VIA EMAIL

Robyn Daniell
Ofgem
9 Millbank
London
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21st December 2017

Dear Robyn,

DCC Price Control Consultation: Regulatory Year 2016/17

Thank you for your letter dated 26th October 2017 concerning the aforementioned consultation, providing an opportunity to respond on your intent.

npower welcomes the opportunity to respond to the consultation questions in respect of the DCC Price Control Consultation for regulatory year 2016/2017, our responses to the specific questions are shown with annexe A, and workshop follow on questions Annexe B appended to the end of this covering letter.

However our views can be summarised as follows;

1. Transparency of costs it is essential to ensure that suppliers are able to effectively scrutinise costs against the assurance that we have been provided. Within the current framework we are not able to determine if costs are justified, necessary, effective or efficient and are reliant on Ofgem solely providing assurance. We would therefore welcome greater transparency to support independent assurance, challenge and review.

2. Effective risk and reward frameworks and controls is paramount to incentivise the DCC to deliver to plan both effectively and efficiently to minimise any risk/exposure to Suppliers our, Customers (present and future) and delivery of the overall smart roll out programme to UKPLC.

3. Improved accuracy of estimated costs to ensure that there are not significant variances between the predicted costs and actuals for the regulatory year in focus. This will support less volatility in the price of the DCC service and reduce market exposure to increasing costs, allowing suppliers to plan and deliver their programmes with confidence.

4. Suppliers are wholly dependent on the DCC to successfully deliver their regulatory commitments, plans and milestones. Failure to do so has impact on ALL suppliers, the smart rollout and ultimately the end consumer. Therefore, it is essential that this is coupled with a more effective risk and reward incentivisation to effectively drive performance outcomes.

I trust this response meets your approval and I am available to discuss at your convenience if needed on the contact details shown.

Yours Faithfully,

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Annexe A Response to Consultation questions

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

We note the significant increase in external costs that have largely been driven as a result of a change within the scope of the DCC work. The information provided does not allow us to ascertain if the costs have increased solely as a result of the change in scope or if these are part of miscalculations within the previous year submission or tender bid.

In order to determine if the costs are both economic, justifiable and efficient we would need additional detail that clearly presents the 39% increase in costs associated to Software and hardware. This is a significant increase upon the prior year forecast and needs to be explained.

We would welcome additional detail and transparency to support us in considering the answer to the above question in a more complete and informed manner.

Question 2: Do you have any views on DCC's contract management performance?

It is difficult to make an assessment in respect of the DCC's contract management performance. This is due to a lack of trackable milestones within the document that could allow us to assess if the DCC has maintained necessary performance through the regulatory year.

The DCC has been declared live for over 12 months and there are currently less than 100 meters across industry fitted to the production system and therefore, with the high cost of the DCC we would expect that the readiness, and ability to scale for mass-deployment would by more advanced and secure than its current position.

Within our testing stage we have been particularly disappointed with one of the CSPs (North) and the satisfactory resolution of issues that have taken longer than expected to resolve (often around two weeks). In particular the communications within the CSP's area is intermittent at best, and often require a 24 hour lag to reinstate a connection. DCC's contract management of CSPs could be significantly improved in order to deliver stable, consistent service to suppliers.

It is essential for suppliers to have access to relevant key performance measures in operation, thus giving increased transparency, assurance and direction on priorities to DCC. This should be consistent with other industry service providers (such as Distribution Network Operators, Gas Distribution Networks and the Data Transfer Service).

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Question 3: What are your views on our proposals on DCC's Internal Costs?

We have reviewed your proposals in respect of the DCC's internal costs. We cautiously agree with the proposal as it is difficult with the limited information provided to assess if the cost challenge could go further. The internal costs are similar to the external costs in the context that there has been a dramatic rise to the numbers (of staff) quoted within the original tender document. In particular the licence award envisaged that the DCC would have an ongoing staff requirement of 90 full time employees, whereas the current projections show the numbers to be four times the size of the original projection.

We do not have direct evidence that supports that the changes within internal costs can be attributed to the changes to the Smart Energy Code and Great Britain Companion Specification. Therefore, we have to rely on Ofgem's scrutiny to assure us that the internal costs are due to these factors and not to underlying inefficiencies or worse any under estimation of the task at the time of the licence tender.

Question 4: What are your views on our assessment of DCC's performance against IM9 and 10?

We support the downward adjustment by the removal of the margin associated with the Baseline Margin Performance Adjustment. We believe that this should be the absolute minimum sanction that should be applied to the DCC for their failure to deliver release 1.2 and 1.3 on time/plan.

The failure to deliver Release 1.2 and 1.3 has had significant impacts to the overall Supplier costs of developing systems to manage the delays, we have incurred significant consequential impacts on our deployment plans with the potential for stranded labour and meter asset costs. Whilst there is the additional cost burden for suppliers we shouldn't lose sight of the impact in meeting consumer need and expectations of Smart Metering.

We believe that Ofgem should take more rigorous and robust action for the delays as the availability, functionality, stability, scalability and meeting of milestones of the DCC remains critical and pivotal for the successful rollout.

Question 5: What are your views on our assessment of DCC's application to adjust their baseline margin?

