British Gas
Looking after your world

28th December 2018

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Dear Jacqui

DCC Price Control: Regulatory Year 2017/18 Consultation

British Gas response to Ofgem's DCC price control review of regulatory year 2017/18 is not confidential and may be shared.

We have worked closely with DCC to identify and resolve issues, and mitigate risks. BG have also provided feedback on many areas of DCC's costs and performance. We remain concerned about the significantly increased cost of the DCC and their Service Providers since the original tender. We are also very sensitive to DCC performance.

Whilst the leadership team have introduced more customer focus, the potential for energy suppliers to suffer increased costs is high. Based on evidence to date, the incentive regime for delivery and performance has not delivered the desired outcomes, creating bias towards technical milestone accomplishment, instead of service delivery.

We answer Ofgem's specific questions in the appendix and raise our key concerns below.

<u>Key concerns</u>

We would like to work with DCC and Ofgem to improve the transparency of DCC's costs and ensure that:

1. DCC does not charge more for delivering a service than it already bid for (except for known scope additions, such as dual band Comms Hubs).
    a. The scaling programme is an example, we just cannot understand how DCC could ask for more money.
    b. There is not a single example of incremental requirements from Users post tender that are driving additional scaling costs
2. DCC does not recover the costs of its delays, supply chain issues or planning errors from Energy Suppliers. Not only does this create additional costs for consumers, it also reduces incentive for DCC to get things right first time.

3. Develops services that add value as equitably as they recuperate cost. We are supportive of DCC providing services that reduce total costs from the system, but they need to be of benefit to all or paid for on a gain share basis.

Here are a few areas Ofgem might want to consider reviewing in DCC's charges:

- Operating at Scale (O@S) – the planned maintenance by DCC's service Providers.

  We have been told by DCC that these costs were incurred by their SPs to bring their service up to scratch, unfortunately we have no evidence this is the case. We believe O@S will cost between £30m - £50m. The original tender(s) should have included these maintenance items.

ASK: Ofgem to ensure that O@S costs are not included in DCC's fixed charges.

- Defective R1.2 Comms Hubs

  We believe at least £7m of CHs were defective and returned to DCC in 2017/18 (i.e. 141k CHs at a fully financed cost of £50 each). DCC have told us it is £4m. Either DCC have undervalued the cost to be returned or they have not published cost reflective charges. We believe customers are due a higher value to be returned. The cost of these was recovered through the prudent estimate in 2017/18. Via SEC Ops, DCC have agreed that customers should not pay for these and the full cost now needs to be returned.

ASK: Ofgem to ensure the full cost (£7m) of defective CHs is returned Energy Suppliers.

- WAN LED light issue

  The Arqiva EDMI CH does not currently conform to SEC as the WAN indicator (LED on front of the hub) is a constant light from the point of installation (it simply shows the CH is on). CR333 has been raised by DCC to Arqiva to fix, however it is believed that other items were added to the change request meaning the full CR cost will be borne by consumers.

ASK: Ofgem to check that CR333 has not been passed through to DCC User charges.

- Single (DCC run) test lab

  There has been limited transparency of the business case for the DCC test lab, whilst we might not be averse to it per se, we do not believe that the £100m project costs have been subject to anywhere near the amount of scrutiny required, i.e. a 30-minute presentation to industry and discussion at the Finance forum. A more rigorous consultation should have taken place. This should have also ensured that costs and benefits were not inequitably distributed.

ASK: DCC Users should be able to review and feedback on the Business Case for the DCC test lab, particularly if the main customers are unlikely to use its facilities (although likely to be paying for the service via fixed charges).
ASK: DCC should be discussing the impact on fixed charges of 'innovative' services and how the new revenue stream(s) reduce fixed charges.

- Demand / Traffic management

DCC have raised several capacity curbing ideas and at least 3 SEC modifications (to date) to protect the system from peak demand. Whilst it is understandable that DCC wishes to protect the system from overuse, they have yet to inform their customers of the peak capacity, the level of risk of hitting peak and whether that total peak capacity (from the original tender) has been built. No savings from a traffic management scheme have been shared (even though there's potentially reduced capacity spend).

We believe DCC is more at risk from Other DCC Users, who do not contribute to the fixed charges but could send large messages over the system and potentially outside of the control of the scheme (i.e. from requesting 48 half hourly reads every day, which is a large message that could be requested during peak periods.)

