIS' updated rollout projections, which has led to revised assumptions around costs relating to communication hubs. Section 2 summarises the External Cost variations, DCC's justifications and our response.

1.28. Internal Costs have increased by 62% over the Licence term compared to last year's forecast, from £426m to £690m. This is largely driven by increases in baseline costs, particularly due to increases in the Operations, Programme and Corporate Management cost centres. Section 3 summarises the Internal Cost variations, DCC's justifications and our response.

Comparison to the Licence Application Business Plan (LABP)

1.29. As the length of time since the DCC Licence award increases, we will continue to place a greater weight on comparison to the previous year's forecasts to inform our cost assessment rather than DCC's Licence Application Business Plan (LABP). However, comparing costs back to the LABP remains an important benchmark for DCC costs and allows us to hold DCC to account for its competitive bid position and to ensure costs are economic and efficient.

1.30. Figure 1.2 shows how the main cost categories in RY19/20 compared to the forecast at LABP. In aggregate, costs are £2.106b, or 103%, higher over the Licence term compared to DCC's forecast as part of the bid.

Figure 1.2: Comparison of RY19/20 costs to LABP in current year prices

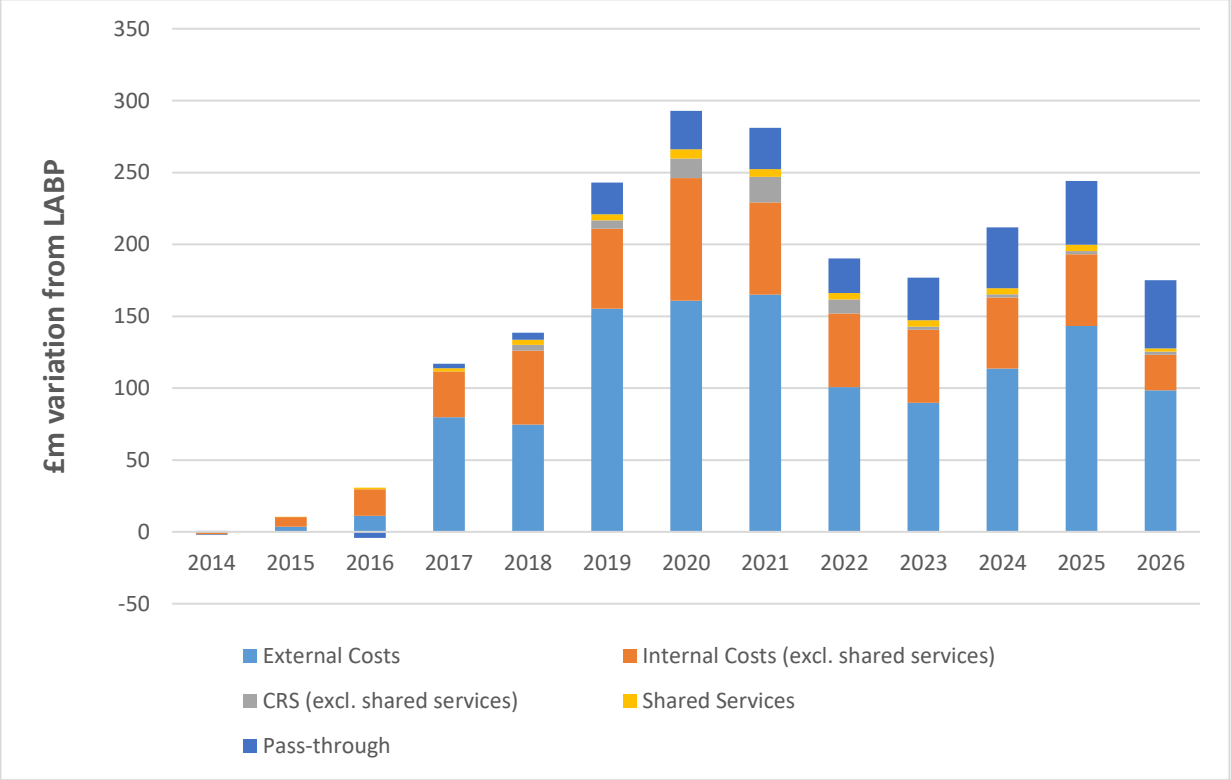


Figure 1.2: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
External costs	0.6	3.6	11.3	79.8	74.7	155.2	160.8	165.1	100.6	89.9	113.7	143.1	98.5
Internal costs	-1.7	6.7	18.4	31.7	51.4	55.8	85.3	64.2	51.3	50.7	49.3	49.9	24.6
CRS costs (excl.SS)	0.0	0.0	0.0	0.0	4.1	5.6	13.6	17.7	9.8	2.2	2.3	2.3	2.3
Shared Services costs	-0.2	0.1	1.2	2.2	3.6	4.4	6.3	5.4	4.5	4.5	4.3	4.4	2.2
Pass-Through costs	-0.3	-0.1	-4.1	3.2	4.9	22.1	26.7	28.7	24.1	29.7	42.3	44.3	47.4

Comparison to last year's forecast

1.31. Figure 1.3 shows how the main cost categories in RY19/20 compare to the forecast created as part of DCC's RY18/19 submission.

1.32. Overall, costs are £189m higher over the Licence term compared to the forecasts in DCC's RY18/19 submission.

Figure 1.3: Comparison to RY18/19 forecast in current year prices

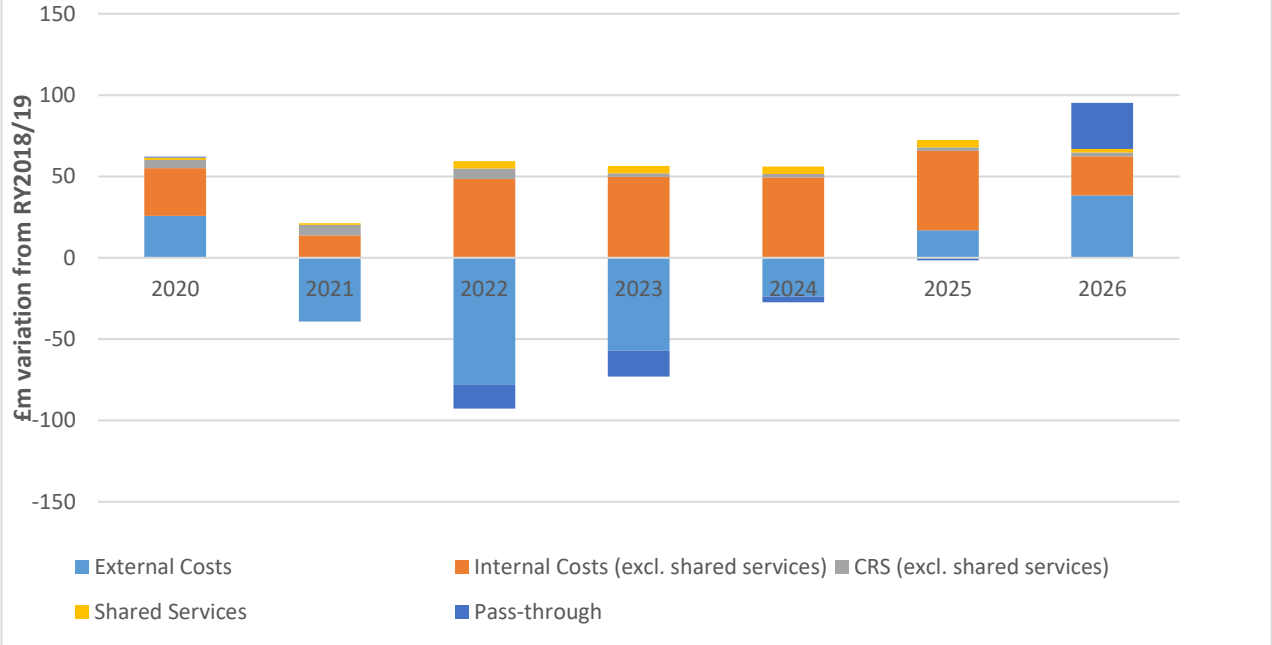


Figure 1.3: data table

£m	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
External costs	25.8	-38.9	-78.1	-57.1	-23.8	16.8	38.3
Internal costs	29.3	13.8	48.4	49.8	49.3	48.9	24.1
CRS costs (excl. SS)	5.0	6.4	6.5	2.2	2.3	2.3	2.3
Shared Services costs	1.4	1.0	4.5	4.5	4.4	4.4	2.2
Pass-Through costs	0.6	-0.1	-14.7	-16.0	-3.5	-1.5	28.3

Over-recovery of revenue

1.33. The Licence requires DCC to take all reasonable steps to ensure that its Regulated Revenue does not exceed a prudent estimate of Allowed Revenue for each Regulatory Year.[11] Detailed information on Allowed Revenue, Regulated Revenue, and DCC's Charging Statement can be found in the RY15/16 Consultation Paper.[12]

1.34. We introduced a penalty interest rate regime, which is designed to incentivise DCC to improve the accuracy of its charges to customers and to deter it from over-recovering revenues.[13] The threshold to apply the penalty interest rate for over-recovery is equal to 110% of allowed revenue. Where DCC exceeds this threshold, a penalty interest rate of 3% above the Bank of England base rate on any proportion of over-recovery that DCC has not justified to the Authority's satisfaction is to be applied.

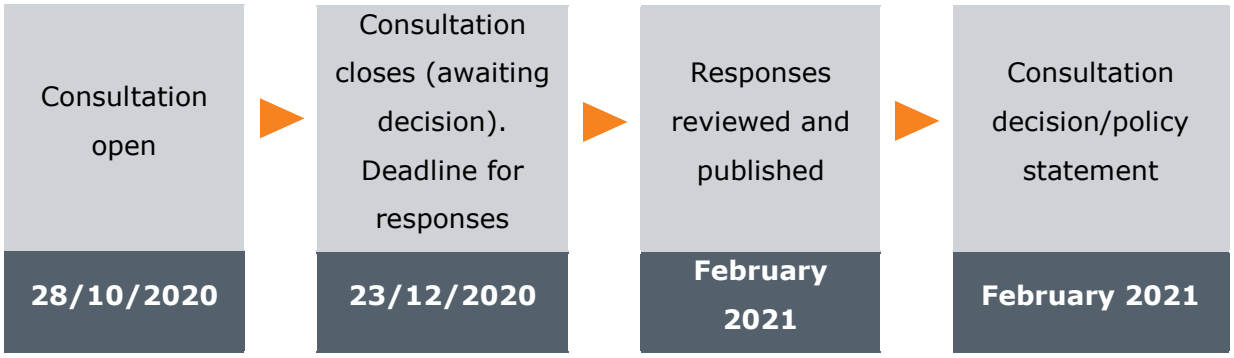
1.35. DCC over-recovered revenue from customers by 109% in RY19/20, which is below the 110% threshold. This is a slight increase from RY18/19 where DCC's over-recovery was 108%. However, this is still an improvement over previous years – in RY16/17 over-recovery was 122% and in RY17/18 it was 116%.

[11] See LC36.4
[12] https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-decision-regulatory-year-201516
[13] https://www.ofgem.gov.uk/system/files/docs/2016/05/decision_to_modify_smart_meter_communication_licence_for_dcc_penalty_interest_rate_web_version.pdf

Consultation stages

1.36. The key dates of the consultation process are set out in Figure 1.4 below.

Figure 1.4: Consultation stages



How to respond

1.37. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.38. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.39. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.40. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.41. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.42. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.43. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

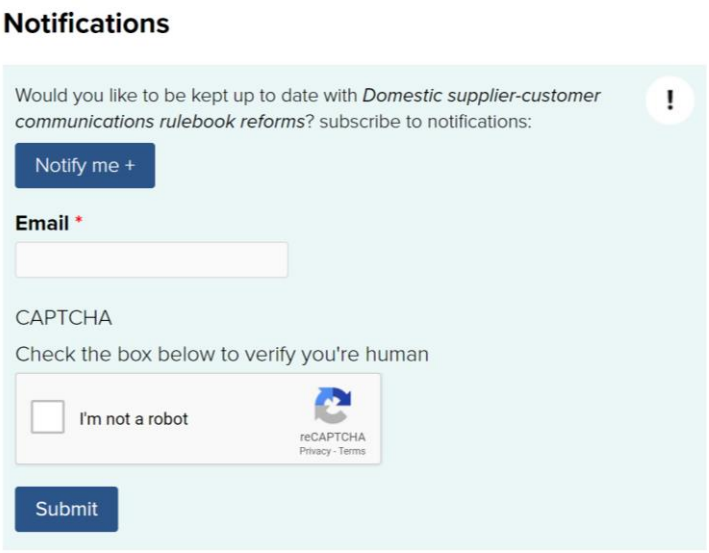
1.44. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

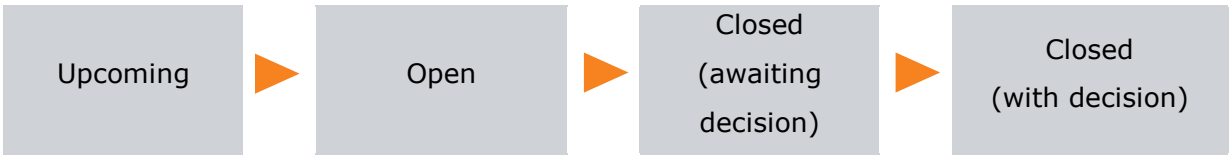
Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations.



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. External Costs

Section summary

One of DCC's key responsibilities is the management of its Fundamental Service Providers (FSPs) to ensure value for money and a high quality service for customers. DCC is also responsible for the enrolment of SMETS1 meters into its centralised communications system. This involves managing services from a range of existing SMETS1 service providers, along with new service providers, enabling communication between DCC Users and all enrolled SMETS1 meters through the DCC infrastructure.

This section summarises the costs incurred by DCC's service providers on both the SMETS1 and SMETS2 programmes in RY19/20. We are minded to find External Costs economic and efficient.

DCC has provided evidence on its approach to achieve best commercial outcomes. However, we continue to have concerns over aspects of DCC's contract management and procurement processes, in particular DCC's use of letters of instruction and adherence to the change management process.

In May 2020, we held a consultation on the revised OPR, which would include a Contract Management Incentive. These concerns strengthen our view that a Contract Management Incentive is needed to incentivise best practice in this area. We have published our decision on the revised OPR alongside this price control consultation.

Questions

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

What are External Costs?

2.1. External Costs form a part of DCC's allowed revenue. These costs are incurred by DCC's Fundamental Service Providers (FSPs) in their delivery of the core SMETS2 programme as well as other service providers delivering more recent SMETS1 and Switching programmes.

2.2. The FSPs were appointed following a competitive tender process that was run by the government. They include the Data Service Provider (DSP), CGI, and the two Communication Service Providers (CSPs), Arqiva and Telefonica. Together, the FSPs are responsible for delivering the data and communications services to support smart metering across Great Britain.

2.3. The SMETS1 service incorporates a range of existing SMETS1 service providers (Smart Meter System Operators (SMSOs)), along with new service providers, to enable a service where all DCC Users are able to communicate with all enrolled SMETS1 meters. RY18/19 saw the first reporting of the costs for the SMETS1 service providers in the RIGs.

2.4. DCC's SMETS1 service providers are:

- CGI/IE, Secure, Trilliant, and DXC, translating DCC format service requests into a format that SMETS1 meters can understand (in effect acting as upgraded SMSOs);[14]
- Capgemini and Critical Software, providing Dual Control Organization (DCO) software enhancing security arrangements of the SMETS1 solution; and
- Communications Service Providers Vodafone and Telefonica whose network will allow DCC to communicate and control the SIMs in each comms hub.

2.5. In RY19/20, DCC negotiated the S1CSP contracts with Vodafone and Telefonica as well as an enduring contract with Critical Software for its DCO delivery.

[14] Additionally, DXC acts as the Application, Network, and Security Operations (ANSO) service provider supporting the communication with Landis + Gyr devices and Trilliant comms hubs.

Table 2.1: Overview of DCC's contracts with SMETS1 service providers, signed in RY18/19 and RY19/20 (highlighted)

Role + Capacity	Provider	RY of contract
IOC	S1SP_1: CGI IE	18/19
MOC	S1SP_2: Secure	18/19
FOC	S1SP_3a: Trilliant S1SP_3b: DXC (ANSO)	18/19
DCO	S1_DCOa: Capgemini	18/19
DCO (SDA contract only)	S1_DCOb: Critical Software	18/19
DCO (Variation to SDA + Enduring Contract)	S1_DCOb: Critical Software	19/20
Communications Service	S1CSP_1: Vodafone	19/20
Communications Service	S1CSP_2: Telefonica	19/20

How have External Costs changed?

2.6. Over the course of RY19/20, DCC incurred a total of approximately £343m in external costs across SMETS2, SMETS1 and Switching programmes.[15] Table 2.2 shows the variation in External Costs (adjusted for inflation) for RY19/20 and the full Licence term relative to RY18/19 and LABP forecasts.

Table 2.2: External Costs variations compared to RY18/19 and LABP forecasts (adjusted to inflation)

	Variation for RY19/20		Total variation over the full Licence term	
	£m	%	£m	%
From RY18/19 forecast	25.799	8	-117.050	-4
From LABP forecast	160.814	88	1196.775	66

[15] The switching programme is discussed separately in chapter 6.

2.7. Compared to last year's forecast in the price control, the external costs are 8% higher for RY19/20 and 4% lower over the full Licence term. Compared to LABP's forecast, total External costs are 88% higher for RY19/20 and 66% higher over the full Licence term.

2.8. The projected 4% drop in External Costs over the course of the Licence amounts to £117m as shown in Figure 2.1 and Table 2.3.This variance to the forecast has been driven by a decrease of £492m in the forecast costs of Communication Hubs (CHs) as a result of DCC incorporating BEIS' revised forecast of the SMETS2 rollout, rather than cost efficiencies driven by DCC.

Figure 2.1: External Cost Variance across the whole Licence period

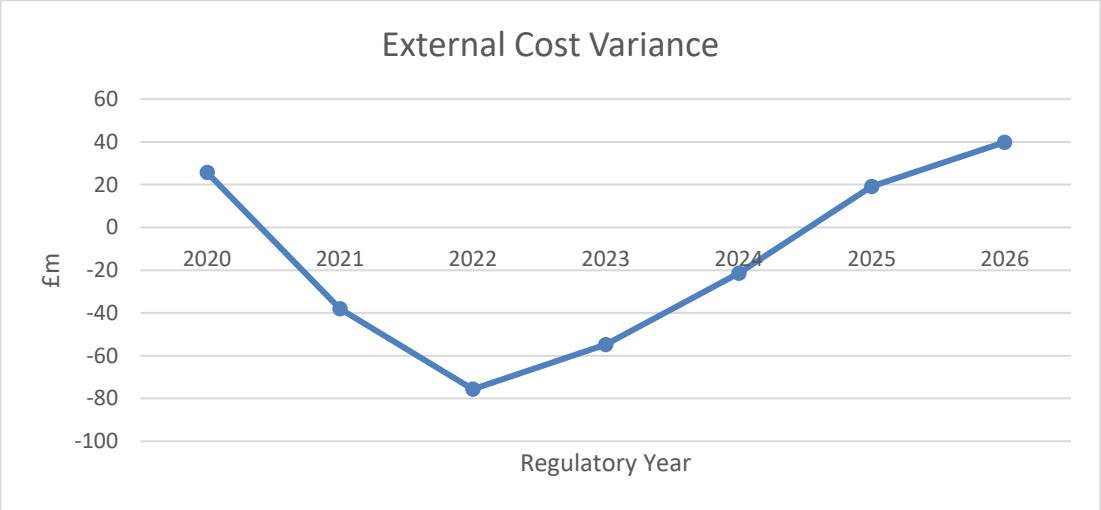


Table 2.3: Input for Figure 2.1

Reg. year	19/20	20/21	21/22	22/23	23/24	24/25	25/26
Variance (£m)	25.79	-38.90	-78.08	-57.13	-23.81	16.81	38.27

2.9. After controlling for these decreases in CHs costs, the External Costs forecast is showed to have in fact increased by £375m, or 12%, over the licence period. The net variance is set out in Figure 2.2. These costs are primarily driven by the SMETS1 programme as evident from Table 2.4.