We would support the rationale to reduce the baseline margin by £8.8mn however, it is not possible to ascertain if this reduction should be deeper than the proposed reduction. We would ask that the £5m in the DCC margin is reviewed again, in the wider context of the considerable amount of additional costs that have been incurred by suppliers as a result of the non-delivery of key milestones by the DCC. It would seem perverse and unacceptable that suppliers will have to accept a large increase in costs that are associated with the delay to the SMETS 2 roll out at the same time that DCC are allowed to increase their margin by £5m.

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Question 6: What are you views on out assessment of DCC's application for External Cost Contract Gainshare?

In principle we accept the DCC's application for the external cost contract gain share however, it would appear that the DCC can gain benefits from contract improvements but they do not appear to suffer any consequential damages as a result of non-performance.

We would welcome additional focus on encouraging the right behaviours in terms of general management of both performing and non performing contracts. This will ensure that we move away from the current model of reliance on suppliers to fund poor performing DCC contract management and improve performance across the board.

Question 7: What are your views on DCC's reporting which explains its reasons for over-recovery of revenue in RY16/17?

The DCC have made a number of arguments to explain the over-recovery of income in Regulatory year 2016/17, and we rely on Ofgem to determine whether these recoveries are justifiable, fair and reasonable. However, the charges for Regulatory year 2016/17 were set with a degree of prudence as to the level of costs the DCC needed to recover in order to operate. We also note that the DCC included an additional three week cost buffer as contingency, as well as requiring suppliers to post significant levels of additional collateral.

We would ask that Ofgem closely scrutinise the proposed charges for RY2018/19 to ensure that they are not overly generous a forecast as appears to have been the case in previous years. Whilst we are pleased that the DCC have agreed to refund to Suppliers the over recovery for 2016/17 in early 2018 it should be done as a matter of urgency to provide refunds to parties as soon as practical.

Annexe B – Workshop Follow on questions

Following the Ofgem workshop on 6th December 2017 a number of further questions were asked about improving stakeholder input to the process. These questions, together with answers, are outlined in the below;

How much influence do you feel you currently have?

We have limited influence, insight and assurance over the process. We are heavily reliant on Ofgem conducting due diligence and rigor of the DCC cost base and the associated performance of their Financial Service Providers (FSP).

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The DCC charges, which are a reflection of DCC costs and allowed income, are costs seemingly imposed upon us over which we have little, or no, influence or control. As the vast majority of costs are the result of having to deliver mandatory requirements then there is limited scope for us to engage in any negotiation of the service and associated cost and performance in delivery of same. It is essential to have greater transparency to support with our understanding of DCC performance and costs.

What are the barriers to engagement/influence?

The barriers to engagement are starting to reduce as the DCC are more willing to engage with suppliers around their cost base albeit there is more to be done and accelerated. In addition they are improving Suppliers insight with more detailed analysis. However, this is limited due to the current regulatory framework and constraints of the existing commercial confidentiality arrangements will allow. These barriers should be tested to establish whether the scope can be reasonably expanded, similar to how other monopoly regulated providers operate.

There are more substantial barriers to our ability to influence, in particular:

- The mandatory requirements of the SEC, GBCS and other documents;
- The terms of the License award to DCC; - which could be amended
- The contracts in place with the FSPs.

Much of the increase in DCC costs has had to be independently assessed and approved by Ofgem based on one of the above, and this will inevitably reduce our level of influence over the process and DCC costs.

What level of influence would you like?

We would like a greater degree of transparency, influence and prioritisation over the costs however, given the issues identified above this may be unlikely in the short term. We would prefer to have more certainty (forecasts) and accuracy (actuals) around DCC costs over a 12 to 18 month time horizon, as the nature of the market is such that significant cost increases cannot be absorbed or passed on at short notice. As it stands, the prospective DCC charges from April 2018 will not be known for certain until early 2018, and there will be substantial delay in passing these costs through to Suppliers. It appears that the impact and risk of deferred (ex-post) pass-through falls almost entirely on suppliers, we feel there should be a more equitable share of this risk between suppliers and the DCC.

How comparable are these governance arrangements to other organisations?

Other regulated costs are reviewed on a less frequent basis and Ofgem should look to align to this for DCC in the future. The eventual removal of a yearly price control may establish a more transparent framework that will be beneficial to stakeholders.

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How can we removed any barriers and make the process better?

Some suggestions for making the process better are as follows;

- Ensuring that the DCC specifically link each cost increase to an individual scope change in either the SEC/GBCS. At the moment the link is at too high a level is too general and ambiguous.
- Fixing the DCC charges earlier in the annual cycle, up to six months in advance.
- Reduce the frequency of the price control, such that two or three years are reviewed at once, and the price control set for several years in advance.
- Ensure that the DCC identify actions that suppliers can apply to reduce DCC costs, including agreement on prioritisation.
- DCC to improve financial engagement with Suppliers, e.g. current webinars are ineffective and do not add value, or allow for effective challenge testing or transparency
- The workshop hosted by Ofgem was a positive intervention and initiative; this should be seen as the start of an improving transparent process and needs to be built upon to give industry assurance, confidence and certainty of outcomes, in performance, delivery, and financial controls and prudence.

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