ASK: Ofgem to ask DCC to be more transparent about the current and future system capacity and savings made from Traffic Management

- DCC's lack of support for SEC modifications

  DCC have caused several SEC mods to fail – elongating delivery times, quoting high costs and not delivering impact assessments. SECAS will be able to provide Ofgem with all the detailed examples. The industry is now 'modification fatigued' and less supportive of working groups and raising modifications as a result.

ASK: Ofgem to investigate if DCC is in breach of LC23 Change Control for the Smart Energy Code.

Always happy to discuss further.

Yours sincerely,

Steve Briggs.
Head of Smart Metering Programme
British Gas
[via email]

Appendix A Ofgem questions:

1. Do you consider the external costs to be economic and efficient?
    - No, we struggle to view the external costs as economic and efficient given the high quotes and significant delay DCC and their Service Providers have given in terms of SEC modification impact assessments.
    - We struggle to understand why change requests (and therefore further costs) need to be raised when a system does not meet business requirements, although many were signed off by DCC design team. End consumers should not be paying for changes to non-SEC compliant systems, processes or Comms Hubs.
    - Whilst we have seen significant increases in the set-up costs from DCC's Service Providers we have not received a reduction in fixed operational costs, which not have been incurred as go-live has been delayed. Our questions and challenges to DCC's Finance team about these costs remain unanswered.
    - We strongly believe the Service Providers incurred small fixed operating costs due to the delay in live releases from the original *Commencement of initial Operational Services* milestone 30th September 2015 to equivalent full go-live (i.e. R1.4) in November 2017. However very little change has been seen in the charging statements and budget within Fixed Operational category in the External costs.

£m	2016/17	2017/18
Set up costs LABP	23.9	24.1
Set up costs variance	37.0	43.7
Fixed Op costs LABP	115.1	113.0
Fixed Op costs variance	-0.5	7.8

2. Do you consider the internal costs to be economic and efficient?
    - The internal costs are improving, however there is still work to do. Our comments from previous PCR responses still stand. For example, we do not believe DCC needs a large London based office given the GB wide locations of their customers.

3. Do you have views on the benchmarking of staff remuneration?
    - The Hays system appears to be a reasonable benchmark for DCC salary costs, however Ofgem needs to be mindful that other benefits should be taken into account.
    - We would not expect the 50% range to be used for inexperienced, new starters.
    - Job descriptions used in benchmarking must be reflective of the roles and responsibilities of the post holder. A random sample / audit would be welcomed to ensure scores and therefore salaries are not over inflated.
    - We note that bonuses have not been included in benchmarking activity and these could be used to significantly increase staff remuneration.

4. Do you have views on the shared services from Capita?
    - We disagree with DCC's assertion that Capita should not be helping them with culture, values and other areas within the Support Services / Overhead cost, due to the financial ring fencing of the DCC. The financial ringfencing does not mean DCC needs to work as a complete silo within Capita. DCC should be able to benefit from Capita group's services, especially as they are already paying 9.5% on top of internal cost.
    - Here at Centrica, all businesses within the group share the same values, similar culture and ultimate strategy. Likewise, the DCC and Capita both benefit from employees

having experience in both organisations, having common values, culture etc helps the transition as employees move between roles.
- We believe DCC/Capita is simply increasing its baseline margin by charging an overhead for shared services and recruiting within DCC to deliver those services (whilst also adding to internal costs). This practice needs to cease immediately and those costs incurred returned to customers. All future costs must be disallowed.

5. Proposals for more evidence from DCC on customer views for future price control submissions
    - We agree that DCC needs to provide evidence of how they have collected, reviewed and taken account of their customers' feedback in terms of their spend, innovation and business case agreement. In 2017/18, DCC started the process, however it still has not achieved the right balance of transparency or engagement with the industry.
    - There are many examples where DCC have consulted, received negative feedback but continued the same course – moving to release 1.x, performance measurement methodology to name but a few.
    - DCC needs to remain mindful that they are a monopoly business, whose customers cannot choose whether to take their services or not. They are not a commercial organisation with the pressures of competition to keep their costs down and their performance up. DCC have proved several times that they do not fully understand the detailed services and processes that Energy Suppliers and Networks need to deliver as they are somewhat removed from the end consumer.