Figure 2.2: External Cost Variance across the whole Licence period (controlling for CHs cost decrease)

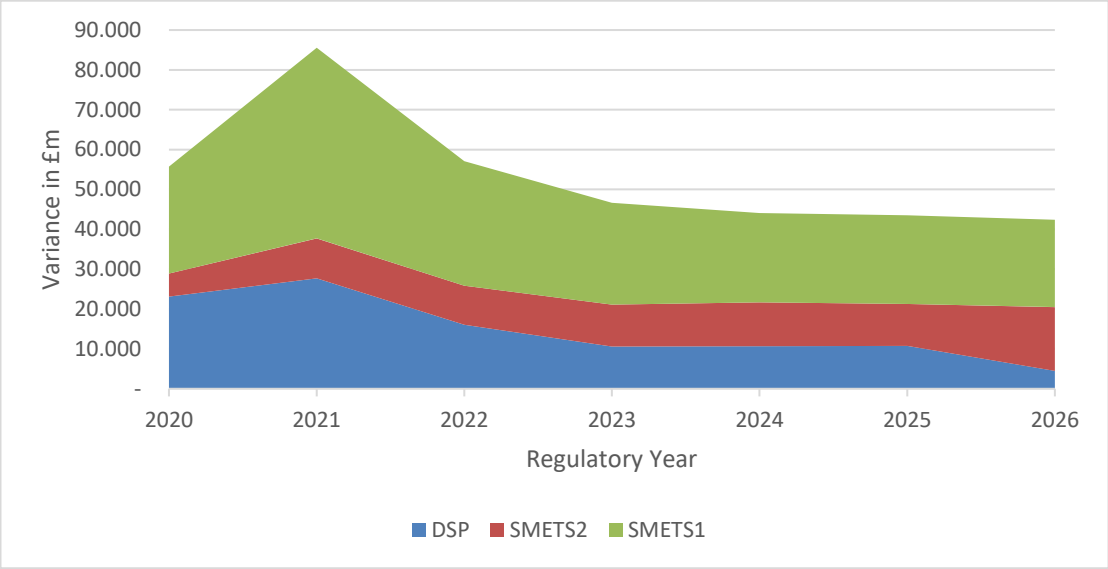


Table 2.4: Input for Figure 2.2

Variance in each reg. year (£m)	19/20	20/21	21/22	22/23	23/24	24/25	25/26
SMETS2 (CSPs only)	5.787	10.009	9.798	10.529	10.925	10.527	16.022
DSP	23.108	27.701	16.087	10.575	10.714	10.749	4.479
SMETS1 providers	26.809	47.848	31.217	25.560	22.467	22.239	21.935

2.10. Figure 2.3 shows a breakdown of the external cost variances in RY19/20 when controlling for CHs cost decreases in the CSP costs. Over 48% of the total increase in RY19/20 is due to the cost variance in SMETS1 (SMETS1 service providers not including DSP), totalling £26.8m. DSP variance was the second highest, accounting for 42% or £23.1m of the cost increase. SMETS2 variance (CSPs only) was comparatively lower at 10%, or £5.8m.

2.11. Table 2.6 provides cost variation by FSPs and SMETS1 SPs in RY19/20 compared to the RY18/19 forecast. The variances for CSPs have been controlled for CHs decreases. The table shows a 75% increase in SMETS1 service provider costs compared to last year's forecast and a considerable increase in costs incurred for DSP services, which rose by 29% from RY18/19. Costs for DSP services are projected to be 25% higher compared to the RY18/19 forecast over the course of the Licence period.

2.12. The main drivers behind the variances in SMETS1 costs were enduring costs for the two new SMETS1 CSPs (Vodafone and Telefonica); the running costs for the DCO (Critical); the need for extended cover for the development and implementation of IOC, MOC and FOC testing; and the build and operation of the Commissioning Party by Capgemini.

2.13. The main drivers for the SMETS2 costs were:

- extended cover for testing and fixes on the R2.0 Programme (for the CSPs);
- delivery of the November 2019 SEC release; and enhancements to Testing Services and the Self-Service Interface and Remedy systems (for the DSP). Note that DSP costs combine both SMETS1 and SMETS2 work-streams.

Figure 2.3: External Cost Variance in RY19/20 (controlling for CHs cost decrease)

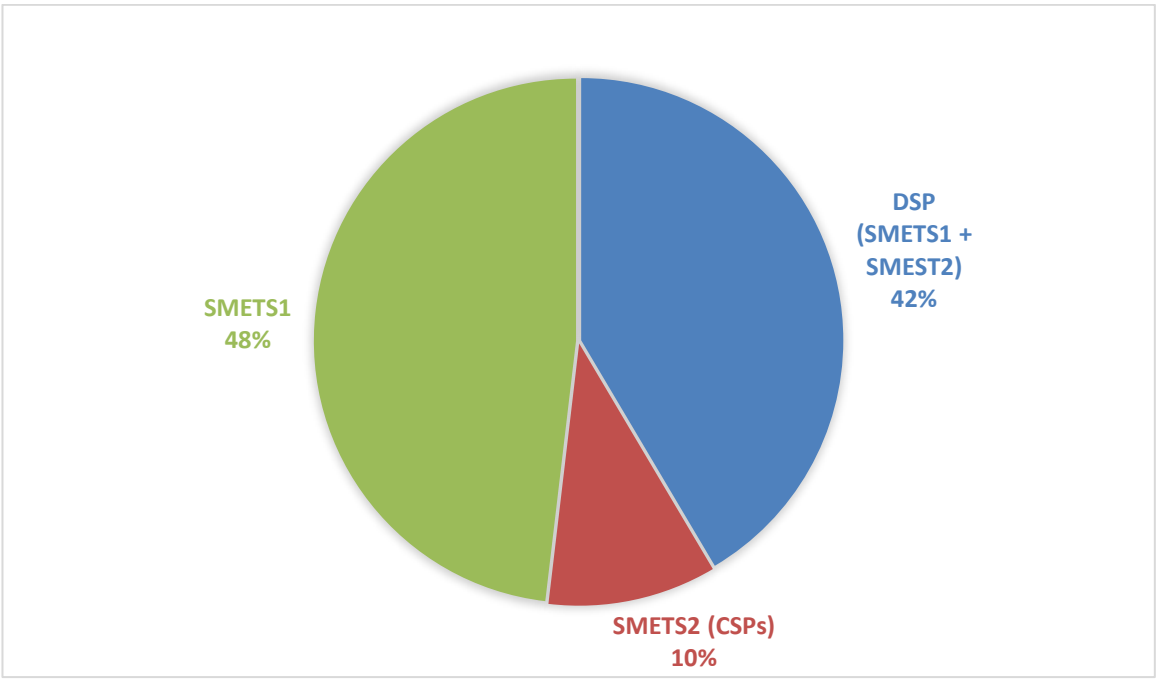


Table 2.5: Data for Figure 2.3

	SMETS2	SMETS1	DSP
Variance from RY18/19 (in £m)	5.787	26.809	23.108
as % of total Variance in RY18/19	10.4	48.1	41.5
Total Variance (in £m)			**55.704**

Table 2.6: Cost variation by FSPs and SMETS1 SPs compared to RY18/19 forecast (controlling for CHs cost decreases)

Cost Variation	RY19/20	Over the Licence term
DSP	29%	25%
CSP N	5%	4%
CSP C	1%	2%
CSP S	2%	4%
SMETS1	75%	61%

DCC's Justification

2.14. DCC has justified material External Costs by programme/project-related Change Requests (CRs) and Project Requests (PRs). Material external costs are defined as CR/PR costs with a 'life value' that exceeds £1m.

2.15. Table 2.7 and Figures 2.4 and 2.5 show new costs for individual projects within the SMETS2 and SMETS1 programmes, which were justified by individual CRs and PRs. See Appendix 2 for further details on DCC's justification.[16]

[16] Note that a portion of the newly justified costs were forecasted in RY18/19; therefore, they do not align with the variance.

Table 2.7: Newly justified material costs incurred on projects within the SMETS2 and SMETS1 programmes

	Project	New material CRs/PRs	Cost (£m)	% of total (within Programme)	Total
SMETS 2	R2.0	CR1046, CR1079, CR1057, PR1153, PR1089	38.10	72%	£52.65m
	November 2019 SEC Release	CR1138	3.80	7%	
	Self-Service Interface	PR1079	2.01	4%	
	Testing Services	CR1287	8.74	17%	
SMETS 1	Build and Test: IOC	PR1106, PR1125	6.30	18%	£35.23m
	Build and Test: MOC	PR1047, CR1119, PR1119	4.81	14%	
	Build and Test: FOC	PR1045, CR1106, CR1134, CR1218	13.88	39%	
	Build and Test: DCO	PR1160, PR1067, PR1124	4.56	13%	
	Migration: IOC	PR1059, CR1168, PR1145	5.68	16%	

Figure 2.4: Costs incurred on newly justified material CRs/PRs within the SMETS2 programme disaggregated by individual projects

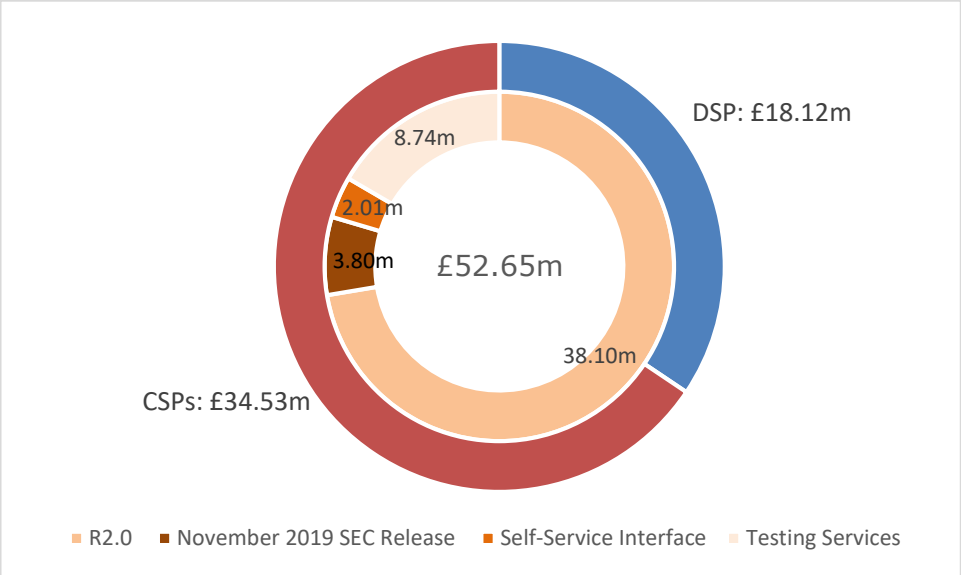


Table 2.8: input for Figure 2.4

Project	Cost (£m)	% of total cost	Total (£m)
R2.0	38.10	72%	52.65
November 2019 SEC Release	3.80	7%	
Self-Service Interface	2.01	4%	
Testing Services	8.74	17%	
Service provider			
DSP	18.12	34%	52.65
CSPs	34.53	66%	

Figure 2.5: Costs incurred on newly justified material CRs/PRs within the SMETS1 programme disaggregated by individual projects

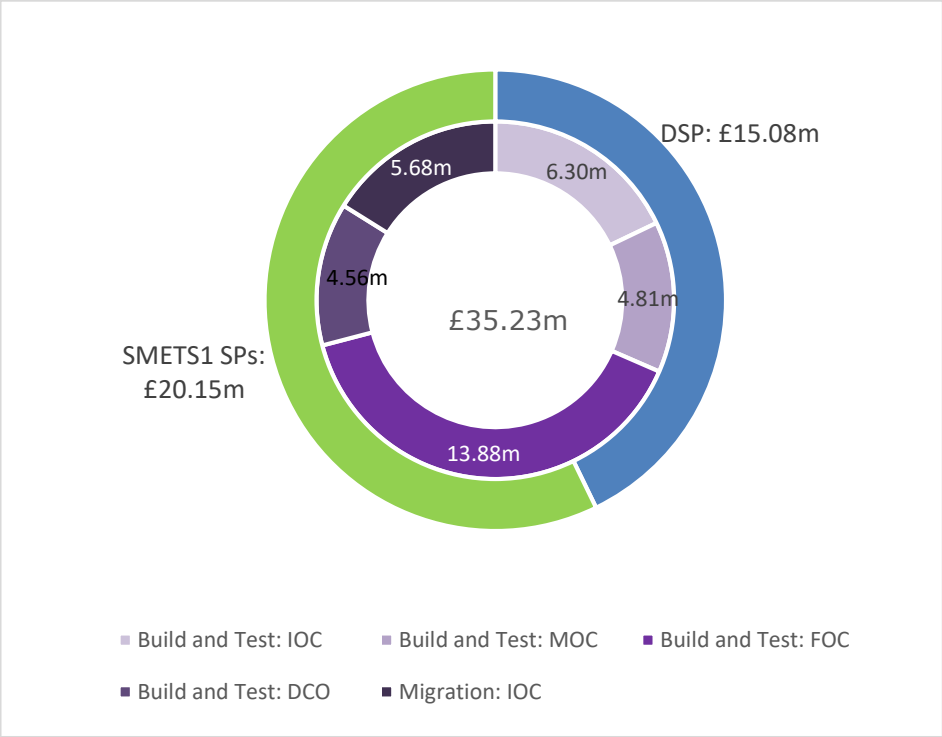


Table 2.9: input for Figure 2.5

Project	Cost (£m)	% of total cost	Total (£m)
Build and Test: IOC	6.30	18%	35.23
Build and Test: MOC	4.81	14%	
Build and Test: FOC	13.88	39%	
Build and Test: DCO	4.56	13%	
Migration: IOC	5.68	16%	
Service provider			
DSP	15.08	43%	35.23
SMETS1 providers (excl. DSP)	20.15	57%	

SMETS2

2.16. In RY19/20 the SMETS2 work-stream consisted of four main projects: Release 2.0, November 2019 SEC Release, Self-Service Interface, and Testing Services. Altogether, new material CRs and PRs justified as part of the SMETS2 programme amounted to £52.65m.

2.17. Release 2.0 represented the largest share of newly incurred costs. The project began in RY17/18, and encompasses a system update to the network enabling the roll-out of Dual Band Communication Hubs (DBCHs). This work has been delivered by both CSPs in their respective regions. In the North, R2.0 was consolidated in March 2020 after reconciliation of all payments made to date to CSP-N. A distinct work-stream now continues under CR1057 as Release 2.1 which had commenced as part of R2.0 in RY19/20 but will not incur separate costs until RY20/21.

2.18. DCC explained the financing of the principal CRs 1046 and 1079 for R2.0 on a Time and Materials basis with payments to Arqiva tied to agreed monthly milestones. DCC negotiated an additional discount on the fixed price offered by CSP-N on CR1057 (R2.1). DCC also provided justification for raising an additional PR1153 (CSP C+S only), which DCC believe was necessary to provide cover for several critical tasks prior to the restarting of DIT[17] for DBCHs.

2.19. Additional costs were driven by three projects delivered by the DSP, in order of magnitude: Testing Services, November 2019 SEC Release and Self-Service Interface. DCC described the drivers and the scope of these projects, along with the due diligence process followed in each case. DCC also presented its strategies in negotiating with the DSP, including challenging resource profiles, capping maximum spend and setting up milestone payments, evidencing achieved savings where appropriate.

SMETS1

2.20. Newly justified costs within the SMETS1 programme related to 'Build and Test' projects for IOC, MOC, FOC cohorts and the DCO as well as the migration of IOC meters. Most CRs and PRs sought to accommodate additional testing and extension of activities for the revised timelines on SMETS1 migration.

2.21. The Build and Test project for FOC, contributed the largest share to the cost increase: £13.9m or 39% of new SMETS1 costs. The main expenditure, totalling £8.4m, was the

[17] Device Integrated Testing

procurement of licences under CR1106. Support for FOC also drove new costs under DCO-related CRs and PRs.

2.22. The IOC testing and migration also saw a significant increase in costs. These were driven by activities extended beyond the original IOC go-live date in May 2019 due to delays, and the Commissioning Party build and service, facilitating the migration of the IOC cohort.

2.23. DCC explained that a restructure of the SMETS1 Programme under the government's LC13 plan was carried out in the last quarter of 2018, which led to DCC having to consult on revised go-live dates for IOC, MOC and FOC. As a result, negotiations on several MOC and FOC-related CRs and PRs began late and/or were temporarily financed by letters of instruction, providing commercial cover while negotiations were ongoing. DCC believe that sufficiently strong controls were in place to ensure the economy of these intermediate costs in the absence of a contract.

2.24. Table 2.10 provides an overview of cost variances for SMETS1 service providers in RY19/20 as well as across the Licence period. In RY19/20 DCC concluded negotiations of commercial arrangements for the provision of the remaining services with Critical Software and with SMETS1 CSPs Vodafone and Telefonica. By virtue of being new contracts, they have contributed to the SMETS1 cost variance directly.

2.25. DCC has provided evidence on its negotiations with CSW, Vodafone and Telefonica. DCC demonstrated due diligence in negotiating the contracts and achieved better terms than those originally proposed. Contracts were signed with Vodafone and Telefonica with break clauses included in both agreements. Savings were achieved as a result of negotiations with CSW, albeit some were subsequently offset by the delay on the IOC go-live date.

Table 2.10: Cost variances for individual SMETS1 service providers in RY19/20

	RY 19/20		Over the whole Licence period	
	Cost variance from RY18/19 (in £m)	% of the total External Cost variation from 18/19 forecast	Cost variance from RY18/19 (in £m)	Variance from RY18/19 forecast (in %)
S1SP_1: CGI	4.814	9%	3.88	10%
S1_CSP_1: Vodafone	0.442	1%	107.38	N/A
S1SP_2: Secure	-15.238	-27%	-4.02	-3%
S1_CSP_2: Telefonica	0.015	<1%	9.73	N/A
S1SP_3a: Trilliant	6.616	12%	21.82	43%
S1SP_3b: DXC	6.724	12%	13.76	43%
S1_DCOa: Capgemini	17.187	31%	24.68	53%
S1_DCOb: CSW	6.249	11%	20.85	397%
Total SMETS1 SP costs	**26.809**	**48%**	**198.07**	**61.16%**

Our view

2.26. The SMETS2 submission was acceptable. DCC explained drivers and scope for material CRs/PRs, its strategy for securing value for money, and adherence to change processes. There is evidence that DCC consistently strove to negotiate better deals and challenged its providers on the costs of individual CRs/PRs. However, in future price control submissions, we would welcome the following improvements in the quality of the submission in order to reduce the need for follow-up clarification questions:

- Costs justified in the narrative submission to align with figures provided in the RIGs templates and supplementary schedules with clear explanation for any discrepancies;
- More completeness in the provision of supporting documents and evidence; and
- A clear summary of cost variances, including variances on previously justified drivers and ongoing projects, with a narrative around changes to forecast. Notably, the change in the forecast costs of CHs was missing from the narrative submission.

2.27. The SMETS1 submission was comparatively of better quality. We note that DCC has followed Ofgem's recommendation from last year to better explain its assessment of trade-offs that DCC choose to make during contract negotiations. Similar to the SMETS2 External costs reporting, in future price control SMETS1 submissions, we would welcome more diligence in the reporting of justified costs incurred both through new material PRs/CRs and contracts with new service providers, and their alignment between the qualitative and quantitative submissions.

