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Dear Robyn,

Citizens Advice are pleased to respond to Ofgem's consultation on how the DCC price control has functioned in the regulatory year 2014/15.

The Data Communications Company (DCC) has proposed a baseline margin adjustment of £3.114m over the course of the licence to 2021/22. £2.637m of this adjustment relates to a perceived shift in its risk exposure in the licence period. In our view, the DCC's proposals refer to risks that should have been priced into their bid for the licence and consequently included into the fixed baseline margin allocation. Ofgem is therefore right to propose disallowing the large majority of the requested adjustment.

However, Ofgem does accept a proportion of DCC's requested variation (Chapter 6 of the consultation document). In general, we are sceptical about making these baseline adjustments on the basis of supposed shifts in the DCC's risk profile. The DCC participated in a competitive process: it received the contract, in part, because its margin for risk was priced more cost-effectively than other companies. Given the novelty of the smart meter roll-out, DCC should have had a realistic expectation that their duties and risk profile could evolve during the implementation phase. To ensure that post-hoc increases to the DCC's profitability do not undermine the competitive process, an exceptionally good case must be made for **any** increased baseline margin adjustment. However, the consultation document does not make clear how you have calculated the possible variations of £0.322m or £0.483m, nor is the case the DCC makes for the wider adjustment convincing.

Without understanding this rationale, and without a more persuasive case for the adjustment, it is not possible for us to support this increase. We recognise that the sums involved here are relatively small. But there is a principle at stake: in the absence of compelling evidence regarding new risks' unforeseeability, companies should not be additionally recompensed for risks they failed to price.

Should you judge that — the above considerations notwithstanding — a baseline line adjustment remains appropriate, we support your intention to reduce the rate of return from the plainly excessive 15%. However, we are not convinced by the analysis you have undertaken to support a rate of 10%. Your analysis appears to have identified a relevant class of company (IT systems providers in the energy sector) and then concluded that the DCC should enjoy the highest rate of return of all companies



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identified within this class. Far more detailed analysis is required to justify this exceptional rate of return, especially if you intend to use this rate for in further adjustment requests.

We also note that you are benchmarking Real Price Effects to the RPI rather than CPI. RPI is no longer a designated national statistic by the Office for National Statistics. Other regulators are moving away from using RPI (including the Civil Aviation Authority, the Water Industry Commission for Scotland, Ofcom and Ofwat), reflecting serious concerns about its legitimacy. We recommend that Ofgem use CPI to benchmark RPEs for the DCC price control.

Finally, we recognise that the DCC's operations face considerable uncertainty and that this is why you have initially opted for ex-post rather than ex-ante regulation for the majority of the DCC's activities. We also note your concurrent consultation on *Proposals for DCC's role in developing a Centralised Registration Service and penalty interest proposals*, which introduces further elements of ex-post regulation, alongside encouraging ex-ante regulation for procurement costs.

Consumers' interests are generally best served by ex-ante regulation, in order to provide stable incentives and to reduce the risk premia that monopolies would inevitably seek from ex post regulation. We therefore welcome your ambition to move over to ex-ante regulation for the DCC over time. Given the DCC has been operational for two years, Ofgem should now set out a timetable for implementing ex-ante regulation for this price control.

If you would like to discuss any of the points raised in this response, please do not hesitate to contact me.

Yours sincerely,

Morgan Wild
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Citizens Advice