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for energy consumers

For the attention of SEC parties,
DCC and other interested parties.

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Further consultation on DCC Baseline Margin adjustment RY 2015/16

We published our consultation on the DCC price control for regulatory year 2015/16 on 17 November 2016.¹ We are now consulting on a discrete change to one aspect of our proposed decision, having considered responses to the November 2016 consultation.

This further consultation relates solely to DCC's application for a Baseline Margin Adjustment for RY 2015/16. We are not seeking views on any other aspect of our proposed decision. **Comments from stakeholders are sought by 21 February 2017.** We are due to publish our final decision on all aspects of the DCC price control before the end of February 2017.

Our November position

DCC submitted an application for a £1.604m adjustment to their baseline margin in July 2016 (the '2016 notice'). DCC argued that an increase in volume activity should attract margin owing to drivers of change in 2015/16 that were not anticipated at licence award. These drivers were associated with the re-planning to a multi-release strategy and new scope activities including the enrolment and adoption of SMETS1 meters and provision of dual band comms hubs. DCC quantified this variation as the difference between actual Full Time Equivalent resource (FTE) in 2015/16 and the FTE they were forecasting for 2015/16 in the Licence Application Business Plan (LABP).

We did not agree with the way DCC had quantified this change and proposed to amend DCC's application to reduce the adjustment to £0.647m. Based on the information we had at the time, we considered that the most appropriate approach to quantifying the variation was to consider the difference between actual FTE in 2015/16 and the FTE DCC were forecasting in the previous year's price control (2014/15).

Interpretations of the BM adjustment mechanism

We have reviewed the responses to our November consultation, and it has become clear from DCC's response that Ofgem and DCC have taken different interpretations of the relevant licence conditions that govern the baseline margin application process. DCC has been applying different certainty thresholds to price control forecasts and forecast costs on which they deem it appropriate to apply for a BM adjustment.

¹ <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201516>

By contrast, we applied the same certainty threshold in both the price control forecasts and baseline margin applications. We think this is the most appropriate approach. However, we recognise that there are different interpretations of the licence conditions, particularly in relation to when the grounds for a baseline margin application arise.

In their 14/15 baseline margin application (the '2015 notice'), DCC noted that it expected to submit a further application once future costs were more certain; but at the same time included projections of these costs in their price control forecasts. If the DCC expected the impact of the associated drivers to extend into 2015/16, we consider this should have been reflected in their 2015 notice, as this would have been the correct Application Window under the licence.

Our discretion

In recognition of the uncertainty surrounding when costs are likely to have arisen, which dictates when DCC should make an application for a Relevant Adjustment, we consider it is appropriate to re-assess the application for a Relevant Adjustment that DCC submitted this year. We have requested further information from the DCC to support this re-assessment.

This re-assessment is focussed only on the part of the proposed Relevant Adjustment for this year that we considered should have been applied for in the 2015 notice, and that DCC would have been entitled to but for the timing of that application.

Further evidence from DCC

We issued a request for further information to DCC to provide evidence on what proportion of the FTE variation in their 2016 notice was explained by the drivers of change identified in the 2015 notice. DCC stated that these drivers were:

- Change driven by the evolution of the DCC solution through the design and development process
- Change to timing and complexity of externalities following amendments to GBCS and requirements of the SEC

Conclusion on DCC's justification

DCC submitted further information which categorised the changes in FTE volumes outlined in their 2016 notice into four groups. Based on our assessment of the information, we have classified these groups as:

1. FTE not forecast in 14/15 owing to drivers of change outlined in the 2016 notice
2. New scope FTE not forecast in 14/15 as outlined in the 2016 notice
3. Specific FTE forecast in 14/15 and identified in the 2015 notice, which have continued into 15/16
4. Specific FTE forecast in 14/15 which have continued into 15/16, but without an explanation of the link to the drivers identified in the 2015 notice

Across these groups, DCC has identified changes in volumes relating to programme management, design & testing, regulation and new scope activities.

We have applied our discretion to allow consideration of the 2015 notice for the reasons outlined above. We propose that DCC has provided sufficient justification for groups one to three above. We do not consider that DCC has, to date, provided sufficient justification for group four; i.e. the roles that DCC were forecasting they would need but where the additional information did not provide an explanation of the link to the drivers identified in the 2015 notice.

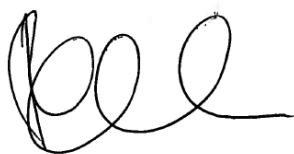
We therefore propose to amend our consultation position from allowing a £0.647m adjustment to a £1.109m adjustment, allowing for any proposed cost disallowances on the underlying activity.

To inform our final position, we are asking stakeholders for any representations on this change to our consultation proposal. Our final decision will need to be consistent with our principal objective of protecting the interests of existing and future consumers.

If you wish to provide a response, please send it to robyn.daniell@ofgem.gov.uk by 21 February 2017. Given the discrete nature of this consultation and the framework for the baseline margin process set out in the DCC licence, we consider that 5 working days is an appropriate length of time for parties to respond.

Separate to this year's decision, to mitigate the risk of future confusion, we plan to discuss in further detail the threshold of likelihood or certainty required to make an application for a Relevant Adjustment.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Rob Salter-Church', written in a cursive style.

Rob Salter-Church
Partner, Consumers and Competition