2.28. Through the submission and further clarification questions, we consider that DCC has sufficiently justified the External Costs incurred in RY19/20 as economic and efficient. However, we have concerns about the contractual process for certain PRs/CRs relating to the Commissioning Party Service and the FOC testing within the SMETS1 work-stream. Specifically, these relate to DCC's extensive use of Letters of Instruction and inconsistent adherence to best practice in agreeing costs with service providers.

Letters of Instruction

2.29. Letters of Instruction (LOIs) are used to provide commercial cover for projects while negotiations between DCC and a relevant service provider are underway. However, in the absence of a contract and negotiated deliverables, extensive use of LoIs beyond a reasonable period allowing for negotiations to be concluded may not represent best practice and value for money. Specifically, we are concerned that extensive use of LoIs may result in the lack of clarity of scope of the project under negotiation, a weaker negotiating position for the DCC, payments made at higher rates and potentially higher overall costs.

2.30. DCC has recently decided to move away from the use of Letters of Instruction towards 'Urgent Work Orders' (UWOs) with the aim of providing 'stronger systematic control'. UWOs specify the service they relate to, comprise terms and conditions and a purchase order and are limited to a 3-month duration.

2.31. We welcome this change and encourage DCC to have strong controls in place when financing a project outside of negotiated terms. We expect DCC to keep their approach under review and work towards continuous improvement of contractual processes. However, we remain concerned that extensive use of LoIs may not have led to the best

possible outcomes for the scope, quality and cost of contracts, which DCC entered into in RY19/20.

Change Management Process

2.32. DCC manages large volumes of complex contractual and solution-based projects and changes. To ensure best outcomes, a Change Management Process and a Project Request Process are in place, which provide a standardised way of undertaking change or project requests.

2.33. In the case of a change request, a Preliminary Impact Assessment forms the basis for estimating the costs of a contract change, in which the parties assess in detail the required scope and the value for money. This can be bypassed in exceptional circumstances when a change request has to be progressed urgently, in which case the parties would proceed directly to the second stage of the process, the Impact Assessment. In at least one instance, DCC entered into a contract without conducting either a Preliminary Impact Assessment or an Impact Assessment, basing the contract cost on the Rough Order of Magnitude, despite sufficiently generous timelines.

2.34. We are concerned that a lack of adherence to the change management process may not have led to the best possible outcomes within the SMETS1 programme.

Contract Management Incentive

2.35. These aforementioned concerns reinforce our view of the need for the Contract Management Incentive within the revised OPR framework. We expect that the incentive will lead to ongoing improvement in contract management processes, resulting in savings for customers.

2.36. The decision on the revised OPR[18] has been published alongside this consultation. We consider that this will provide an appropriate incentive to DCC to improve its performance in the management of its contracts.

[18] http://www.ofgem.gov.uk/publications-and-updates/dcc-operational-performance-regime-review-october-2020-decision

3. Internal Costs

Section summary

This section summarises DCC's incurred Internal Costs for RY19/20 and updated forecasts. DCC has justified the majority of these costs. However, we propose to disallow £4.385m of costs incurred in RY19/20. This is due to insufficient justifications provided around DCC's use of a one-off retention scheme, contractor benchmarking, expansion of the strategy and product management team and accommodation cost relating to Preston Brook.

We are minded to disallow £4.654m of DCC's forecast costs over RY20/21 and RY21/22 due to a lack of clarity or certainty over forecasts related to the Network Evolution programme and the associated forecast of proposed RY19/20 disallowed costs.

We are also minded to disallow £172.003m of baseline forecast costs from RY22/23 to the end of the Licence term due to a lack of justification provided by DCC.

Question 2: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Question 3: What are your views on our proposals to disallow the cost of DCC's retention scheme?

Question 4: What are your views on our proposal to disallow the incurred and forecast costs associated with the product management team?

Question 5: What are your views on our proposal to disallow the forecast variance of the Commercial Operations and Vendor Management teams?

Question 6: What are your views on our proposal to disallow the incurred cost variance associated with Preston Brook?

Question 7: What are your views on our proposal to disallow all variance in forecast internal costs?

How have Internal Costs changed?

3.1. Figure 3.1 shows the distribution of costs by general ledger (GL) code over the Licence period, based on DCC's RY19/20 submission. Based on DCC's price control forecast, which includes only those costs that are significantly more likely to occur than not, Internal Costs peak in RY19/20, and fall in subsequent Regulatory Years. Internal Costs in RY19/20 are £99.1m, £29.3m more than was forecast for RY19/20. The GL codes are dominated by payroll costs – this reflects the fact that DCC is a relatively asset light company with a primary focus on contract management and programme delivery. Total internal costs are therefore driven primarily by salaries and headcount.

Figure 3.1: Forecast internal costs by cost type or GL code in current year prices

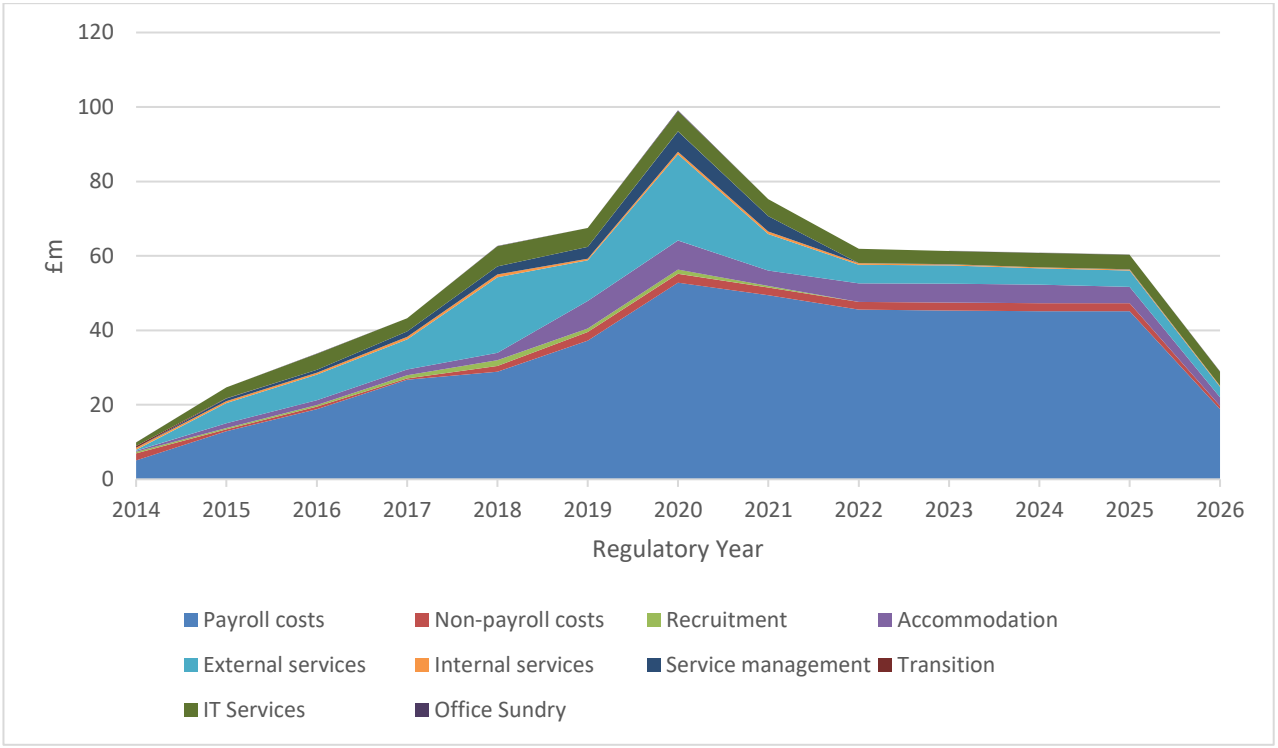


Figure 3.1: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Payroll costs	5.1	12.9	18.8	26.7	28.9	37.2	52.8	49.5	45.5	45.3	45.1	45.1	18.8
Non-payroll costs	1.9	0.5	0.7	0.3	1.5	2.3	2.4	2.0	2.1	2.2	2.2	2.2	0.9
Recruitment	0.4	0.3	0.4	0.9	1.5	1.0	1.2	0.5	-	0.0	-	-	-
Accommodation	0.3	1.3	1.3	1.5	2.0	7.3	7.8	4.0	5.0	5.1	5.0	4.4	2.3
External services	0.3	5.4	6.8	8.1	20.3	10.9	23.2	9.8	4.9	4.9	4.4	4.4	2.8
Internal services	0.5	0.5	0.5	0.6	0.7	0.4	0.6	0.8	0.4	0.3	0.3	0.3	0.3
Service management	-	0.7	0.8	1.5	2.2	3.2	5.5	4.1	0.1	0.1	0.1	0.1	0.0
Transition	0.5	0.0	-	-	-	-	-	-	-	-	-	-	-
IT services	0.9	2.9	4.3	3.5	5.4	5.1	5.5	4.6	3.8	3.5	3.8	3.9	3.8
Office sundry	0.0	0.1	0.1	-	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0

3.2. Figure 3.2 shows forecast Internal Costs by cost centre. Operations, Corporate Management, and Programme are the three largest cost centres in RY19/20. The increased headcount, as well as costs associated with the SMETS1 programme – reported under Additional Baseline - and the fit out of the Brabazon House test lab are significant drivers of Internal Costs in RY19/20.

Figure 3.2: Forecast Internal Costs by cost centre in current year prices

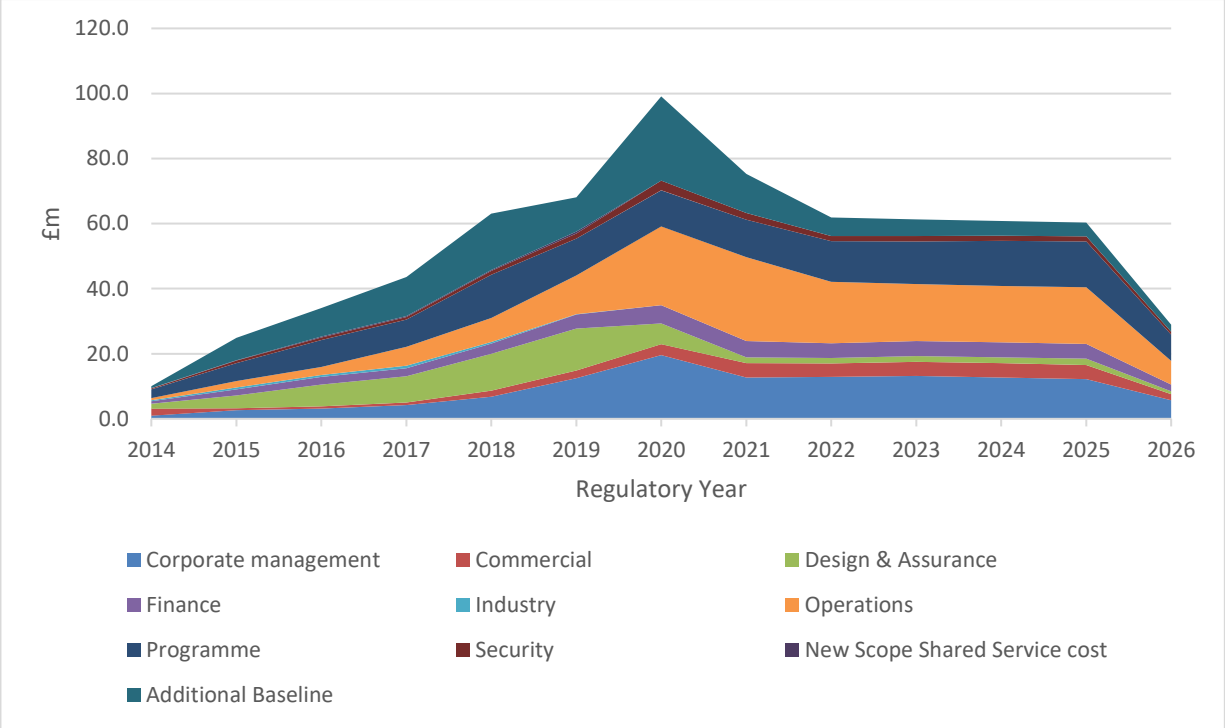


Figure 3.2: data table

£m	RY13/14	RY14/15	RY15/16	RY16/17	RY17/18	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	1.0	2.7	3.2	4.2	6.8	12.5	19.6	12.7	12.9	13.2	12.7	12.2	5.7
Commercial	2.1	0.6	0.7	0.8	1.8	2.4	3.4	4.4	4.2	4.3	4.3	4.3	1.9
Design and Assurance	1.5	3.9	6.6	8.1	11.3	12.8	6.4	1.8	1.6	1.7	1.8	2.0	0.9
Finance	0.8	1.9	2.4	2.5	3.2	4.3	5.6	5.0	4.6	4.6	4.6	4.5	2.1
Industry	0.3	0.6	0.6	0.7	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operations	0.7	2.0	2.5	5.8	7.4	11.9	24.3	25.8	18.9	17.6	17.4	17.4	7.3
Programme	2.7	5.4	8.2	8.4	13.3	11.4	11.0	11.5	12.5	13.1	13.8	14.0	8.1
Security	0.3	0.8	0.7	0.7	1.1	1.5	3.0	2.0	1.6	1.6	1.6	1.6	0.9
Additional Baseline	0.6	6.8	8.8	12.0	17.3	10.5	25.9	12.0	5.7	5.2	4.6	4.2	2.2
New scope shared service cost	0.0	0.2	0.3	0.3	0.4	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Variance on last year's forecast

3.3. In RY19/20 Internal Costs, excluding Shared Services, were £99.1m. This is £29.3m (42%) higher than forecast in RY18/19 and £85.3m higher than the LABP forecast. Over the remainder of the Licence period, Internal Costs are forecast to increase by a further £263.5m relative to the RY18/19 forecast, and by £537.7m compared to the LABP.

3.4. Figure 3.3 shows the variance in costs by GL code compared to the RY18/19 forecast. Payroll costs account for the greatest proportion of the variation in Internal Costs over all forecast years. However, in RY19/20, External Services accounted for the largest proportion of the variation (63%) followed by Accommodation (19%) then Payroll costs (14%). The majority of the variance in External Services in RY19/20 is attributed to the SMETS1 Enrolment and Adoption programme, accounting for 76% of the External Services variance.

Figure 3.3: Internal Cost variance by cost type or GL code relative to RY 18/19 forecast (excluding Shared Services) in current year prices

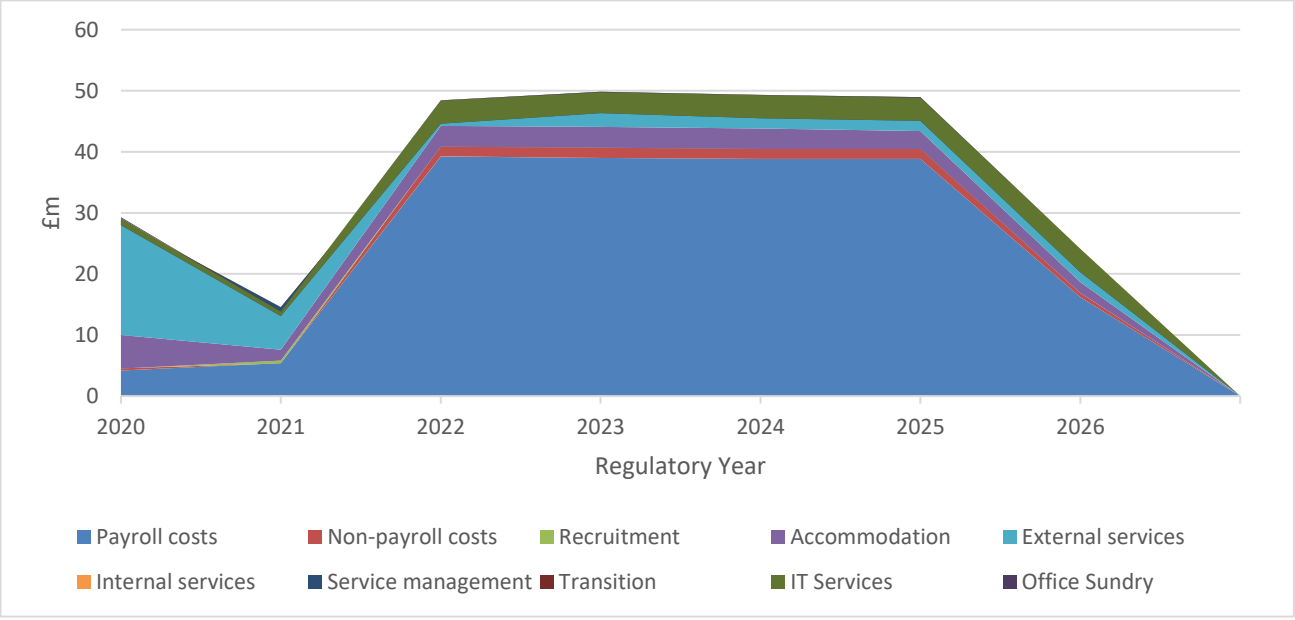


Figure 3.3: data table

£m	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Payroll costs	4.2	5.4	39.2	39.0	38.8	38.8	16.2
Non-payroll costs	0.4	-0.1	1.7	1.7	1.7	1.7	0.7
Recruitment	-0.1	0.5	-0.1	-0.1	-0.1	-0.1	0.0
Accommodation	5.5	1.8	3.4	3.4	3.3	2.9	1.8
External services	18.4	6.6	2.2	4.2	3.7	3.6	2.3
Internal services	0.3	0.4	-0.1	-0.2	-0.2	-0.2	0.0
Service management	-0.7	-1.5	-1.8	-1.8	-1.8	-1.8	-0.7
Transition	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IT services	1.2	0.7	3.8	3.5	3.8	3.9	3.8
Office sundry	0.2	0.0	-0.1	-0.1	-0.1	-0.1	0.0

Payroll

3.5. DCC has applied for the payroll costs shown in Table 3.1. Payroll costs incurred in RY19/20 are more than forecasted in RY18/19 and continue to increase over the forecast in future years.

Table 3.1: Payroll costs compared to last year's forecast

Payroll (£m)	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
18/19 accepted forecast	48.640	44.070	6.310	6.299	6.299	6.299	2.618
Variation proposed in 19/20	4.178	5.402	39.233	38.995	38.840	38.840	16.174
Total	**52.819**	**49.472**	**45.543**	**45.294**	**45.140**	**45.140**	**18.793**

Headcount

3.6. Figure 3.4 shows that DCC's permanent staff headcount has increased from 421 full time equivalents (FTEs) in RY18/19 to 530 FTEs in RY19/20. This is a slight decrease of -4% compared to last year's forecasts for RY19/20. However, the number of contractors

increased from 83 in RY18/19 to 112 in RY19/20. This is an 85% increase over last year's forecast for RY19/20.

3.7. Headcount is then expected to increase for permanent staff to 551 FTEs and decrease for contractors to 61 in RY20/21. DCC did not provide forecasts for its headcount beyond RY20/21.