6. DCC processes for getting meaningful customer input into decision making?
    - The current process of DCC discussing (briefly) with several different transitional and / or enduring groups their latest innovation or service is not working. Each group is viewing the DCC's presentation from differing angles with no collaboration between them. No business case, in any organisation, can be agreed without collaboration between several departments to ensure it is fit for purpose, value for money and can deliver what and when is required. The same should apply to the DCC using the industry's specialist groups.
    - Our proposal is a subcommittee of the SEC panel, which is balanced between each of the current subcommittees in representation (i.e. test assurance, operational, technical and business process) with DCC's customers (large suppliers, small suppliers and DNOs), plus the addition of financial experience. This could be arranged via careful selection of industry nominees, perhaps facilitated by SECAS. We would expect each participant to be fully active in the subcommittee and not simply take a seat / notes.
    - This new subcommittee could work (possibly under NDA) to achieve the level of transparency and business requirements for any DCC innovation or business case. Working through each business case, challenging and moulding DCC's plans for the industry and future customer base.

7. DCC adjustment to baseline margin?
    - We are surprised and disappointed by the DCC request for a significant increase in their baseline and Ofgem's minded to position. Whilst DCC's scope has increased with Dual Band CHs and SMETS1 E&A, we believe many areas in their baseline margin argument are without merit.
    - Several of the areas within DCC's baseline margin request are for areas that should have been anticipated during the tender process, i.e. supporting a changing business.

8. Baseline margin due to unanticipated customer expectations / demands?

- We do not agree that the customer expectations or demands were or could be unanticipated and we are not aware of any explicit requests to move beyond ITIL etc.

Baseline Margin Driver	Sub driver	Ofgem's view	BG's view
Moving from project to multiple programme delivery	• Multi release • Multi programme • Increased security requirements		• The move to R1.x from a single release was not supported by DCC customers as it added significant complexity to our rollout. DCC should not receive additional margin for R1.x delays.
Operational change	• Moving beyond ITIL • Operating model • Scope of Support • Service standard expectations	• Insufficient evidence of change requirement	• We agree with Ofgem. • We have seen no evidence of higher / greater expectations on DCC
Supporting a changing business	• Resource planning and management • People Transformation • Support • PA support • Compliance Volume Increase	• DCC's compliance work has not significantly increased beyond what could have reasonably been expected at Licence award.	• We believe some of these areas should be covered by the Capita Shared Service and therefore do not drive additional resource needs • We agree with Ofgem on compliance
Increase in Customers	• Increase in customers • Increase in test participants		• The number of customers is reasonably stable and new entrants are heavily supported by their respective Shared Service Provider, taking the burden from DCC.
Technology driven change	• Technology transformation programme • Increase in devices		• We believe that technology driven change is covered by R2.0 and R3.0 and does not need to be a separate category.

Commercially driven change	• Increase in key suppliers • Strategic procurements	• Should have been anticipated at time of tender	• We agree with Ofgem's view
Regulatory change	• Performance reporting & PCR • Future incentives and regulatory regimes • Regulatory change	• No significant increase in regulatory burden.	• We agree with Ofgem's view
Moving from a government led transition phase	• New products and services	• Not material change	• We agree with Ofgem's view • We believe this will reduce the regulatory burden on DCC

9. Views on the external contact gain share?

    - We do not have enough information to give a view. However, we would welcome clarity on the share being given back to customers.

10. Proposal for DCC over recovery?

    - DCC continue to over recover and include a prudent estimate in their charging statements and budgets, which is not part of their Licence allowed revenue formula. Ofgem need to enforce penalty interest to incentivise DCC to stop adding the prudent estimate that clearly is not required.
    - DCC had £42.9m in cash and bank balances at the end of regulatory year 2017/18, their need for a prudent estimate to ease their cashflow position is clearly erroneous. The cash and bank balances are also broadly similar to 2016/17 year end position of £43.2m, even with early repayment of over recovery in Q1 2018. See DCC's annual report 2017/18, page 39.
    - We believe there is further revenue to be returned to customers from the defective R1.2 CHs (proof of defects shared with SECAS and within release notes of subsequent FW).
        - We understand that approximately £4m has been included in the over recovery in 2017/18, however 141k CHs were returned to DCC.
        - The fully financed cost of a CH not redeployed in the DCC's charging statement was £50 per CH (see page 7 of charging_statement_ry1819_-_issue_1.0__final_ or page 5 in version 2.1).
        - Therefore, we calculate this to be £7m, so £3m needs to be added to the money to be returned in Q1 2019.
        - Either DCC has incorrectly calculated the money to be returned or they are not cost reflective in their charging statement.