The voice of the energy industry

Energy UK Response to Ofgem's DCC Price Control Consultation for Regulatory Year 2017/18

28th December 2018

About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 680,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests over £12.5bn annually, delivers around £84bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

Introduction

We welcome the opportunity to respond to this consultation and confirm that our response is not confidential. We have kept our response high-level, capturing overarching key points on behalf of our members, who may also respond separately.

Energy UKs views on DCCs Internal Costs

During Regulatory Year 2017/18, DCC's costs have again risen sharply and continue to be significantly greater than those anticipated in their Licence Application Business Plan (LABP). The consultation highlights DCC's overall cost overrun, in comparison to the LABP, which amounts to £1.386 billion (73%) over the period of the licence. This is a significant sum in relation to the Smart Metering Implementation Programme (SMIP) benefits case and represents approximately £55 from every energy customer[1]. We expect this to have a material impact on the SMIP Impact Assessment when BEIS updates this in 2019.

DCC cost increases are ultimately borne by consumers and clearly there will be a huge challenge to energy suppliers to balance consumer impact and reputational implications within the Price Cap. There is also a clear risk that these cost increases may undermine positive messaging to customers on the overall benefits of smart meters, leading to loss of confidence and further knock-on impacts on uptake and rollout efficiency. This may ultimately impact on our members' All Reasonable Steps obligations to complete the rollout of smart meters by the end of 2020.

DCC's Licence was granted following a competitive tendering process, and we would expect its outturn costs to closely mirror those outlined in its tender for the majority of cost lines. However, just five years into the Licence period, the costs far exceed those tendered, calling into question the value of the original tendering process. Whilst we recognise the challenges faced by DCC and its Service Providers in delivering such a complex programme, the significance of DCC's cost overrun gives cause for concern over DCC's ability to plan its business and forecast future costs. Industry has little confidence in the DCC's ability to accurately forecast costs, as evidenced by numerous examples highlighted by Ofgem in the consultation document itself, and this must improve. We have also previously highlighted concerns over DCC's management of contracts with its core Service Providers, as significant costs are quoted

[1] *Based on 25 million energy customers*

and incurred as a result of business-critical changes that are essential in order to deliver the stable and resilient infrastructure needed to complete the smart meter rollout programme. It would not seem unreasonable to have expected DCC to have foreseen the need to do this at the time of their tender, and to have priced accordingly.

DCC's approach to benchmarking of staff remuneration

Without seeing the specific detail behind DCCs benchmarking process (for example, the "Payhub Salary Database" is not in the public domain), it is difficult for us to make any specific observations in relation to the DCC's approach to staff remuneration. Therefore, we must trust that Ofgem has the relevant level of information it needs to make decisions in this area.

The one area that remains a concern to Energy UK and its members is the continued increase in FTE headcount, which far exceeds the peak level of FTE expectations within the DCC's original LABP submission. We are also led to believe that, in addition to the overall numbers of FTE's in place, there is a disproportionate number of senior management staff within the DCC with a ratio close to one management level employee to every four non-management employees, whereas a more typical ratio in similar service industry organisations is closer to one manager per 10 employees.

As Energy UK has not been able to obtain specific evidence to support this (including being unable to find a full organisational structure for the DCC in the public domain), we would like to suggest that this is an area that requires further scrutiny by Ofgem to ensure that the DCC is not operating under an overly "top-heavy" management structure, before concluding the Price Control process.

Enabling meaningful customer input to DCC's decision making

Energy UK and its members have been concerned for some time that DCC is undertaking pieces of work that incur significant additional costs, without proper, informed customer consultation and approval, and without providing a Business Case that should normally sit behind any such activities. These concerns are further heightened by the costs quoted by the DCC when carrying out impact assessments of baseline changes to its systems via the SEC Modification process. There is an increasing concern from our members that, if the scale of costs quoted in many of the changes progressed thus far is the benchmark, such costs will ultimately become a barrier to innovation and change. We would welcome any Ofgem support on ways to help address these concerns.

We fully support Ofgem's desire to see DCC decisions informed by an understanding of its customers' needs. Our members include DCC's biggest customers and provide the bulk of its income. Our members are increasingly frustrated with the limited extent to which they can influence both what DCC does, and what it costs.

We believe that DCC costs should be subject to more formal oversight and governance by its customers and Users, in addition to the existing Price Control scrutiny that Ofgem applies. There are numerous ways in which this could be delivered, and Energy UK is currently undertaking further analysis in this area with a view to developing a number of proposed approaches for consideration. We will be happy to share further output form this work with Ofgem early in the new year.

Energy UK also welcomes DCC's recent consultation publication that is seeking views from its customers on how DCC can improve engagement with its key stakeholders and have greater influence in DCC's decision-making going forward – we will be responding to DCC accordingly on this matter.

We believe there are several ways in which scrutiny and input by DCC's customers (DCC Service Users) could improve DCC's overall effectiveness and efficiency. These include:

- by better understanding DCC customers' needs and appetite for various types of DCC work;
- by more accurately forecasting levels of demand for services, resulting in improved business planning, tariff pricing and recovery of allowed revenue;
- by taking into account DCC customers views when appropriately scrutinising DCC's cost forecasts and business cases for future work through an appropriate forum under the SEC arrangements;

- by developing greater shared understanding of requirements for DCC work in relation to industry change and the challenges for DCC with progressing any change with its core Service Providers; and
- by reducing DCC's risk in relation to cost recovery, allowing them lower but more reliable income and margins.

The effectiveness of the current DCC Price Control regime is being called into question by DCC's continuously rising costs. The current, ex-post, Price Control arrangements seem increasingly inappropriate for the future tasks faced by DCC, and a move towards an ex-ante approach has been mooted – we also referred to this in our response to the Price Control consultation for Regulatory Year 2016/17. Whilst an ex-ante Price Control would provide far greater certainty about the immediate future costs for all DCC Users, there is a view that there is still insufficient stability in the overall DCC infrastructure to allow for an ex-ante approach to be adopted just yet. Energy UK would welcome wider examination of this idea by Ofgem in collaboration with industry. Energy UK and its members would be happy to support Ofgem on further work to examine and help shape any potential change to the Price Control mechanism that will enable industry as a whole to protect consumers from additional rising costs.

I hope that these overarching key points are helpful. Please let me know if we can provide any further clarity or assistance. We look forward to further engagement with Ofgem on these key matters alongside our members.

Yours sincerely,

Daisy Cross
Head of Smart Programme – Energy UK