Figure 3.4: DCC headcount (FTEs, excluding service desk staff)

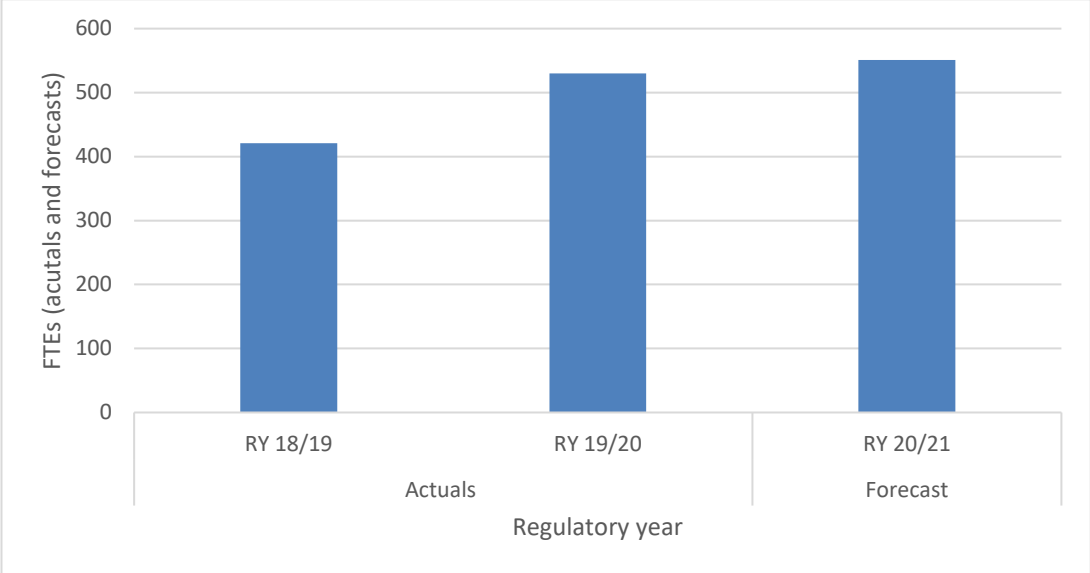


Figure 3.4: data table

	Actual RY18/19	Actual RY19/20	Forecast RY20/21
FTEs	421	530	551

Permanent-contractor staff ratio

3.8. In RY16/17 the ratio was around 40% contractor to 60% permanent staff. In RY17/18 there was a significant reduction in DCC's dependence on contractors and the ratio was 22% contractor to 78% permanent staff. The ratio has remained at this level for RY 19/20.

Benchmarking

Context

3.9. We expect DCC to recruit staff at economic and efficient remuneration levels. Similar to five previous price controls, DCC provided evidence of this for permanent staff through a benchmarking exercise that compared base salaries to equivalent roles in the wider employment market, using the Hay Group's "PayNet" salary (excluding bonus) database.

3.10. When recruiting permanent candidates DCC's default strategy is to offer remuneration packages that are in-line with market averages. For benchmarking purposes, using the Hays database, the "market average" would be defined as the 50th percentile of a distribution of salaries for comparable roles.

3.11. DCC use a different approach for contractors. In line with their approach for RY18/19, DCC use an independent I.T. recruitment consultancy to benchmark all contractors within I.T. and technical sectors. For the remaining roles, the recruitment consultancy engaged with partner organisations to produce appropriate benchmarks.

DCC's justification

Permanent staff

3.12. The Hay's PayNet database compares salaries against more than 24,000 global organisations in over 110 countries. The database produces benchmarks based on percentiles from a distribution of salaries of comparable roles. The database allows for a benchmark to be tailored to specific industries and job families, and a benchmark is only supplied if there is a sufficient number of comparable roles to make the data meaningful.

3.13. DCC's aim is generally to offer remuneration rates, which equate to the market average for permanent members of staff up to the 50th percentile. However, DCC state it may have to offer higher than the 50th percentile of the benchmark to attract exceptional candidates. This can be due to the role requiring niche or technical skills, or merely the lack of supply in the market. Thus, recruiting managers have the discretion to offer up to 10% above the benchmark with approval required by the Chief Regulatory Officer and Chief People Officer. If the salary is in excess of this, a business case is required for approval at the monthly financial performance review.

3.14. DCC uses the Hay's PayNet database to benchmark permanent staff based on salary only. DCC concedes that this may be different for employers that contribute to the benchmark. However, DCC chooses this approach as benefits, such as an employee's annual bonus rate, are set by DCC/Capita policy and are not subject to negotiation with a potential employee. DCC sets the bonus rate based on the seniority of the role, with employees receiving either a 10%, 20%, 30% or 50% rate. The majority of permanent staff receive a 20% annual bonus rate.

3.15. DCC stated that it benchmarks at three distinct stages during the recruitment process:

- Before the role is launched;
- Before DCC chooses to interview a candidate; and
- Prior to agreeing a remuneration package with a candidate.

3.16. As part of its submission, DCC presented a comparison of the remuneration of permanent members of staff with the Hays 50th percentile + 10%.

3.17. This year DCC reported recruiting approximately 80 roles in RY19/20 with a salary above the 50th percentile + 10%. DCC calculated that this resulted in an overall marginal cost of £0.656m. Note this figure assumes that all staff were hired at the beginning of RY19/20, whereas many staff only commenced employment midway through the regulatory year. This results in an over-estimate of the incurred cost to DCC.

3.18. In their submission, DCC gives justifications for approximately one third of the individual roles recruited above the 50th percentile + 10%. In general, these justifications argue that exceeding the benchmark was necessary due to the complex nature of these "highly specialised" roles and that the skills and experience to undertake these roles are scarce in the market.

Contractors

3.19. Similar to permanent staff, DCC stated that it benchmarks at various stages during the recruitment process:

- Before the role is launched;

- Before DCC chooses to interview a candidate; and
- Prior to agreeing a remuneration package with a candidate.

3.20. DCC hired 179 contractors in RY19/20. Approximately 80% of contractors and their associated expenditure fell within the Design, Assurance, Programme, Operations and Security cost centres. This mirrors the situation in both RY17/18 and RY18/19.

3.21. Following our consultation position on contractor benchmarking in RY18/19, DCC reviewed all its contractor benchmarks with the independent I.T. recruitment consultancy. The process concluded mid-December 2019. As such, DCC continued to hire contractors based upon the maximum benchmark up until 20 December 2019, as was their approach in RY18/19. Following the completion of the re-benchmarking process on 20 December, DCC begun to hire contractors up to the average benchmark, with hiring managers able to exceed this by up to 10% with the approval of the HR business partner.

3.22. As part of its submission, DCC presented a calculation of the marginal costs associated with all contractors hired in RY19/20 that exceeded the maximum benchmark up to 20 December 2019, and the average benchmark + 10% after this date. This resulted in a total marginal cost of £0.414m based on 61 roles hired over the relevant benchmark.

3.23. DCC provided justifications for these contractors only where the variance between the incurred cost and the relevant benchmark was greater than £10k. In general, DCC argued that it was necessary to exceed the benchmark on the basis of the complexity and specialised nature of these roles.

3.24. In response to our Cost Visit questions, DCC stated they are planning to review how they benchmark their contractors, including whether to change providers and internal processes. However, DCC will continue to use the independent I.T. recruitment consultancy in the interim period.

Our view

Permanent-contractor staff ratio

3.25. We welcome DCC's continuous improvement in the permanent-contractor staff ratio. We recognise that there are always likely to be some roles that are most efficiently filled by contractors rather than permanent staff.

Permanent staff

3.26. This year DCC's permanent staff FTE increased from 421 full time equivalents (FTEs) in RY18/19 to 530 FTEs in RY19/20. As such, it is increasingly important that DCC applies its hiring policies robustly to drive payroll efficiencies.

3.27. We note that in RY19/20 DCC has become less consistent, compared to previous years, in hiring staff at salaries below the 50th percentile + 10%.

3.28. We also note DCC's justification around some individual roles and recognise that DCC needs some flexibility around the 50th percentile in order to attract the best talent.

3.29. As such, we applied a methodology to calculate the inefficiency of DCC's approach to benchmarking permanent staff hired in RY19/20. This methodology used the 50th percentile + 10% for roles in the majority of cost centres, with the 75th percentile used for cost centres that require specialised, technical skills. This approach ensures that DCC has some flexibility to offer salaries at higher than the market average in business critical areas, while also ensuring adherence to a benchmarking approach.

3.30. If we apply this approach pro-rata across all hires in RY19/20, we would consider making a disallowance of £0.299m.

3.31. Given that this is a new approach to assessing whether DCC's permanent benchmarking is economic and efficient, we propose to apply this methodology from RY20/21, with the intention of making a disallowance if DCC continue to incur an inefficiency in this area.

3.32. As such, our minded-to position is not to make a disallowance in this area for RY19/20. However, we expect DCC to apply its hiring policies for permanent staff more rigorously going forward.

3.33. In addition, we note that DCC excludes bonus payments from permanent staff benchmarking. In RY18/19 we stated our expectation that DCC should provide more justification around bonus payments. We note in this year's submission that DCC intends to explore the feasibility of benchmarking benefits beyond the base salary in future years. Given that DCC's annual bonus rates, amongst other benefits, make up a significant part of an employee's remuneration package, we encourage DCC to incorporate the benefits package into their approach to benchmarking permanent staff. We will further scrutinise this aspect of DCC's benchmarking in RY20/21.

Contractors

3.34. We welcome DCC's reviewed approach to benchmark contractors based on the average benchmark + 10% from 20 December 2019. This has resulted in a significant improvement in the cost efficiency of contractors hired after this date. We encourage DCC to continue to apply this approach consistently going forward.

3.35. However, throughout most of RY19/20, DCC continued to use the maximum market rate as the benchmark for contractor daily rates. We maintain our position from previous price controls that this is not a fair or robust approach to benchmarking contractor daily rates to secure economic and efficient outcomes.

3.36. As a result, we have decided to disallow some costs where they fall above reasonable market rates. For contractors hired before 20 December 2019, we applied a methodology based on the average benchmark for the majority of cost centres. For contractors in cost centres requiring specialised, technical skills, we applied the maximum benchmark, in line with DCC's argument on the need for flexibility. Finally, for contractors hired after 20 December 2019, we have applied the average benchmark + 10%, in line with DCC's revised approach.

3.37. We note that DCC's own methodology to calculate the marginal cost only includes contractors hired in RY19/20. However, a significant number of contractors that we deemed inefficient in RY18/19 continued to incur a cost in RY19/20. We consider that DCC should make efforts to avoid rolling over contractors hired above market average rates to drive efficiency gains. As such, we have included these contractors - as they continue to incur costs – within the scope of our assessment. This is consistent with our methodology from RY18/19.

3.38. **In light of the above, we are therefore minded to disallow £1.272m of contractor costs in RY19/20.**

Retention Scheme

Context

3.39. In April 2018, DCC introduced a one-off retention scheme to reward staff who had been in post from 31 July 2018 to 31 March 2020. This scheme incurred its full cost of £2.499m in RY19/20.

DCC justification

3.40. The retention bonus took the form of a one off payment for all permanent staff who passed the two year eligibility criteria, and were not assessed as "improvement required" at the end of DCC's performance appraisal process.

3.41. Providing they are eligible for the scheme, the performance of individual staff members did not affect the bonus amount received. Instead the amount awarded under the scheme was derived by DCC's performance as a business measured against operational performance (including the Operational Performance Regime and customer effort), cost competitiveness and communication hub installations.

3.42. DCC used an external partner to assess DCC's performance, which provided a 66% rating against DCC's objectives. The bonus amount for each individual employee was then determined as: average salary over 2 years * 66% * individual annual bonus rate.

3.43. When questioned on the justification for this scheme during the Cost Visit, DCC stated the aim of the scheme was to retain DCC staff during a critical time of delivery for the smart metering programme. The scheme sought to retain key skills and experience, reduce recruitment costs and mitigate risks of departures. However, DCC were unable to quantify the impact of the scheme on retention.

Our view

3.44. We acknowledge that initiatives to improve staff retention can be appropriate expenditure, which lead to cost efficiencies and higher performance in the long run.

However, it is important that such initiatives are designed effectively to be fit for purpose and economic and efficient.

3.45. Given DCC's justification, from both the submission and the Cost Visit, we consider there is insufficient evidence that DCC analysed in detail the issues around retention in the organisation, ahead of introducing the scheme. This could have included quantitative indicators, such as cost centres and staff levels where attrition was highest, as well as a qualitative understanding of the drivers of those attrition rates, that would have informed the design of the scheme. We are concerned that DCC took a wide approach to eligibility, rather than designing the scheme to target areas of the organisation that were identified as business critical for the smart metering programme or that had particularly high turnover rates.

3.46. We also note that the mechanics of the scheme produce a significantly higher bonus for senior staff in the organisation. This is a result of the scheme factoring into the calculation of the retention bonus both an individual employee's annual salary and their annual bonus rate. We might expect junior staff to have a higher level of turnover compared to senior staff, and would expect this consideration to be accounted for in the design of the scheme.

3.47. Furthermore, DCC did not provide sufficient evidence that alternatives to a retention bonus scheme were explored before – or alongside - its introduction. For example, we note that in RY19/20 DCC is investing in a "People Transformation" programme, which involves various initiatives to improve staff well-being and diversity and inclusion that may have a positive impact on retention.

3.48. We also consider that DCC have so far provided limited evidence that the scheme as implemented had a positive impact on staff retention rates.

3.49. Overall, we do not consider DCC has sufficiently justified this expenditure to be economic and efficient.

3.50. **In light of the above, we are therefore, minded to disallow the full cost of the retention scheme £2.499m in RY19/20.**

3.51. We remain open to receiving additional evidence from DCC to justify its use of the retention scheme and would use such evidence to revisit the proposed disallowance.

3.52. We expect DCC to provide evidence showing where there was a clear business need to improve retention in the organisation, and why the design of the scheme was appropriate and value for money.

Corporate Management

Context

3.53. DCC's Corporate Management cost centre is responsible for DCC's regulatory and strategy capabilities, communications, internal controls, and stakeholder engagement. It also includes costs for the managing director, the senior management team, and the DCC board.

3.54. Payroll costs in Corporate Management increased from £4.064m in RY18/19 to £8.5m in RY19/20. As noted above, £2.499m of this increase is attributed to the retention scheme.

3.55. The cost centre's head count significantly increased by 17 FTE in RY19/20, from 37.7 FTE to 54.8 FTE. This increase in head count was largely forecast in the RY18/19 submission and is partly driven by the expansion of the Strategy and Product Management team.

3.56. The Strategy and Product Management team is formed of three sub-teams: Strategy and Business Planning, Business Development, and Product Management teams.

DCC's justification

3.57. DCC aims to broaden the scope of its operations to develop new innovation and growth initiatives.

3.58. To provide the additional resource required to develop these initiatives, DCC expanded the Strategy and Product Management team in RY19/20. This involved a restructure of senior roles in the team, as well as the recruitment of five new roles to form the Product Management sub-team. DCC explained that FTE remained largely as forecast but senior manager roles were allocated differently than had been originally planned.

3.59. In its submission, DCC stated that the Product Management sub-team is responsible for the development of new value propositions based on existing capabilities, such as propositions for Electric Vehicles, supporting vulnerable customers, experimentation and testing.

3.60. In response to our clarification questions, DCC provided further information explaining that the sub-team focussed on delivering product offerings for existing customers. The sub-team would also be expected to be able to undertake increased stakeholder engagement relating to business planning and innovation and growth initiatives, ensuring that its propositions are developed in line with industry expectations.

Our view

3.61. We acknowledge that this team is not currently developing Value Added Services, which require Ofgem approval. We also recognise there may be benefits in improving current service offerings, for example improving DCC's testing capabilities.

3.62. However, given DCC's current level of maturity, we are concerned that this may not be an appropriate time for the growth of the product management team or the expansion of DCC's service offerings through developing new initiatives. DCC's headcount increases have historically been justified to meet the additional demands or complexities of DCC's operation. It is important DCC does not expand past what is economic and efficient; particularly in regards to DCC's offerings beyond its core service.

3.63. As we consider that DCC's main focus should remain delivery of its core business, we would require additional evidence demonstrating how these activities complement DCC's core service offer. It is also unclear to what extent DCC is developing certain products or services in line with industry expectations. We would need further justification showing that DCC has ensured any growth in this area is underpinned by customer demand.

3.64. We are inviting DCC customers and relevant stakeholders to provide their views on the types of products they would like DCC to be developing, and engagement to date on current products or services. We would like to see evidence that the product management sub-team is undertaking robust stakeholder engagement, ensuring that any new initiatives – and therefore the growth of the team - are justified appropriately.

3.65. We also consider that the forecast variance across RY20/21 and RY21/22 associated with this team do not meet the necessary threshold of certainty as we do not have evidence that future requirements or customer demand are known at this stage.

3.66. **We are therefore minded to disallow the incurred cost associated with this team of £0.509m for RY19/20, and disallow forecast costs of £1.245m over RY20/21 and RY21/22.**

3.67. We highlight that we are open to receiving additional evidence from both DCC and DCC customers to justify the activities of the product management team. We would like to see evidence that the activities of this team are driven by customer demand, and that this sub-team is undertaking robust stakeholder engagement, ensuring that any new initiatives are supported by customers.

Commercial

Context

3.68. The incurred cost of the Commercial cost centre in RY19/20 was £3.154m, slightly more than the forecast of £3.037m. DCC has forecast that incurred costs will rise to £4.241m in RY20/21. Payroll costs are the main driver of the forecast variances, and are expected to increase over the baseline by £1.313m in RY20/21, largely driven by activities in the vendor management and commercial operations teams.

3.69. The Commercial cost centre is responsible for DCC's contractual frameworks, procurement of new service contracts, and the commercial management of DCC's service providers. As such, this cost centre will play a role in DCC's Network Evolution programme.

3.70. Network Evolution is a portfolio of programmes with an overarching aim of future-proofing the network. The programme began in late RY19/20, and is planned to continue for approximately five years. Network Evolution comprises four distinct programmes:

- Re-procurement of the Data Services Provider (DSP)
- Designing and procuring future-proof communications hubs and networks (CH&N)

- Procuring a replacement or extension to the Smart Metering Key Infrastructure (SMKI) security service
- Designing and implementing automated testing of SEC releases.

DCC's justification

3.71. The variance in the RY19/20 Commercial costs were driven by factors including the expansion of the supply chain, increased complexity of contracts, increase in requirements related to the SMETS1 and Switching programmes, and delivery of the newly-introduced Network Evolution programme.

3.72. In its forecasts, DCC has described Network Evolution as a primary driver for the change in resource for the Commercial Operations and Vendor Management teams. However, DCC did not quantify the value of the forecast variance attributed to the Network Evolution programme within these teams, stating that the volume of contract change and contract management expected to be required for Network Evolution is as yet undetermined.

3.73. In response to our clarification questions, DCC provided further evidence outlining the corporate objectives and key priorities for the Commercial cost centre. DCC explained in its submission that other cost drivers, alongside Network Evolution, include increasing requirements of the Switching programme, improving contract management practices, and a greater volume of SEC Mod change, similar to its justification for RY19/20.

3.74. At the Cost Visit we further challenged DCC over the certainty of its forecasts and questioned which costs have been attributed to the Network Evolution programme. DCC was not able to provide clarity over which costs had been attributed to Network Evolution, nor provide justification that costs relating to Network Evolution met the certainty threshold to be included in the forecast.

Our view

3.75. We consider that DCC's incurred costs in the Commercial cost centre for RY19/20 have been sufficiently justified as economic and efficient. However, we have remaining concerns regarding the forecast costs for this cost centre.

3.76. Some of DCC's forecast activities have been defined more clearly and therefore the associated increase in resource costs will likely be more certain. However, we have been unable to determine which proportion of the forecast costs are attributed to more uncertain activities and remain unable to reconcile the forecasts with the explanations provided by DCC.

3.77. **As we are unable to determine the proportion of costs associated with Network Evolution, we are minded to disallow the whole forecast variance for the Commercial Operations and Vendor Management teams, amounting to £3.409m over RY20/21 and RY21/22.**

3.78. We would welcome further evidence to clarify the assumptions used to produce the forecast, as well as further justification to allow us to quantify the variance attributed to different commercial activities.

Accommodation

Context

3.79. A significant proportion (47%) of the RY19/20 variance in the Corporate Management cost centre was driven by Accommodation costs, totalling £5.314m. The vast majority of these costs were associated with the refurbishment and expansion of DCC's Brabazon House location, which began operations in 2019. A significant variance was also attributed to the fit out of Ruddington House.

3.80. DCC vacated its Preston Brook office as a result of the move to Brabazon House. Preston Brook had a notice period of 6 and 9 months for the two areas DCC was contracted to, and DCC later negotiated the 9 month notice period down to 6 months. DCC agreed not to give notice until it was fully transitioned into Brabazon House.

3.81. The associated variance for Preston Brook was £0.210m.

DCC's justification

3.82. The consolidation of testing and business activities into Brabazon House and closure of the Preston Brook office was expected to reduce operational costs. The Brabazon House costs are an ongoing spend from previously signed contracts; DCC indicated in its RY18/19 submission that it expected significant additional cost associated with Brabazon House in RY19/20, but could not provide a forecast in the previous price control as the costs did not pass the certainty threshold.

3.83. DCC's justification for not giving notice to vacate Preston Brook until fully transitioned was to ensure continuity of service to its customers.

Our view

3.84. We welcome that DCC has looked for efficiencies by consolidating its services and that DCC expects the move out of Preston Brook into Brabazon House to deliver direct cost savings over the coming years.

3.85. We consider that DCC has provided sufficient justification for the majority of the Accommodation cost variances, and note that DCC previously indicated that it expected further refurbishment costs in RY19/20 but could not provide certainty over the forecasts.

3.86. However, we also expect DCC to demonstrate that it has incurred all of its costs as efficiently and economically as possible; doing everything it reasonably can to ensure value for money, including considered assessment of trade-offs and risks.

3.87. We consider that DCC could have planned accordingly to vacate Preston Brook during the 6 month notice period, rather than waiting until fully transitioned into Brabazon House. We understand that different office moves will have differing timescales and levels of complexity. However, once DCC had sufficient certainty over the progression of the move, DCC could have started the notice period whilst the transition was underway, thus ensuring cost efficiencies for its customers with minimised risk.

3.88. Although the move out of Preston Brook is expected to deliver savings and DCC negotiated a shorter notice period for one contracted area, we do not consider that the move itself was carried out efficiently.

3.89. We recognise that continuity of service is important and view a certain 'buffer' period as necessary to minimise risk in light of unexpected circumstances, which may delay a move.

3.90. **We are therefore minded to disallow £0.105m of the variance associated with Preston Brook,** allowing for an overlap of 3 months in each contracted area (therefore 6 months of costs total) to take DCC's justification into account.

Baseline forecast costs

Context and DCC's justification

3.91. DCC baseline forecast costs for RY22/23 onwards increase by an average of £43m each year. DCC however did not provide any justification for this increase in forecast costs.

3.92. As with the RY18/19 price control submission, and in line with our Price Control Processes and Procedures Guidance[19], DCC's criteria for inclusion of costs is whether activity and costs are significantly more likely to occur than not. DCC therefore only attempted to justify forecast costs for RY20/21 and RY21/22 as the certainty criteria had not been met for RY22/23 onwards.

Our view

3.93. **We are minded to disallow all variation in DCC's baseline forecasts from RY22/23 onwards given the lack of evidence and certainty provided in justifying these costs. This amounts to £172.003m.**

3.94. We expect DCC to be committed to finding efficiencies and delivering value for money. We welcome that in its submission DCC provided an overview of the efficiencies that DCC expects to be achieved over the course of the next regulatory years for the different cost centres. We expect DCC to be able to provide more certainty over its forecast cost savings and expect DCC to continue to look for future efficiencies.

3.95. We expect DCC to commit to these efficiency targets and continue to communicate its approach to identifying savings to its customers through its quarterly finance forums.

[19] https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures-2019

SMETS1 Programme

3.96. Table 3.2 shows a breakdown of the variation in SMETS1 internal costs from the RY18/19 forecast. The costs are mapped directly against the price control General Ledger codes (GLs). The variance is driven almost entirely by External Services, which have seen an increase of £14m.

3.97. The majority of the variance in External Services is attributed to the SMETS1 Enrolment and Adoption programme, accounting for 76% of the External Services variance.

Table 3.2: Variance from RIGs by GL

General Ledger Code Area	Variance for RY19/20 (£m)
Payroll costs	0.123
Non-payroll costs	-0.128
Recruitment	-0.077
External services	14.049
IT Services	0.007
Internal services	0.137
Office sundry	0.001
Accommodation	0.065
Total	**14.174**

DCC's justification

Payroll costs

3.98. DCC has provided justification of incurred and forecasted payroll variances up to RY21/22.

3.99. In RY19/20 the overall payroll cost variance was only £0.12m; however, there were notable increases and decreases in costs for different sub-teams as set out in Table 3.3. Three out of six sub-teams have seen a decrease in costs against the forecast; this reduction has been offset by an increase in costs in two other sub-teams: Service Delivery and Security, both of which show variances exceeding the materiality threshold of £0.15m.

3.100. In their submission and in response to clarification questions, DCC justified the increases in costs for these two sub-teams by the need for additional resources in key areas following a restructure, and for strengthening governance as the overall complexity of the SMETS1 programme has increased.

3.101. Among specific drivers for payroll cost variance in RY19/20 were issues relating to testing and migration of the IOC cohort of SMETS1 meters[20], and the decision to amend the Joint Industry Plan resulting in changes to the timelines of MOC and FOC cohorts. In addition, interoperability of the L+G CHs and the Vodafone network required a change in the design and re-run of migration testing, increasing the payroll variance in both RY19/20 and RY20/21. Changes to the Programme required extension to existing resources and additional service delivery and security roles.

Table 3.3: Payroll variance across sub-teams

SMETS1 Payroll Costs per sub-team	Variation in RY19/20 (in £m)
Commercial and Regulation	-0.371
Design and Assurance	-0.402
Operations	0.080
Security	0.366
Service Delivery	1.732
Testing	-1.283
Total	**0.123**

[20] The specific drivers in relation to the IOC cohort were as follows: device issues found during SIT; migration testing taking longer than planned; limited availability of devices for testing; delay in IOC Go-live and the start of migrations; migration issues with Itron devices; delay in Go-live date with Honeywell Elster devices; testing of Aclara Devices; changes to auxiliary load, split supplier IDs, file sequencing, and EE roaming; and complexity of DMCT analysis.

Non-resource variance: external services

3.102. As set out in Table 3.4, the SMETS1 Programme saw seven procurements over the course of RY19/20 that exceeded the materiality threshold of £0.15m. This resulted in a total variance in non-resource costs of £14.05m compared to RY18/19 forecast.

3.103. Additional resources needed to support the restructure of the Programme accounted for over 50% of this variance. This was driven by an extension of the RY18/19 procurement of the SMETS1 delivery partner and a new contract for a SMETS1 executive PMO. These contracts contributed to the External Services variance by a total combined cost of £7.634m. DCC provided evidence of the process and decision-making for both procurements.

3.104. Further material costs were incurred for contracts with the following SMSOs: Morrisons Data Services (for the migration of their meters within the MOC cohort) with a variance of £2.00m; and British Gas and Npower (for the design and build of the Requesting Party) with a variance of £1.74m and £0.89m respectively. In spite of these contracts being single source procurements, DCC showed how they had engaged in price negotiations, which led to overall savings.

3.105. Procurement of the SMETS1 Migration Reporting System (MRS) added further £1.14m to the External Services variance in RY19/20. DCC outlined the benefits of the MRS, options under consideration and the reasons for their preferred solution.

Table 3.4: Material variance for External Services in SMEST1

Service procurement	Material Variance (in £m)
Interop checker	0.140
SMETS1 - npower	0.891
Telefonica UK CSP enduring services (Global M2M APN Solution)	0.152
SMETS1 delivery partner	7.156
SMETS1 Executive Programme Management Office	0.478
SMETS1 migration - Morrisons data services	2.004
SMETS1 Requesting Party – British Gas	1.741
SMETS1 support	0.075
SMETS1 Migration Reporting System	1.135
Total Variance External Services	**14.049**

Our View

3.106. We accept DCC's clarification on variances in payroll costs. In their justification of external services, DCC supplied sufficient evidence on the drivers, as well as their assessment of available options and trade-offs made during negotiations with the contracted parties.

3.107. We therefore consider that DCC's internal costs for SMETS1 for RY19/20 are economic and efficient.

Shared Service Charge

Context

3.108. DCC pays a Shared Service Charge to its parent company, Capita, to cover support services such as HR tools, property services, payroll, IT and senior management input. Inclusion of the Shared Service Charge was part of the competitive bid during the Licence tender. It is calculated as a percentage of Internal Costs, as set out in the LABP.

3.109. DCC is required by the RIGs to report information on the Shared Service Charge, including how it has been calculated and how the Shared Service Charge provides value for money. DCC must also ensure there is no cross-subsidisation across affiliates or related undertakings.[21]

3.110. In the RY16/17 price control decision,[22] we decided that in future years we would not require further justification for the Shared Service Charge associated with Baseline Activity[23] for price control purposes.

3.111. For New Scope Activities,[24] DCC must provide full justification to demonstrate that any Shared Service Charge relating to these activities is economic and efficient.

DCC's justification

3.112. This year DCC applied the Shared Service Charge at a rate of 9.5% on Baseline costs, which amounted to £7.658m in RY19/20 and £57.299m in forecast costs to the end of the Licence term.

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[21] This is a requirement under Licence Condition 11 of the Smart Meter Communication Licence.

[22] https://www.ofgem.gov.uk/system/files/docs/2017/03/2017.02_data_communications_company_dcc_price_control_decision_201511.pdf

[23] Baseline Activity is activity associated with delivering the requirements provided to the Licensee during the Licensing Competition. This includes both activities that the Licensee was expected to fully cost in the LABP and activities that were known but not fully scoped at that time and so not fully costed.

[24] New Scope Activities are activities associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence Award. The Switching Programme is considered New Scope.

3.113. DCC did not apply for a Shared Service Charge for New Scope Activities, nor on its Switching Programme expenditure this year, so did not submit any justification.

Our view

3.114. As in previous years, we propose to accept the 9.5% Shared Service Charge associated with the delivery of the baseline requirements of DCC's core smart metering service, including SMETS2 systems, SMETS1 enrolment and provision of DBCH.

3.115. **We propose to disallow the Shared Service Charge associated with the proposed unacceptable Internal Costs. This amounts to a disallowance of £0.417m in RY19/20 and £17.030m in forecast costs to the end of the Licence term**.

4. Performance Incentives

Section summary

This section covers DCC's submission of its performance under the Operational Performance Regime (OPR) and any relevant Baseline Margin Project Performance Adjustment Schemes.

DCC submitted a reduction in its margin of £0.840m under the OPR, and £0.482m due to its project performance.

We propose to increase the reduction due to DCC's performance under the OPR by £0.804m to £1.644m, but we are seeking stakeholders' views on whether it is appropriate to reduce this increase. We propose no changes to the reduction due to DCC's project performance.

We remain of the view that the current OPR may not be providing the best incentives to DCC or adequately reflecting customer experiences. We have published the decision to our May 2020 OPR Review consultation alongside this document.

Question 8: What are your views on our proposed position on DCC's operational performance?

Question 9: What are your views regarding DCC's failure to ensure all CSPs met their contractual milestones and its wider performance in the North region?

Question 10: What are your views on our proposed position on DCC's project performance?

Background

4.1. All of DCC's Baseline Margin (BM) (including adjustments) is at risk against one of DCC's performance regimes.

4.2. The margin DCC recovered in RY16/17 and RY17/18 was not put at risk against a performance regime as the Implementation Performance Regime had concluded and the

OPR was yet to begin. All of the Baseline Margin recovered in RY16/17 and RY17/18 is being put at risk across RY18/19, RY19/20 and RY20/21.

4.3. This is the second year in which DCC's performance is being assessed by the Operational Performance Regime (OPR), and the final year of assessment of the R2.0 Baseline Margin Project Performance Adjustment Scheme (BMPPAS).

4.4. In May 2020, we consulted on a revised OPR framework as we became concerned that the current OPR metrics may not be providing the best incentives to DCC, and may not be reflective of customer experiences. We have published the decision to that consultation alongside this price control consultation.

4.5. Separately to the BM, DCC receives margin on the Switching Programme. This Switching margin is at risk under a separate performance regime. The first milestone of the Design, Build and Test Phase has been assessed in this year. This is covered in the Switching section of this document.

Operational Performance

Context

4.6. The current OPR was initially consulted on in March 2016 and the final decision and direction was published in September 2017.[25]

4.7. The current OPR consists of five equally weighted performance measures: two Service User Measures (SUM) and three Service Delivery Measures (SDM). Table 4.1 lists the five measures and subdivisions.

[25] For more detail on the current OPR please refer to the decision document and consultation documents: https://www.ofgem.gov.uk/publications-and-updates/decision-dcc-s-operational-performance-regime

Table 4.1: Operational Performance Measures

Measure	Area of reporting	Metric	Weighting
SUM1	DCC service desk	Percentage of incidents resolved within Target Resolution Time	20%
SUM2a	Communication Hubs	Percentage of Communications Hubs delivered on time	10%
SUM2b		Percentage of Communications Hubs accepted by customers	5%
SUM2c		Percentage of Communications Hubs not faulty at installation	5%
SDM1a	DCC WAN coverage	All CSP contractual milestone dates met	20%
SDM1b		Percentage of first time SMWAN connectivity at install	
SDM2	Core service requests	Percentage of service responses delivered within Target Response Time	20%
SDM3	Service/System Availability	Percentage availability of Data Service, User Gateway, Service Management System and Self Service Interface	20%

4.8. These OPR performance measures are composed of a combination of the performance measures reported to the SEC and described in DCC's Performance Measurement Methodology.

DCC's submission

4.9. The total BM at risk under the OPR this year is £8.040m. DCC reported its performance as resulting in the loss of £0.840m of its BM (and therefore the BMOPA term takes the value of -£0.840m). Table 4.2 shows the performance DCC reported and the corresponding margin lost.

Table 4.2: DCC's submitted OPR values

OPR measures	BM at risk (£m)	BM reduction (£m)	% margin lost
SUM1	1.608	0.000	0.0%
SUM2a	0.804	0.000	0.0%
SUM2b	0.402	0.000	0.0%
SUM2c	0.402	0.000	0.0%
SDM1	1.608	0.804	50.0%
SDM2	1.608	0.036	2.2%
SDM3	1.608	0.000	0.0%
Total	**8.040**	**0.840**	**10.4%**

4.10. In DCC's submission it requested an adjustment to one of the five performance measures, SDM1, to reduce the amount of BM lost.

4.11. As part of SDM1, DCC must ensure that the CSPs meet all contractual coverage commitments in the Regulatory Year. If DCC does not achieve this it will lose all of the BM associated with SDM1. (This is irrespective of how DCC performs in the other component of SDM1: Percentage of first time SMWAN connectivity at install.)

4.12. This year DCC missed one of the milestones in the north region which covered 8,386 delivery points.

4.13. DCC requested that it retain half of the BM associated with this measure (£0.804m) on account of the limited impact of the missed coverage milestone, and the relatively quick resolution of the issue.

Our view

4.14. We note that DCC has performed well in the OPR performance measures, and we acknowledge DCC's arguments that the missed milestone had minimal impact and DCC worked to resolve the issue quickly.

4.15. In the last regulatory year a coverage milestone was also missed in the North region, which led to DCC losing the full amount of margin associated with SDM1, £1.283m. In our decision we acknowledged the limited impact of the missed milestone but stated that considering the full context of the situation (including the wider issues in the North region and DCC's failure to inform its customers of the missed milestone at the time) there was insufficient justification for us to modify the default OPR position.

4.16. We therefore propose to take a consistent approach to that of last year, and request stakeholders' views on the wider context of this missed milestone in the North region, and to what degree we should increase the margin retained by DCC.

4.17. As we have not yet received stakeholder views, **our minded-to position is the default position of the OPR to make a reduction to the BM of the full value associated with the SDM1 milestone, £1.644m.**

4.18. However, should we receive additional evidence that demonstrates the missed milestone had a minimal impact and that the wider situation has improved, we propose a decreased reduction up to the amount requested by DCC (£0.804m) based on the responses we receive.

Project Performance

Context

4.19. The Secretary of State may create a BMPPAS, defining a Project and an incentive regime, which determines the BM DCC retains based on its performance in the defined Project. BM adjustments which are awarded to DCC for work associated with such a Project are held at risk by the BMPPAS incentive regime.

4.20. Any reductions made due to a BMPPAS incentive regime are made through the BMPPA term given in the Licence.

4.21. Earlier this month (October 2020) BEIS published their decision on whether to revise the R2.0 BMPPAS. They concluded that they did not believe it was appropriate to make changes to the scheme. Therefore, this is the final year of the BMPPAS regarding the R2.0 project.

DCC's submission

4.22. DCC submitted results for the final two milestones of the eight which comprise the R2.0 BMPPAS incentive regime, milestones 4A and 4B. DCC retained no margin associated with these milestones. The total reduction to the BM this year is £0.482m, 87% of the total possible £0.554m. Table 4.3 gives the proportion of margin lost for each milestone, and the overall percentage.

Table 4.3: DCC's submitted R2.0 performance values

R2.0 measure	BM at risk (£m)	BM reduction (£m)	% margin lost
1A	0.035	0.017	48.3%
1B	0.035	0.017	48.3%
2A	0.047	0.047	100.0%
2B	0.047	0.012	25.0%
3A	0.059	0.059	100.0%
3B	0.059	0.058	99.2%
4A	0.136	0.136	100%
4B	0.136	0.136	100%
Total	**0.554**	**0.482**	**87.0%**

4.23. Due to the nature of the project performance mechanism in the Licence (Condition 38), any reductions made due to a missed milestone in this year will also lead to reductions in future years where BM is associated with the missed milestone. DCC will have its BM reduced by a minimum of an additional £0.427m across future years because of these, and previous, missed milestones.

Our view

4.24. We have identified no issues with DCC's reporting of its performance in the R2.0 project, but note that DCC has performed poorly in meeting the milestones set out in the BMPPAS.

4.25. **Our minded-to position is to accept DCC's submitted value for the BMPPA unchanged as £0.482m.**

5. Baseline Margin and External Contract Gain Share

Section summary

This section summarises DCC's application for adjustments to its Baseline Margin and External Contract Gain Share.

DCC submitted an application for an adjustment to its Baseline Margin of £10.795m for RY19/20 to RY21/22. We find that DCC has not provided sufficient evidence to support part of its application, and propose to reduce it by £3.275m. Considering both this, and the disallowances from our assessment of Internal Costs, we propose to amend DCC's Baseline Margin application and allow £7.521m.

DCC submitted an application for an adjustment to its External Contract Gain Share (ECGS) of £3.812m across RY19/20 to RY25/26. This adjustment relates to the continuation of re-financing arrangements and the financing of Communication Hubs (CHs). We propose to accept DCC's ECGS Adjustment application of £3.062m relating to the continuation of re-financing arrangements and reject £0.751m of the adjustment relating to CHs financing.

Questions

Question 11: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

Question 12: What are your views on our assessment of DCC's application to adjust its ECGS?

Baseline Margin

Background

5.1. The Baseline Margin adjustment mechanism allows DCC to apply for a Relevant Adjustment to the Baseline Margin values specified in Appendix 1, Condition 36 of the Licence. The adjustment mechanism itself is detailed in Appendix 2, Condition 36 of the Licence.

5.2. The Baseline Margin adjustment mechanism was included in the Licence in recognition of the uncertainty of the nature and risks of DCC's Mandatory Business over the Licence term. The adjustment mechanism is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business – including the volume, characteristics, risks and timescales of these activities. Greater detail of the conditions and requirements for a Baseline Margin Relevant Adjustment can be found in the RIGs, and the processes and procedures document[26].

5.3. DCC's Baseline Margin (including adjustments) is subject to DCC's performance regime under which its Baseline Margin may be reduced for poor performance. 100% of the Baseline Margin recovered this year is held to account by the Operational Performance Regime, and by a Baseline Margin Project Performance Adjustment Scheme (for Release 2.0), as directed by the Secretary of State.

DCC's Application

5.4. Alongside its RY19/20 price control submission, DCC has applied for a £10.795m adjustment to its Baseline Margin for work performed in RY19/20, RY20/21 and RY21/22.

5.5. DCC has identified seven drivers, which are associated with new activity, and one new driver of change to aspects of its Mandatory Business (shown in Table 5.1). In addition, DCC has applied for adjustments where there is increased cost certainty associated with

[26] Section 4:Baseline Margin Adjustment Section - https://www.ofgem.gov.uk/system/files/docs/2019/07/2019.06_processes_and_procedures_guidance_document.pdf

drivers accepted in RY16/17, RY17/18 and RY18/19, including for activity related to SMETS1 and Brabazon House.

Table 5.1: New Activities and their corresponding drivers as identified in the Baseline Margin Application

Change Driver	Activities: Resource and Non-Resource
SMETS1	SMETS1 programme – various resource and non-resource activities
Service Standard expectations	Customer engagement roles and Order Management System (OMS)
Change to DCC's Supply Chain structure (Increase In Commercial activity)	Supplier Relationship Management dashboards and additional resources related to increased level of commercial activity
Increase in Security Requirements (Security Driven Change)	Enterprise IT and Black Swan Crisis Management
Technology Driven Change	Network Evolution, ESME Noise Rise Study and Emulators
Increased Certainty on R2.0	Interoperability Dual Band Communication Hubs (DBCH) Testing
Facilitating and Supporting Future Releases (New Driver)	November 2019 and June 2020 SEC Releases, and Multi Release
Increased Certainty on New Scope – Future Activities	Enduring Change of Supplier (ECoS)

5.6. SMETS1 relates to the contract extension of DCC's SMETS1 programme delivery partner, building migration capability, procurement of the Executive Programme Management Office (PMO) and various other testing activity. DCC is applying for an adjustment of £3.345m due to new activities associated with this driver.

5.7. Service Standard Expectations relates to investments in DCC's operational capacity. This activity includes primarily investments in an improved OMS to meet increases in the volume of CHs and customers as the smart meter rollout progresses, and to ensure the OMS remains compliant with the SEC. In addition, this work also relates to the degree of customer engagement, which DCC believes has exceeded beyond the original LABP assumptions, requiring additional resources. DCC is applying for an adjustment of £1.282m due to new activities associated with this driver.

5.8. Increase in Commercial activity relates to additional resources required to manage an increased number of contracts, Project Requests (PRs), Change Requests (CRs) and procurements, which DCC believe could not be envisaged at Licence Application Business Plan (LABP). DCC also procured a set of Supplier Relationship Management Dashboards to help track supplier performance. DCC is applying for an adjustment of £0.582m due to new activities associated with this driver.

5.9. Security Driven Change relates to activities enabling the transformation of DCC's security model. This includes bringing DCC's IT infrastructure in-house, enabling DCC to manage its own security policies and systems, as previously IT infrastructure was shared via the Capita IT network. Black Swan Crisis Management activity relates to DCC procuring Deloitte to conduct a crisis simulation exercise to test DCC's crisis capability management and ensure DCC meets good industry practice. DCC is applying for an adjustment of £0.546m due to new activities associated with this driver.

5.10. Tech Driven Change relates to DCC's network evolution activities: designing and procuring future-proof CHs and Networks; Smart Metering Key Infrastructure (SMKI); Test Automation; and the re-procurement of the Data Services Provider (DSP). In addition, DCC has also included Device Emulators and ESME Noise Rise Study as non-resource costs, which DCC believe have been driven by external requirements that have increased in scale and complexity beyond the original requirements of the LABP. DCC is applying for an adjustment of £0.538m due to new activities associated with this driver.

5.11. R2.0 relates to interoperability test events. These testing events allow device manufacturers to test interoperability issues between a wide range of devices and Dual Band Communication Hubs (DBCHs). DCC is applying for an adjustment of £0.071m due to new activities associated with this driver.

5.12. Facilitating and Supporting Future Releases is the only new driver raised in RY19/20. This driver relates to the November 2019 SEC Release, which contained DCC system-impacting changes arising from SEC Modification Proposals, requiring additional resources to deliver this release. DCC is applying for an adjustment of £0.057m due to activities associated with this driver.

5.13. Increased Certainty on New Scope – Future Activities relates to work around the planning, development and implementation of the ECoS solution. DCC believe this work resulted

from the material change of scope in the LC13 Delivery Plan. DCC is applying for an adjustment of £0.034m due to activities associated with this driver.

5.14. Table 5.2 provides an overview of DCC's Baseline Margin Application by new activity and activity related to previously awarded drivers where there is increased cost certainty associated with drivers accepted in RY16/17, RY17/18 and RY18/19.

Table 5.2: Breakdown of Baseline Margin for BM Drivers by new activity and activity related to increased cost certainty

Change Driver (£m)	New Activity	Activity related to increased cost certainty	Total
SMETS1	3.345	0.761	4.107
Service Standard expectations	1.282	0.429	1.710
Change to DCC's Supply Chain structure (Increase In Commercial activity)	0.582	0.624	1.205
Increase in Security Requirements (Security Driven Change)	0.546	0.138	0.684
Technology Driven Change	0.538	0.334	0.872
Increased Certainty on R2.0	0.071	-	0.071
Facilitating and Supporting Future Releases (New Driver)	0.057	-	0.057
Increased Certainty on New Scope – Future Activities	0.034	-	0.034
Other[27]	-	2.055	2.055
Total	**6.455**	**4.341**	**10.795**[28]

[27] Other includes: Facilitating Additional Relevant Services; Cost Reduction based on previously awarded BM; Moving from Project to Multiple Programme Delivery and other previously awarded BM drivers.
[28] Numbers may not add up to due to rounding.

5.15. To calculate the proposed adjustment, DCC first quantified the change in volume of activities associated with each driver in terms of the number of FTE resources required, as well as the additional external services used in lieu of DCC recruiting more in-house resources. DCC then calculated the Baseline Margin as 15% of the sum of the Baseline Margin and associated costs for each role (this is consistent with previous years and the original Baseline Margin given in the Licence – please see the RY16/17 price control consultation document for more information)[29].

Our View

5.16. We consider that the conditions for DCC to make a Relevant Adjustment to the Baseline Margin have been met. However, DCC has not provided sufficient evidence to support the full amount for which it has applied.

5.17. When determining any Relevant Adjustments to DCC's Baseline Margin, the Licence Condition 36.A10 (b) requires us to have regard to DCC's expected rate of return on its activities over time. As in previous price controls, we considered a 15% margin to be acceptable given: DCC's ex-post regulatory framework; that the activities are similar in nature to those included with the LABP; DCC's limited fixed and intangible assets; and that this is the same margin as that agreed at bid, and as such was established through a competitive tender.

5.18. For RY19/20 we regard 15% to be an acceptable margin given that DCC's position and characteristics relevant to earning margin have not substantially changed since last year.

[29] The rate of margin is discussed in more detail in paragraphs 4.20 and 4.21 of the RY16/17 price control consultation - https://www.ofgem.gov.uk/system/files/docs/2017/10/2017.10_1617_price_control_consultation_document.pdf.

New Driver

5.19. We reject the SEC Release activity related to the Facilitating and Supporting Future Release driver. As the roll-out progresses, DCC should have anticipated increased SEC Modification activity, therefore we do not deem this activity a material variation from the LABP. We accept the Multi-Release activity related to this driver. This position is consistent with our previous decisions to allow Relevant Adjustment for work performed in relation to Multi-Release. Note, in previous applications, DCC included Multi-Release under the Moving to a Multi-Programme business change driver. This is a proposed reduction of £0.031m.

New Activities Associated with Drivers

5.20. We have identified six drivers where we propose to make a reduction to the Baseline Margin Relevant Adjustment and one driver where we propose to award the full Baseline Margin DCC have applied for. The reasons for reduction vary for each driver.

5.21. We are minded to reject some of the resource and non-resource activity related to the Increase in Commercial Activity driver. We are minded to reject all new roles associated with this driver apart from those roles related to SMETS1 and some components of Network Evolution activity i.e. CHs and SMKI. We believe DCC were able to anticipate activity relating to the reprocurement of the DSP as well as an increasing level of activity relating to CRs and PRs as the rollout progressed. We expect DCC to continue to ensure its commercial teams are sufficiently resourced to drive effective contract management. As such, we do not believe this increase in volume of work was unforeseen or a material variation from what was envisaged at LABP. Similarly, we are also minded to reject the Supplier Relationship Management Dashboards as we consider this activity part of DCC's standard approach to contract management. We are minded to reject some roles where DCC provided little or no justification for their inclusion under the Commercial Activity driver. This is a proposed reduction of £0.545m.

5.22. We are minded to reject the OMS activity relating to the Service Standard Expectations driver. The underlying driver of this activity is the increase in SMETS1 and SMETS2 installation rates, which is expected as the rollout progresses and are currently below what was envisaged in RY19/20 at LABP. In addition, it is part of DCC's obligations as a

SEC party to ensure its systems remain compliant with the SEC. This is a proposed reduction of £0.519m.

5.23. We are minded to reject customer engagement roles associated with the Service Standard Expectations driver. We consider that the investment DCC has made in this area goes no further than enabling the quality of DCC's customer engagement to meet the standards expected by industry since the award of the licence. This is a proposed reduction of £0.225m.

5.24. We are minded to reject DSP related activity associated with the Tech Driven Change driver. We consider that the need for this re-procurement was known at the time of the original procurement. Therefore, this work was not unanticipated and we do not consider this a material variation from the LABP. This is a proposed reduction of £0.213m.

5.25. We are minded to reject the Emulators activity associated with the Tech Driven Change driver. Emulators help test DCC systems against the latest technical standards, and have been used in previous years by DCC. Therefore, DCC were in a position to anticipate the use of emulators in future years. This is a proposed reduction of £0.150m.

5.26. We note that DCC referred to both Emulators and the ESME Noise Rise Study as Network Evolution in its application. While we have accepted the ESME Noise Rise Study under the Tech Driven Change driver, we do not consider either the EMSE Noise Rise Study nor Device Emulators as Network Evolution activity. We expect DCC to ensure its submission makes a clear distinction between Network Evolution activity and wider Tech Driven Change in future applications.

5.27. We are minded to reject the Increased Certainty on the R2.0 driver. DCC have been running interoperability testing since 2015, and we consider DCC were in a position to anticipate such activity for future years. This is a proposed reduction of £0.150m.

5.28. While we accept the majority of activities relating to the SMETS1 driver, including the reprocurement of DCC's SMETS1 delivery partner, we are minded to reject activity relating to the Executive PMO. We consider DCC were in a position to anticipate the need for further programme management resource earlier in the SMETS1 enrolment and adoption process. This is a proposed reduction of £0.084m.

5.29. We are minded to reject the Black Swan Crisis Management activity related to the Security Driven Change driver. While we encourage DCC to maintain the highest standards in terms of security and welcome improvements in DCC's crisis management, this does not represent a change in industry expectations in regards to DCC's approach in this area. Therefore, we do not consider this activity to be a material variation from the LABP. This is a proposed reduction of £0.055m[30].

5.30. We propose to accept the Increased Certainty on New Scope – Future Activities driver. We accept DCC's argument that the activities and deliverables set out in the ECoS Delivery Plan resulted in a material change of scope, thereby increasing the volume of work on DCC.

Other Reductions and Proposed BM Adjustment

5.31. DCC did not attach grounds to a number of roles in the application. We are minded to reject call of the Baseline Margin associated with these roles. This is a proposed reduction of £0.230m.

5.32. We have also identified a discrepancy between the SMETS1 payroll variance, as stated in DCC's submission under Internal Costs, and Baseline Margin for RY19/20 and RY20/21. We are inviting DCC to explain this disparity. We propose to reduce the Baseline Margin adjustment by an amount proportionate to this disparity which equates to £0.946m.

5.33. The total reduction we are proposing excluding any effects of the cost disallowance is £3.142m.

5.34. In addition to these disallowances, DCC cannot receive a Baseline Margin adjustment on costs that are not economic and efficient. We calculate the effect of the proposed disallowances in the cost assessment on the Baseline Margin application to be £0.133m.

[30] As this is a one off non-resource cost incurred in RY19/20, we are only deducting Baseline Margin for resource incurred in RY19/20.

5.35. Due to the ex-post nature of the price control, the Baseline Margin adjustment is recovered by DCC after the year in which the work on which it is based was performed. The years to which we are proposing the adjustment is made to are RY21/22, RY22/23 and RY23/24.

5.36. Taking all of these disallowances into account, **we propose reducing the adjustment by £3.275m, therefore amending DCC's application to an adjustment of £7.521m between RY21/22 and RY23/24,** as shown in Table 5.3.

Table 5.3: Proposed Baseline Margin compared to Baseline Margin as of the RY18/19 Price Control decision

Baseline Margin (£m)	RY21/22	RY22/23	RY23/24	Total
Baseline Margin as of RY18/19 decision	7.383	6.150	2.366	**15.899**
Adjusted by RY19/20 application (Difference from RY18/19)	11.763 (4.381)	7.741 (1.591)	7.190 (4.824)	**26.694 (10.795)**
Adjusted by RY19/20 consultation proposal (Difference from RY18/19)	10.452 (3.069)	6.338 (0.189)	6.630 (4.264)	**23.420 (7.521)**

Figure 5.1: Comparison between DCC's application and our proposed adjustment

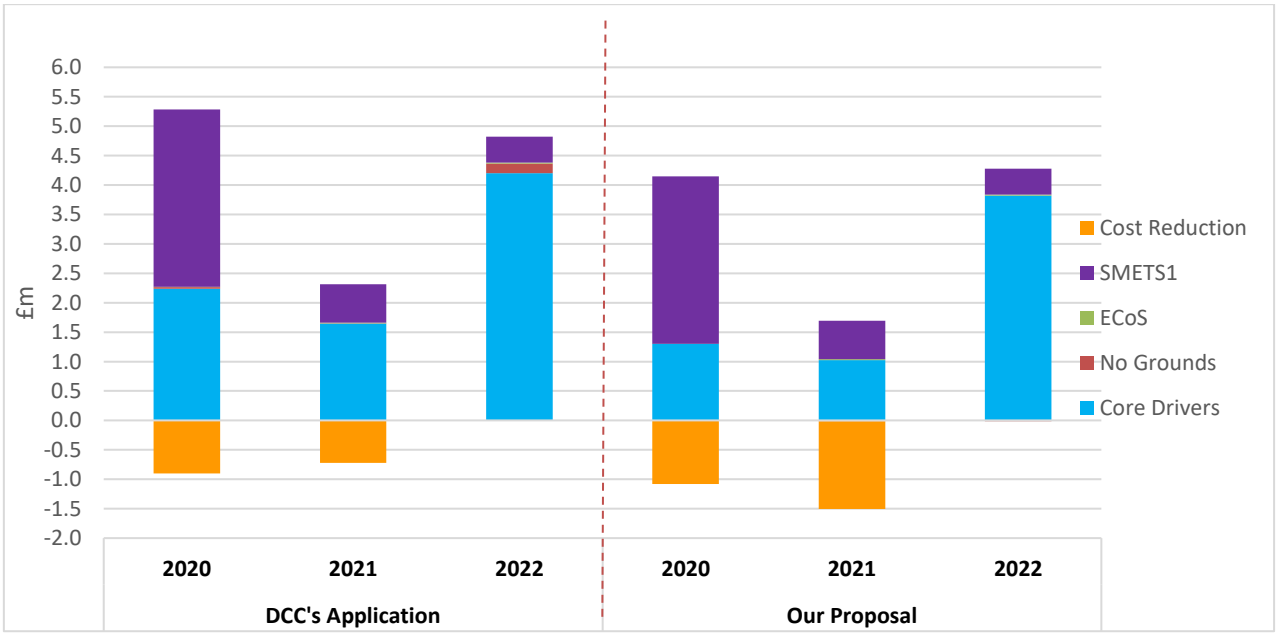

Figure 5.1: data table

Driver	Application			Proposal		
	RY21/22	RY22/23	RY23/24	RY21/22	RY22/23	RY23/24
Core Drivers	2.237	1.645	4.199	1.300	1.026	3.820
SMETS1	3.013	0.651	0.442	2.843	0.651	0.442
ECoS	0.004	0.015	0.015	0.004	0.015	0.015
Cost Reduction	-0.901	-0.723	0.000	-1.074	-1.490	0.000
No Grounds	0.028	0.003	0.168	-0.004	-0.014	-0.014
Total	**4.381**	**1.591**	**4.824**	**3.069**	**0.189**	**4.264**

Table 5.4: Proposed Baseline Margin adjustment compared with DCC's Application

Driver	Application			Proposal		
	RY21/22	RY22/23	RY23/24	RY21/22	RY22/23	RY23/24
Change to DCC's Supply Chain structure	0.209	0.333	0.663	0.023	0.124	0.506
Increase in Security Requirements	0.450	0.104	0.130	0.373	0.104	0.130
Technology Driven Change	0.244	0.257	0.371	0.065	0.129	0.312
People Transformation	0.045	0.074	0.210	0.042	0.074	0.210
Facilitating Additional Relevant Services	0.617	0.259	0.372	0.611	0.259	0.372
Operational Resilience	0.002	0.004	0.117	0.000	0.004	0.117
Service Standard expectations	0.501	0.513	0.696	0.145	0.275	0.546
Supporting a Changing Business	0.014	0.007	0.108	0.014	0.007	0.108
Increase in Customers	0.005	0.002	0.133	0.000	0.002	0.133
Moving from Project to Multiple Programme Delivery	0.028	0.047	0.625	0.028	0.047	0.625
Operational Change	0.011	0.017	0.448	0.011	0.017	0.448

Driver	Application			Proposal		
	RY21/22	RY22/23	RY23/24	RY21/22	RY22/23	RY23/24
SMETS2Ops	0.020	0.015	0.302	0.020	0.015	0.302
R2.0	0.071	0.001	0.000	-0.047	-0.032	0.000
Facilitating and Supporting Future Releases	0.021	0.013	0.024	0.015	0.000	0.011
ECoS	0.004	0.015	0.015	0.004	0.015	0.015
SMETS1	3.013	0.651	0.442	2.843	0.651	0.442
No grounds	0.028	0.003	0.168	-0.004	-0.014	-0.014
Cost Reduction[31]	-0.901	-0.723	0.000	-1.074	-1.490	0.000
Total	**4.381**	**1.591**	**4.824**	**3.069**	**0.189**	**4.264**

External Contract Gain Share

Background

5.37. The formula for DCC's Allowed Revenue includes an External Contract Gain Share (ECGS) term, which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the FSP contracts[32]. This is so that DCC has an incentive to seek and achieve cost savings in the FSP contracts. This term is zero unless DCC applies for a Relevant Adjustment to this term.

DCC's Application

5.38. DCC has applied for a £3.812m Relevant Adjustment to its ECGS term for RY19/20 to RY25/26 on the basis of £13.106m savings to industry as a whole, reflecting a reduction in External Costs.

[31] This also includes the SMETS1 payroll variance discrepancy issue which we have deducted at consultation as mentioned in 1.31.
[32] The terms and conditions through which DCC is able to apply for an adjustment under the ECGS is set out in Condition 39 of the Smart Meter Communication Licence.

5.39. DCC has applied for a Relevant Adjustment for the continuation of re-financing arrangements; these are previously renegotiated and approved interest rates, which have generated a saving across the DSP and the CSPs in RY19/20. The DSP saving relates to the refinancing of milestones associated with CRs for the SMETS1 programme, SEC modifications to the DSP and the R2.0 programme. The CSP savings also relate to the financing of associated milestones. £3.062m[33] of the total Relevant Adjustment is related to the continuation of these re-financing arrangements based on £10.103m savings to industry.

5.40. DCC also applied for an adjustment relating to the financing of CHs. This financing relates to Tranche 2 CHs which represent approximately 85% of all CHs. DCC applied for a Relevant Adjustment of £0.751m (25% gain share) on the basis of £3.003m of total savings to industry relating to CHs financing covering RY19/20 to RY25/26. DCC have calculated this saving based on their negotiated interest rate for Tranche 2 CHs which is relatively cheaper compared to the interest rate agreed for Tranche 1 CHs. These savings stem from DCC's work with its Service Providers who are negotiating these contracts.

5.41. DCC argue the savings realised in RY19/20 are a direct result of the efforts of its commercial team to secure financiers at competitive rates, as well as through the relationship DCC has built with investors over the last few years through meeting payment obligations.

5.42. DCC provided justification of its proposed distribution of the savings, which included benchmarking against comparable gain share arrangements in other regulated industries.

Customer's Benefits

5.43. ECGS is a mechanism which incentivises DCC to identify and secure reductions in the costs of the FSP contracts. The reduction of such costs brings benefits to DCC's customers in the form of savings from lower contractual interest rates on financed milestones.

[33] DCC's gain share for the DSP is 25% and 25%-37.5% for the CSPs.

5.44. Between RY15/16 (DCC's first ECGS Adjustment application) and RY19/20 (including this year's application), DCC has secured cost reductions of £109.6m in the FSP contracts and £3.006m relating to CHs financing (RY19/20 savings) based on DCC's ECGS applications, and brought benefits of £67.0m (60% of total cost reductions) to DCC's customers through lower charges.

Our View

5.45. We are minded to accept the Relevant Adjustment related to the continuation of re-financing arrangements (DSP and CSPs). We consider the Relevant Adjustment to the ECGS term is based on the cost reductions made to the original External Service Provider Contracts in line with the Licence.

5.46. We are minded to reject the Relevant Adjustment related to the financing of CHs. Although we welcome DCC's role in helping customers secure savings related to CHs, and strongly encourage DCC to continue to actively look for such efficiencies, DCC has not provided sufficient evidence on how CHs were costed or included in the original external service provider contracts.

5.47. Licence Condition 39.A4 (a) explicitly states: In order for Ofgem to approve any ECGS adjustment, DCC must *"set out how the costs associated with the activities that are the subject of the proposal were included in the original External Service Provider Contract (or Contracts)".*

5.48. For this reason, we propose to reject ECGS Adjustment application of £0.751m which is based on the "cost reduction" of £3.003m related to the financing of CHs.

5.49. Apart from the CHs financing related ECGS Adjustment application, we consider that DCC's application is duly made and that DCC has provided sufficient evidence that it was instrumental in the arrangement. DCC's application justified that the overall saving from the refinancing would not have been achieved without DCC's involvement.

5.50. We also consider that DCC's proposed distribution of the savings between its customers, the FSPs and DCC is consistent with previous years and appropriate based on the evidence provided by DCC, and regulatory precedent in the industry.

5.51. We therefore propose to reduce the Relevant Adjustment to the ECGS term by £0.751m, therefore amending DCC's application to an adjustment of £3.062m between RY19/20 and RY25/26.

6. Switching Programme

Section summary

This section provides our assessment of DCC's costs associated with the Switching Programme in RY19/20 and forecasts to the end of the licence period. We find that these costs are economic and efficient, but propose disallowing DCC's forecasts for RY22/23 onwards (£20.615m) where DCC has not provided any justification.

This section also gives our view on the first incentivised milestone of the Design, Build and Test phase of the Switching Programme: Delivery Milestone 1. We consider that the amount of delay caused by action within DCC's control extends beyond the four-week margin loss period. We therefore propose DCC should lose all margin associated with Delivery Milestone 1.

Questions

Question 13: What are your views on our assessment of Delivery Milestone 1?

Switching costs

Context

6.1. The Switching Programme has been established to improve consumer's experience of switching between energy suppliers. DCC plays a central role in delivering this programme.

6.2. The costs and performance of the Switching Programme are dealt with separately from the rest of DCC's business.

6.3. For the Switching Programme all costs must be justified as the Business Plan was not competitively tendered, and therefore cannot be considered inherently economic and efficient.

DCC's justification

6.4. DCC submitted costs for the Switching Programme until the end of the Licence. These were a total of £13.613m of incurred costs in RY19/20, which is broken down into £4.868m of internal costs and £8.745m of external costs.

6.5. DCC forecast a total cost of £48.047m costs from RY20/21 till the end of the licence period. However, DCC only provided justification for forecast costs in RY20/21 and RY21/22.

Our view

6.6. Due to the lack of justification, **our minded-to position is to disallow all forecast costs from RY22/23 to the end of the Licence period, £20.615m. We will therefore also disallow the corresponding margin (which is calculated as a percentage of costs), an additional £1.590m.**

Switching Performance

Context

6.7. We published our decision on an updated incentive regime for DCC's role in the Design, Build and Test (DBT) Phase of the programme in May 2019.[34] Note this is a separate regime from the Operational Performance Regime and Baseline Margin Project Performance Scheme (discussed in chapter 4).

6.8. The first of the delivery milestones under the DBT Phase occurred in RY19/20. Delivery Milestone 1 (DM1) required DCC – through its service providers – to develop the CSS (Centralised Switching Service) interface specifications and the CSS Integration Approach

[34] Decision on margin and incentives for DCC's role within the Design, Build and Test Phase of the Switching Programme: https://www.ofgem.gov.uk/publications-and-updates/decision-margin-and-incentives-dccs-role-within-design-build-and-test-phase-switching-programme

(CSSIA), ensuring these are of a high enough quality to be approved and accepted by the programme.

6.9. Whilst the milestone description was not formally agreed until the 5 August 2019, the direction, and supporting decision document, issued by Ofgem on 3 May 2019 outlined the expectations for the milestone, and confirmed the incentivised milestone date as the end of July 2019.

6.10. All margin on internal costs relating to the successful delivery of the DBT phase is at risk against the DBT milestones, with 30% of the margin at risk against DM1. The final values that this represents in terms of margin retained will be finalised when all delivery milestones under the DBT phase have been assessed.

6.11. In this section, we publish our proposed position on whether DCC met DM1 and the length of any delay. This view was independently assured by Moorhouse.

DCC's submission

6.12. DCC submitted evidence that although there were a total of fifteen weeks of delay between the DM1 date and DCC's delivery of the milestone, DCC should only be held accountable for three weeks of this delay. As such, DCC's view is that it should retain 80% of the margin associated with the milestone.

6.13. DCC accept that there were various points where the quality and stability of the CSSIA document – one of the key deliverables under DM1 - was at fault, which resulted in three weeks of delay that was within DCC's control.

6.14. DCC state that the procurement of the CSS provider was delayed by six weeks. DCC state that this was due to the change in positioning of the preferred bidder during the procurement process and the requirement for additional scrutiny; both of which DCC argue were outside of their control.

6.15. DCC also argue that as the milestone description was only formally agreed on 5 August 2019, this resulted in uncertainty around expectations and affected DCC's ability to achieve the milestone, though DCC are unable to quantify this impact.

Our view

6.16. DM1 has a four-week margin loss period from the date of the incentivised milestone where the margin retained decreases up until the 20th day, beyond which 0% of margin is retained.

6.17. We accept DCC's submission that the quality issues with CSSIA resulted in three weeks of delay, which were directly within DCC's control. However, we consider this a conservative estimate that does not take into account the wider impact to the Switching Programme.

6.18. In regards to the procurement of the CSS provider, the six-week delay in signing this contract was due to DCC's need to extend the negotiation period between itself and the bidders. This was to ensure that the outcome of DCC's procurement process was in line with the programme requirements. We consider the onus is on DCC to run a robust procurement process to select the best bidder and apply sufficient scrutiny. It is our view that DCC's procurement process fell short of these requirements, resulting in significant delay to delivery of the milestone, which was within their control.

6.19. In regards to the milestone description, we do not consider that this had a material impact on DCC's timelines for delivery. Ofgem had outlined the milestone description in our October 2018 consultation on the Switching Programme[35], and confirmed this in our May 2019 decision document. Ofgem continued to engage extensively with DCC around their delivery of the milestone to ensure the deliverables were understood.

6.20. Between the delay caused by the quality of the CSSIA document and DCC's own procurement process, we consider there is sufficient evidence showing that the amount of delay that was within DCC's control extends beyond the four-week margin loss period.

6.21. DCC's proposal that 80% of margin should be retained – calculated on the basis that DCC was only responsible for three out of fifteen weeks of delay - is not in line with the

[35] Switching Programme: Regulation and Governance - way forward and statutory consultation on licence modifications: https://www.ofgem.gov.uk/system/files/docs/2018/10/regulation_and_governance_-_way_forward_and_satutory_consultation_on_licence_modifications_4.pdf

mechanics of the scheme; which provide for margin retention based on the total delay that was caused by DCC, rather than a proportion of the delay.

6.22. **In light of the above, we propose that DCC should lose all margin associated with Delivery Milestone 1.**

Appendices

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Appendix 1 – External Costs Assessment

Key material variances

A1.1. In Appendix 1, we provide further context for the External Costs that materially contributed to the variation in RY19/20 (as identified in Section 2). Specifically, these are projects within the SMETS2 and SMETS1 programmes, which incurred new costs in the RY19/20 set out in Table 2.7.

SMETS2

Release 2.0

A1.2. R2.0 encompasses a system update to the network enabling the rollout of DBCHs and associated meters. This solution is intended to overcome issues around getting a strong smart meter signal in some building-types. Work on R2.0 continued from RY18/19 when the programme transitioned into testing phases (DIT, SIT and UIT[36]) under CR253 and CR274. DCC explained that due to limited availability of Dual Band devices, it was necessary to extend the testing phases beyond their original timelines. In RY19/20, CR1046 and CR1079 were progressed to provide cover for continuing the DIT phase. Additionally, CR1057 was raised to in order to:

- release fixes which had arisen from the integration testing undertaken at R2.0; and
- cover the upgrade of the system to GBCS version 2.1.

A1.3. Going forward, CR1057 will progress as a separate project called Release 2.1, which will start incurring its own costs in RY20/21.

A1.4. DCC explained that pending a solution for a fix to the SiLabs, allowing the restart of DIT, DCC and Telefonica had agreed to temporarily pause work on CR1079 for the meter manufacturer providing sub-GHz gas meters. Consequently, DCC raised PR1153 (CSP C+S only) to provide cover for several critical tasks prior to the restarting of DIT for DBCHs.

[36] Device Integration Testing, System Integration Testing, and User Integration testing, respectively

A1.5. Finally, DCC raised PR1089 with the DSP in order to accommodate any further extensions to the DIT DBCH testing – specifically for:

- R2.0 Dual Band testing activities with non NXP sub-GHz meters from the 1st April 2019 until 30th November 2019 or end of DBCH DIT Phase; and
- any further testing of the DBCH with NXP based meters from 1st March until the end of DBCH DIT.

A1.6. An overview of the new CRs and PRs under R2.0 and affected FSPs is provided in the table below. These CRs and PRs translated into the total of £38.10m additional costs. CR1046 and CR1079 represented the largest share of these new costs.

Table A1.1: Overview of newly justified Change Requests and Project Requests within the R2.0 programme

Material CRs	Description	Service Providers Affected
CR1046	CR1046 covers the inclusion of additional scope for DIT for R2.0. This additional testing is required to ensure that the DIT phase covers all test requirements sufficiently. More specifically, CR1046 covers the DIT for DBCHs from MM1 with NXP 868 meters.	CSP (N) CSP (C) CSP (S)
CR1079	Covers R2.0 Dual Band testing activities with non-NXP Sub-GHz meters supplied to be supplied by Meter Manufacturer 2 (MM2), from the 1st of March 2019 until 31st August 2019 or end of DBDIT. This Change Request also covers any further testing of the DB communications Hubs with NXP based meters (from MM1) from the 1st of March until the end of DB DIT.	CSP (N) CSP (C) CSP (S)
CR1057	CR1057 introduces the first CH Firmware Maintenance Releases after the go-live of R2.0. It incorporates the latest	CSP (N)

Material CRs	Description	Service Providers Affected
	version of the Release 1.3 (R1.3) code firmware as well as the latest variants to GBCS.	
PR1153	DCC raised PR1153 to provide cover for the variable tasks that require fixing prior to the restarting of DIT for DBCHs.	CSP (C) CSP (S)
PR1089	R2.0 Dual Band DIT with MM2 and DIT Phase Completion.	DSP

November 2019 SEC Release

A1.7. DCC raised CR1138 with the DSP to covers changes required to support the November 2019 SEC Release. CR1138 provides a release wrapper for a range of CRs, covering post PIT[37], *eg* SIT and UIT phases of the Release and System Integration. These component CRs and their descriptions are provided in table A1.2.

Table A1.2: Overview of Change Requests associated with November 2019, subsumed within CR1138.

CR #	SECMOD ref	CR Title
CR229	SECMP0023	Correct units of measure for uncontrolled Gas Flow Rate
CR243	SECMP0025	Electricity network party access to load switching information
CR292	N/A	Amendments to anomaly detection attributes
CR305	SECMP0039	Comms Hubs returns notifications

[37] Pre-Integration Testing

CR #	SECMOD ref	CR Title
CR1022	SECMOD060	Retention of CH's in Pending state in SSI
CR1055	N/A	Suppression of duplicate power outage alerts
CR1056	N/A	I&C Retry Configuration
CR1066 Part 1	SECMP0062 Part 1	Traffic Management - Alert Storm protection

A1.8. During negotiations with the DSP, a second version of CR1138 was issued to accommodate the following changes: extension of the SIT testing period, changes to the execution dates of the UIT testing phase, greater detail on the UIT scope, an automation of the regression testing within UIT, and the postponement of the go-live date from 7 to 24 November 2019.

A1.9. DCC argued that not delivering the SEC System Release in November 2019 would have increased the backlog of change to be delivered in future release slots, delaying other mandatory change.

A1.10. The newly justified costs amounted to £3.80m.

Self-Service interface

A1.11. DCC uses the Self Service Interface (SSI) portal as the primary solution for its customers to raise, update and view progress on incidents, query the Smart Metering Inventory, check SM-WAN coverage and test CHs connectivity, raise Service Catalogue requests, or view the DCC System status, among others. Remedy (DSMS) and multiple DSP applications interface with SSI to provide these services.

A1.12. DCC raised PR1079 to provide commercial cover for the delivery of DSP's work on identifying, evaluating, designing, building and testing of SSI and Remedy enhancements with the intention to increase the uptake of SSI by customers. This is an ongoing project, which began in 2018 and has been financed by previously justified PR069 and PR1039. Under PR1079, DCC tasked the DSP to:

- Introduce improvements to develop a more flexible delivery capability, including, among others: streamlining governance processes, ongoing customer alignment

and engagement to support and enhance improvements to both the SSI and Remedy, and establishing a joint SSI – Remedy (DSMS) design and development team; and

- Identify and evaluate improvements to SSI and Remedy (DSMS), including on areas such as technical feasibility, SEC compliance options, and security implications.

A1.13. In RY19/20, DCC incurred an additional cost of £2.01m on the Self-service interface project.

Testing Services

A1.14. DCC explained that the continuous provision of Testing Services is contained in Section H14 of the SEC. This section supports the regulatory framework underpinning Test Participants to support User Integration Testing (UIT) across SMETS1 and SMETS2, Production Support Testing (PST) for SMETS2, and Systems Integration (SI) Release Management.

A1.15. DCC raised CR1287 with the DSP to transition the work done under CR279 until March 2019. CR1287 extends across UIT-A and UIT-B Test Environments and covering the whole period of RY19/20.

A1.16. The costs incurred on CR1287, which were justified for RY19/20, totalled £8.74m.

SMETS1

A1.17. As the SMETS1 programme evolved, it became apparent that its complexity was much greater than initially envisaged in terms of the architecture, meter behaviour and implementation time for meter migration requested by DCC's customers. This has led to a restructure of the Programme in the last quarter of 2018, which revised the LC13 plan and the timelines for all cohorts.

A1.18. The SMETS1 service for IOC meters went live at the end of July 2019 with a two-month delay against the timeline in the revised LC13 plan. In October and November 2019, DCC further consulted on amendments to the Delivery schedule within the Joint Industry Plan (JIP). The adopted changes revised the timetable for the MOC and FOC meter cohorts and added new milestones for firmware development linked to both Secure and Landis+Gyr.

A1.19. The MOC cohort was split into two releases: MDS Cohort, which went live in March 2020, and Secure Cohort, which was further delayed (due to Secure entering SIT later than originally planned) and went live in August 2020. DCC explained that the main driver behind the FOC delays was the availability of new firmware from L+G required to begin SIT.

A1.20. In addition to delays to testing and 'go live' dates on IOC, MOC and FOC, the other main drivers of cost variances in RY19/20 were enduring costs of the newly contracted SMETS1 CSPs (Vodafone and Telefonica) and DCO (Critical Software), and the build and operation of the Commissioning Party by Capgemini.

Procuring remaining service

DCO: Critical Software

A1.21. In RY18/19, DCC entered into contract with Critical Software (CSW) for the development of the Dual Control Organisation (DCO). The costs and the scope of this agreement were justified in last year's submission. However, as a result of the change in the SMETS1 delivery timescales, DCC considered it necessary to negotiate the following variations:

- Additional out of hours support for IOC SIT and new GSME (Gas Meter) requirement for IOC;
- Movement of the LC13 timelines and additional effort required to complete DCO Development for MOC; and
- Movement of the LC13 timelines and additional effort required to complete DCO Development for FOC.

A1.22. Additionally, a contract for the enduring support services was signed for the provision of the DCO Enduring services for all cohorts, commencing from IOC go-live date to the end of October 2021. Following negotiations, DCC achieved a savings on the original quoted charges; this was later adjusted upwards due to a two-month delay on the IOC go-live date.

SMETS1 CSPs: Vodafone and Telefonica

A1.23. DCC entered into contracts with two new SMETS1 CSPs: Vodafone and Telefonica. Their services are critical to the Enrolment and Adoption of those SMETS1 meters which they service.

A1.24. Vodafone is the largest incumbent SMETS1 communication service provider. DCC explained that negotiations with Vodafone focused primarily on harmonising the terms of legacy contracts between Vodafone and individual suppliers. A contract was signed in May 2019. DCC state that the cost has been included in the government's Cost Benefit Analysis informing the 'Go/No Go' decision in 2018.

A1.25. A contract with Telefonica was needed to secure service for SIMs in MDS meters. DCC explained that the costs of the alternative, that is replacing all SIMs, were prohibitive. DCC signed a contract with Telefonica, believing value for money has been achieved. DCC also provided a comparison of the main commercial terms, including cost and data allowance per SIM, between Vodafone and Telefonica.

SMETS1 Change and Project Request Costs

A1.26. The materiality threshold for external SMETS1 costs is £1m - the same as for non-SMETS1. The following sub-sections provide an overview of change requests and project requests associated with individual projects within the SMETS1 programme and the newly justified costs.

A1.27. The main drivers behind the new project costs incurred over RY19/20 were:

- delays in the Programme and extensions of activities that were instructed under previous CRs and PRs; and
- requirements captured in previously agreed contracts, which were de-scoped from those contracts at the time.

Build and Test: IOC

A1.28. The total costs of newly justified project requests relating to the IOC testing amounted to £6.30m. The majority of the new costs were attributed to PR1106. DCC raised this project request with the DSP in order to cover extension of a range of activities relating to the postponed IOC go-live date, including SIT testing and Transition to Operations activities. For project requests, DCC and the DSP agreed monthly trackers and milestones on a time

and materials basis. DCC believes that this approach enabled it to successfully challenge the cost allocation resulting in an overall saving against the original forecasts.

Table A1.3: Overview of Project Requests associated with 'Build and Test: IOC'

CR/PR #	Description	SP affected
Build and Test: IOC		
PR1106	Covers uplifts to PR1001, PR1004 and PR1017 for the extension of activities beyond May 2019 go-live, as a result of the delay in IOC go-live from May to July 2019.	CGI
PR1125	Covers extended SIT activities for the period not covered by PR1106 i.e. between Aug and Oct 2019.	CGI

Build and Test: MOC

A1.29. Total new material costs associated with testing and preparations for the delayed go-live date of the MOC cohort amounted to £4.81m, distributed among three project and change requests, which are described in Table A1.4.

A1.30. Due to the shifting timelines on the MOC migration as a result of the amended LC13 plan, formal negotiations on PR1047 and CR1119 were delayed and DCC issued Letters of Instruction and Letters of Intent to provide commercial cover for work to continue. DCC believe strong controls were in place to ensure the economy of the interim payments. DCC also described its approach to securing value for money; this included, among others:

- Challenging resource profiles provided by the DSP, identifying overlaps and clarifying roles and responsibilities;
- Negotiating on price and timescales; and
- Agreeing monthly trackers with deliverable milestones including efforts expended and materials produced.

Table A1.4: Overview of Project and Change Requests associated with 'Build and Test: MOC'

CR/PR #	Description	SP affected
Build and Test: MOC		
PR1047	Covers the preparation and subsequent execution, of MOC integration testing and, thereafter, the implementation of the MOC solution into live operation.	CGI
CR1119	Covers the execution of SIT for MOC for the period up to September 2019.	CGI
PR1119	Covers the extended Systems Integrator activities to support the revised go-live target of MDS in March 2020 and Secure in June 2020. PR1047 covered these activities up to September 2019.	CGI

Build and Test: FOC

A1.31. The Build and Test: FOC programme contributed £13.88m in new costs. The associated CRs and PRs are listed in Table A1.5. The majority of the new costs were attributed to CR1106 which covered the procurement of Oracle licences by DXC. DCC described its strategy for a cost reduction by levering its partner's status with Oracle.

A1.32. Formal negotiations on several contracts were delayed by the revision of the LC13 plan and DCC used LoIs to provide cover for the work for the duration of the negotiations. DCC's overall approach towards ensuring economy and efficiency of costs incurred within the FOC part of the SMETS1 programme was consistent with its procurement of other contracts. This includes the use of the time and materials charging mechanism where DCC believe a risk premium may be charged by the service provider.

Table A1.5: Overview of Project and Change Requests associated with 'Build and Test: FOC'

CR/PR #	Description	SP affected
Build and Test: FOC		
PR1045	Covers the preparation and subsequent execution, of FOC integration testing and, thereafter, the implementation of the FOC solution into live operation.	CGI
CR1106	Covers the procurement of Oracle licences that will allow DXC to fulfil the mandate of a fully managed hosting service to DCC for FOC (ANSO contract).	DXC
CR1134	Covers Oracle Enduring Support from FOC Service Period Commencement Date.	DXC
CR1218	Covers the extension of DXC resources to support the build and implementation of the FOC. The extension was in direct response to the revised LC13 timescales, postponing the assumed go-live date for FOC to the end of July 2020.	DXC

Build and test: DCO

A1.33. Newly justified costs relating to PRs and CRs within the 'Build and Test: DCO' project totalled £4.56m. Over a half of these new costs were driven by PR1067; DCC explained this was essential for an upgrade of the DCO in support of FOC. DCC provided a narrative around its challenges to the SOWs and the quoted prices across all three projects and, where applicable, the resulting savings.

Table A1.6: Overview of Project Requests associated with 'Build and Test: DCO'

CR/PR #	Description	SP affected
Build and Test: DCO		
PR1160	Covers Time and Material costs for the extension to the required development and support team resources for the DCO FOC programme from December 2019 up to July 2020 Go-Live.	CSW
PR1067	Covers upgrades to the design of the DCO to support FOC. PR1067 is an extension of PR1052	CAP
PR1124	PR1124 was raised to avoid contention and delays to test progress. It proposed to that effect that a separate environment was created to enable SMETS1 FOC testing to proceed in parallel with November 2019 testing. The request for a C-Stream environment was proposed by DCC CTO, following an Environments review with the SMETS1 and November 2019 programme teams.	CAP

Migration: IOC

A1.34. The PRs and CRs needed to support the migration of IOC added £5.68m in new costs. The key drivers were the build and service provision of the Commissioning Party (CP). The CP is a newly established component of the DCC system enabling Smart Metering Systems that have been successfully migrated to DCC to be set up as 'commissioned'. DCC explained that it is providing this capability as an alternative to an active supplier having to undertake these commission steps.

A1.35. In the submission and through responses to Ofgem's clarification questions, DCC provided a narrative explaining the timeline and costs associated with the CP Service as well as its approach towards negotiations with CAP. DCC also highlighted that the CP functionality will only be required for the duration of the SMETS1 migration process.

Table A1.7: Overview of Project and Change Requests associated with the migration of IOC

CR/PR #	Description	SP affected
Migration: IOC		
PR1059	Covers the development of the Commissioning Party (CP) infrastructure.	CAP
CR1168	Covers updates to ANSO Agreement to provide for Commissioning Party activities to facilitate the migration for IOC.	CAP
PR1145	Covers extended services to support Migration Solution Testing following the split of IOC go-live into 2 phases i.e. in July and Sep 2019 to respectively release dormant and active meters.	CGI

Appendix 2 – Internal Costs Assessment

A2.1. DCC's internal Baseline costs are reported by cost centre. DCC reports separately on Additional Baseline and New Scope costs.[38] Table A2.1 gives an overview of the types of costs associated with each cost centre.

Table A2.1: Overview of costs associated with each cost centre

Cost centre	Functions include:
Corporate Management	○ Costs for the managing director, the senior management team, and the DCC board ○ Regulatory affairs ○ Corporate affairs ○ Strategy and development ○ Business improvement and internal audit
Finance & People	○ Regulatory finance activities, including the price control and other regulatory and statutory reporting ○ Commercial finance activities, including producing the company-wide budget, financial stakeholder management and setting DCC charges ○ Maintaining the DCC reporting system, and improving systems to increase performance ○ Developing staff and structure of the organisation
Commercial	○ Commercial operations ○ Programme procurement ○ Contract management ○ Relationship management of DCC's service providers ○ Legal team
Design and Assurance - CTO	○ Design architecture, including testing automation, DSP re-procurement and network evolution comms hubs. ○ Technology innovation

[38] Additional Baseline refers to any costs that are associated with requirements that the Licensee was expected to deliver at the time of the licence award, but were not fully costed in the LABP. New scope refers to activity associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence Award. The Centralised Registration Service is considered new scope.

Cost centre	Functions include:
Operations	○ Ensures that DCC services meet the needs of all service users ○ Designs and provides the day-to-day operational interface for service users including a first line service desk ○ Responsible for operational reporting and the provision of any transitional services ahead of go-live, early life support and enduring operations ○ Manages the operational relationship with DCC's service providers ○ Technical Operations Centre which ensures that the service availability is managed though the monitoring and management of events ○ Testing of live customer and user systems, devices and processes to validate working as designed post-test environments.
Service Delivery	○ Coordinates delivery across the whole DCC ecosystem during the implementation phase ○ Ensures that the services, systems, resources and assets are all in place in accordance with the programme plan ○ Allow DCC to appropriately design and build activities to be completed to facilitate integration and user integration testing ○ Ensures fit for purpose governance to enable multiple concurrent programmes of work in a consistent and well controlled manner. ○ Business analysis (moved to service delivery from design & assurance in RY19/20) ○ Test assurance practice (moved to service delivery from design & assurance in RY19/20)
Security	○ Assures the security of all DCC systems ○ Establishes an information security policy, including security assurance standards, processes, procedures and implementation timescales ○ Maintains information security standards and certification throughout the Licence

A2.2. Figure A2.1 shows the variance over the licence period in Internal Costs by cost centre compared to the RY18/19 forecast. This shows that the increase in costs over the licence period compared to last year's forecast are concentrated in the Corporate Management, Programme and Operations cost centres.

Figure A2.1: Cost variance by cost centre – compared to RY18/19 in current year prices

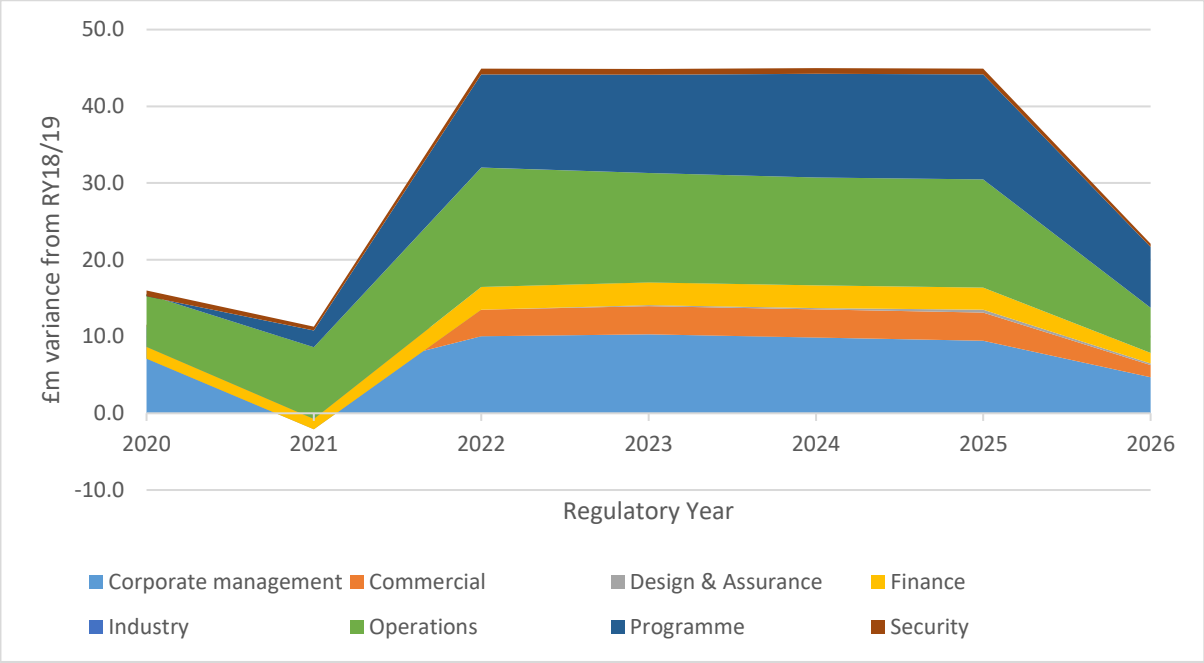

Figure A2.1: data table

£m	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	11.2	4.5	10.0	10.3	9.9	9.5	4.7
Commercial	0.3	1.4	3.5	3.7	3.7	3.7	1.6
Design & Assurance	-4.4	-8.0	0.0	0.1	0.2	0.4	0.2
Finance	1.6	1.4	3.0	3.0	3.0	2.9	1.4
Industry	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operations	6.9	9.3	15.6	14.3	14.1	14.1	5.9
Programme	-0.3	2.2	12.1	12.8	13.5	13.7	7.9
Security	0.8	0.5	0.8	0.7	0.7	0.8	0.4

A2.3. Figure A2.2 shows the variance over the licence period in Internal Costs by cost centre compared to the LABP. This shows that the forecast cost variances over the licence period compared to the LABP are concentrated in Operations and closely followed by Corporate Management, and Programme.

Figure A2.2: Cost variance by cost centre – compared to LABP in current year prices

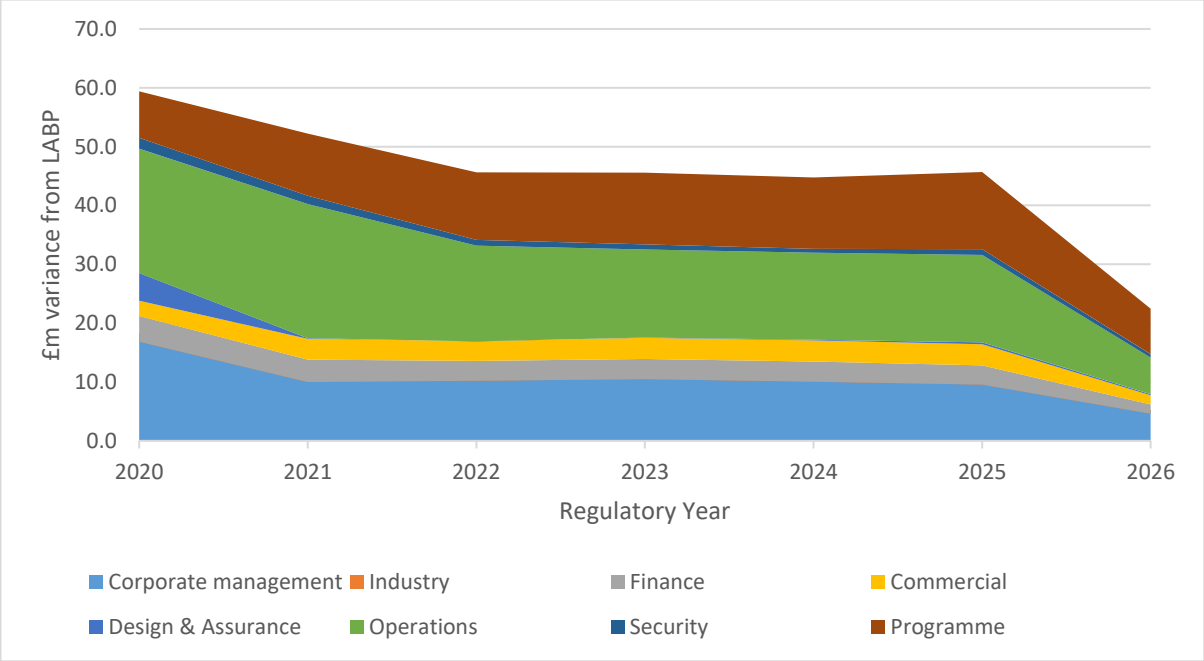

Figure A2.2: data table

£m	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
Corporate management	18.3	11.5	11.7	11.9	11.5	11.0	5.2
Industry	-1.5	-1.5	-1.5	-1.4	-1.4	-1.4	-0.6
Finance	4.4	3.8	3.4	3.4	3.4	3.3	1.6
Commercial	2.6	3.5	3.4	3.6	3.6	3.6	1.6
Design and Assurance	4.7	0.1	-0.1	0.1	0.1	0.3	0.2
Operations	21.1	22.8	16.3	15.0	14.8	14.9	6.2
Security	1.9	1.4	1.0	0.9	0.7	0.9	0.6
Programme	7.9	10.6	11.5	12.2	12.1	13.1	7.7

A2.4. Payroll costs are a major driver of Internal Costs across the different cost centres. Table A2.2 summarises DCC's headcount from RY18/19 to RY19/20 as measured in full time equivalents (FTEs) by cost centre. In RY19/20, there is a 4% decrease in FTE compared to the RY18/19 forecast.

Table A2.2: FTEs by cost centre

Cost centre	RY19/20	RY18/19 forecast for RY19/20
Corporate Management	54.84	53.59
Industry	0.00	0.00
Finance	39.58	38.15
Commercial	24.05	26.13
Design and Assurance	44.94	97.92
Operations	151.81	127.12
Security	17.62	17.43
Programme	70.88	59.12
Additional Baseline	82.77	91.95
Centralisation registration service	0.00	0.00
Total	**530.30**	**551.09**

Appendix 3 – Proposed Allowed Revenue

Table A3.1. Proposed Allowed Revenue for each year to the end of the Licence term

Regulatory Year	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
LABP (19/20 prices)	204.954	237.333	241.805	238.466	245.201	253.171	107.079
Previous year (19/20 prices)	413.632	544.612	470.145	433.634	430.059	427.968	186.967
Submitted AR RY19/20	**474.906**	**487.680**	**440.906**	**422.143**	**459.966**	**500.282**	**282.507**
Cost Disallowances							
Baseline forecast internal costs	0.000	0.000	0.000	-49.759	-49.271	-48.869	-24.104
CRS forecast internal costs	0.000	0.000	0.000	-5.600	-5.664	-5.664	-3.687
SMETS1 forecast internal costs	0.000	0.000	0.000	-0.791	-0.718	-0.718	-0.376
Benchmarking	-1.272	0.000	0.000	0.000	0.000	0.000	0.000
Strategy and Product Management	-0.509	-0.623	-0.623	0.000	0.000	0.000	0.000
Commercial operations	0.000	-0.435	-1.259	0.000	0.000	0.000	0.000
Vendor management	0.000	-0.655	-1.060	0.000	0.000	0.000	0.000
Retention scheme	-2.499	0.000	0.000	0.000	0.000	0.000	0.000
Preston Brook	-0.105	0.000	0.000	0.000	0.000	0.000	0.000
Shared Service Charge	-0.417	-0.163	-0.279	-4.802	-4.749	-4.711	-2.326
Total cost disallowances	**-4.802**	**-1.875**	**-3.221**	**-60.953**	**-60.402**	**-59.962**	**-30.492**
Performance Adjustment Reductions							
OPR	-0.804	0.000	0.000	0.000	0.000	0.000	0.000
CRS performance	0.000	0.000	0.000	-0.476	-0.461	-0.461	-0.192
Consultation AR excluding BM and ECGS adjustments	**469.300**	**485.805**	**437.685**	**360.714**	**399.103**	**439.860**	**251.823**
Baseline Margin and ECGS adjustments							
BM adjustment (19/20 prices)	0.000	0.000	3.069	0.189	4.264	0.000	0.000
ECGS adjustment	0.000	0.000	1.781	0.417	0.420	0.430	0.014
Consultation AR with BM and ECGS adjustments	**469.300**	**485.805**	**442.535**	**361.319**	**403.786**	**440.290**	**251.837**

Table A3.2. Total Proposed Allowed Revenue across the whole Licence term

Regulatory Year	Total across Licence term (£m, RY19/20 prices)
LABP (19/20 prices)	2081.244
Previous year (19/20 prices)	3875.267
Submitted AR R19/20	**4036.641**
Cost Disallowances	
Baseline forecast internal costs	-172.003
CRS forecast internal costs	-20.615
SMETS1 forecast internal costs	-2.604
Benchmarking	-1.272
Strategy and Product Management	-1.754
Commercial operations	-1.694
Vendor management	-1.715
Retention scheme	-2.499
Preston Brook	-0.105
Shared Service Charge	-17.446
Total cost disallowances	**-221.707**
Performance Adjustment Reductions	
OPR	-0.804
CRS performance	-1.590
Consultation AR excluding BM and ECGS adjustments	**3812.540**
Baseline Margin and ECGS adjustments	
BM adjustment (19/20 prices)	7.521
ECGS adjustment	3.062
Consultation AR with BM and ECGS adjustments	**3823.123**

Appendix 4 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally), not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. I.e. a consultation.

3. With whom we will be sharing your personal data

We are not intending to share your personal data with other organisations. We are intending to publish non-confidential consultation responses, including any personal data that may be contained within them.

4. For how long we will keep your personal data, or criteria used to determine the retention period

Your personal data will be held for six months after the consultation closes.

5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 030 3123 1113.

6. Your personal data will not be sent overseas

7. Your personal data will not be used for any automated decision making

8. Your personal data will be stored in a secure government IT system

9. More information

For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise