Ayena Gupta
Metering and Market Operations
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

Email to: smartmetering@ofgem.gov.uk

19 December 2019

Dear Ayena

DCC Price Control Consultation: Regulatory Year 2018/19

EDF Energy is the UK's largest producer of low carbon electricity. We operate low carbon nuclear power stations and are building the first of a new generation of nuclear plants. We also have a large and growing portfolio of renewable generation, including onshore and offshore wind, as well as coal and gas stations and energy storage. We have around five million electricity and gas customer accounts, including residential and business users. EDF Energy is committed to building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

We welcome Ofgem's decision to disallow some of the costs where DCC has provided insufficient supporting evidence. However, further explanation is required as to why Ofgem does not propose to disallow any External Charges given that DCC charges (excluding pass-through) to the end of the Licence Term are estimated to be £3.1bn, with an increase of £592m from Regulatory Year (RY) 18/19 to RY25/26. This suggests that DCC's Fundamental Service Providers (FSPs) are fulfilling all of their contractual obligations, which is not the case. Ofgem should carry out further work to confirm whether DCC Users are receiving value for money from the FSPs; particularly in the North Region where Users are experiencing an increasing number of issues leading to a deterioration of service.

We agree that the Operational Performance Regime (OPR) should be modified to better incentivise DCC to provide a good service to its customers and deliver on its licence objectives. The OPR must ensure that the DCC is delivering the level of performance required to ensure consumers benefit from its services.

EDF Energy does not agree with the proposed position on DCC's switching performance. Insufficient evidence has been presented to determine that DCC has achieved the Transition Milestones, or that it should retain all margin associated with those Milestones.

Ofgem should investigate whether the DCC costs associated with delivering savings should be deducted from the External Contract Gain Share (ECGS). DCC currently benefits from being paid to seek and deliver a saving, as well as a proportion of the actual saving achieved. There is no consideration of whether the cost of achieving the change may exceed the 'gain' or that DCC may benefit regardless of whether any saving is made.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Tony Neville, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely

R. Beresford

Rebecca Beresford
Head of Customers Policy and Regulation

Attachment

DCC Price Control Consultation: Regulatory Year 2018/19

EDF Energy's response to your questions

Q1. What are your views on our proposal to consider External Costs as economic and efficient?

The lack of evidence provided within the consultation makes it difficult to assess whether the DCC External Costs are economic and efficient. It must be demonstrated that External Costs represent good value for money in an environment of escalating costs. Particularly, in respect of changes to original Service Provider contracts, or new contracts let by DCC for the provision of new services, that are not visible to respondents to this Price Control review.

DCC stakeholders should be provided with evidence that any increases in contract value negotiated with any Service Provider are economic and efficient. Examples include the rising costs associated with SMETS1 Enrolment and Adoption and DCC Release 2.0, which were only reviewed by industry against the original business cases. There is a risk that external cost escalation undermines those original business cases. Another example is the work being undertaken to deliver the 'Production Proving Function' that DCC was instructed to deliver nearly two years ago. This has missed both Releases 2.0 and 3.0, which were the primary basis for incurring the external costs. The lack of transparency on these and other external costs is a significant concern.

A new financial control framework should be established to determine against set criteria whether DCC has secured its external charges in accordance with operating an economic and efficient monopoly.

We expect DCC to provide more detailed assurance around how they have assessed the trade-offs they choose to make in contract negotiations, and how they plan to manage contractual risks to ensure performance and delivery throughout the terms of any contract.

Ofgem has not proposed to disallow any External Charges; despite the fact that the charges (excluding pass-through) to the end of the Licence Term are estimated to be £3.1bn, an increase of £592m from RY18/19 to RY25/26. These are material to the overall costs associated with the provision of DCC services.

When assessing if external costs are economic and efficient Ofgem should note that industry has had to absorb costs associated with the delays caused by DCC. DCC must demonstrate how it has mitigated the cost of delays and defects, within both its own organisation and on behalf of its service providers.

Ofgem should carry out further work to confirm whether DCC Users are receiving value for money from the FSPs, especially in the North region which is subject to ongoing issues.

Q2. What are your views on our proposals on DCC's approach to benchmarking of staff remuneration?

We agree with Ofgem's proposal to disallow £0.539m of contractor costs in RY18/19. DCC must provide evidence to demonstrate which contractor roles have been benchmarked, and which have been paid above market rates.

Payroll costs identified within Section 3 (Internal Costs) of the consultation should be split between permanent staff and contractors. The benchmarked information is particularly relevant as the number of staff employed by DCC far exceeds the original Licence Application Business plan (LABP) projections, and is placing a significantly higher burden on overall DCC costs.

We support DCC's proposal to commission an independent I.T. recruitment consultancy to benchmark contractors within the I.T. and technical sectors to determine minimum and maximum market rates over the year for job descriptions and role profiles for which DCC hires contractors. We would not expect DCC to offer any contractor position with a salary greater than 10% above the 50th percentile.

Before commencing benchmarking activity, DCC need to provide further detail around future expectation of staff requirements. The headcount shown in the consultation remains much too high than we would determine to be efficient. Greater scrutiny of DCC's headcount is required, particularly as numbers have increased from 316 Full Time Equivalents (FTEs) in RY17/18 to 421 in RY18/19 (an increase of 8.5%), and to 551 FTEs in RY19/20 (a further increase of (31%). Additional projects currently being proposed, such as Next Generation Communication Hubs and Automation of Testing, could increase these numbers even further.

There is not any rational basis for the payments of bonuses, especially to Contractors, when there have been multiple delays to DCC's delivery of a number of Releases and additional functionality over the Regulatory Year. Bonuses should be linked to effective delivery. Every time DCC is late with delivery, it results in significant additional charges to DCC Users.

Before any retention bonuses are considered by the DCC they should justify why staff turn-over is so high, particularly when their salaries are already significantly higher than remuneration paid within the energy industry.

Q3. What are your views on our proposal to disallow all costs associated with the external service to develop a KPI Dashboard?

We agree with Ofgem's proposal to disallow £0.455m of costs associated with the provision of a Key Performance Indicator (KPI) dashboard, given the lack of justification and transparency.

We support Ofgem's view that DCC has placed unacceptable additional costs on consumers for which they have not seen sufficient evidence of additional value.

It is difficult to understand why DCC progressed with this activity bearing in mind the existence of a tactical solution and the changes made as part of the Technical Operations Centre's (TOC's) 'Monitoring and Alerting – Strategic' project

DCC must review their existing business plans to identify efficiencies to be achieved through integrating the project with existing or planned services, before progressing with such activities.

Q4. What are your views on our proposal to disallow all variance in forecast internal costs?

We agree with the proposal to disallow £237m of internal costs covering the period RY18/19 and RY21/22 to the end of the Licence term. We note that DCC is unable to justify these costs and an explanation is required as to why such unjustified forecasts have been presented for a second year in succession.

It is of significant concern that, in an environment of rising costs, DCC is attempting to increase its charges without full and proper explanation and justification. DCC must fully engage with its stakeholders and demonstrate how it intends to achieve its cost reduction glide path, not attempt to arbitrarily increase its costs as part of a bargaining position.

We remain concerned at the increase in DCC's SMETS1 costs. DCC is proposing an increase to their forecast of 47% for RY18/19 and 215% respectively, over the Licence term. This increase is unacceptable, especially as the main cost driver is higher payroll costs as a result of increased staffing levels. For this reason, we support the proposal to disallow £28.436m for the period RY21/22 to RY25/26.

We agree that there is uncertainty over the Shared Service Charge, and that DCC must demonstrate that any Shared Service Charge on New Scope Activities is economic and efficient. We support the proposal to disallow £0.094m in RY18/19 and £20.645m in forecast cost to the end of the Licence term.

DCC's internal costs continue to remain high over the remaining period of its licence up to RY25/26 with Energy Suppliers being expected to contribute an additional £443.6m in funding.

Our particular areas of concern are:

i. Payroll charges increasing to £48m in RY19/20.
ii. The number of FTEs in RY17/18 increased to 316, before further increasing in RY2018/19 to 421 increasing again to 551in RY19/20. These levels of increase of FTEs are unsustainable.
iii. The escalation of costs since the LABP, whilst we accept there have been changes to scope (such as SMETS1) the DCC resourcing and associated costs have continued to increase dramatically. This requires deeper investigation by Ofgem.
iv. While Recruitment Charges for RY17/18 peaked at £1.5m they are predicted to be £1.0m in RY18/19 and £1.2m in RY19/20. We do not see a justification for these charges when DCC should be reducing numbers of staff. The number of FTEs in the LABP was 109.
v. Where is the justification for DCC to spend £23.3m on Building Accommodation to the end of the licence?

Q5. What are your views on our position on DCC's operational performance?

We support Ofgem's proposal to further reduce the Baseline Margin reduction submitted by the DCC by £1.267m due to poor performance impacting two measures (SUM2A + SDM1A) in the Operational Performance Regime (OPR). These measures relate to the Percentage of Communications Hubs delivered on time and to Wide Area Network (WAN) Coverage milestones.

We do not agree with the proposed decreased reduction where additional evidence is presented by DCC. It is important that DCC ensures the Communication Service Providers (CSPs) meet their contractual commitments, and that the impacts of any failure are discussed with stakeholders. There is no evidence to support DCC's assertion that the missed milestone had minimal impact on DCC Users.

Within the current scope of the OPR it is not possible to determine the impact of the poor performance in the North Region. We welcome the proposal by Ofgem to modify the OPR performance measures to include the impact on consumers within the performance measures.

This was the first year in which DCC's performance was being assessed by the OPR, and by a Baseline Margin Project Performance Adjustment Scheme (BMPPAS). From the information provided in the consultation we found it difficult to assess operational performance, especially given the number of events and successive delays across the DCC landscape, whether they relate to Release 1.x, R2.0, SMETS1 E&A, Production proving, Planned outages, etc.

Q6. What are your views regarding DCC's failure to ensure all CSPs met their contractual milestones and our proposed adjustments in response to this?

It was disappointing that DCC failed to ensure a CSP achieved Performance Measure SDM1, given the operational impact that WAN Coverage has on the rollout off smart meters. We are also concerned that the DCC did not engage its customers or the SEC Panel when this milestone was outstanding for three months.

Without further details, DCC customers are unable to calculate the full impact of the missed milestone, and therefore cannot agree that the DCC were able to rectify the failure promptly. Through effective contract management we would have expected the DCC to have identified this issue early on, as the WAN coverage of 99.25% is contained within the CSP contract. If this failure had been communicated sooner it may have been possible to put mitigation in place.

As the milestone itself was not met, the DCC should not benefit under the current OPR. However, we agree that the OPR review should consider how a performance measure could be adjusted to account for the impact of any failure on consumers. This could lead to a penalty being increased as well as reduced if there is a disproportionate impact on consumers.

Q7. What are your views on how the Operational Performance Regime could be modified to better incentivise DCC to provide a good service to its customers and deliver upon its objectives?

We agree that the OPR could be modified to better incentivise DCC to deliver on its objectives and provide a good service to its customers and to end consumers.

We support the concept of an OPR and agree that, when properly designed, it can provide a good incentive on DCC to perform well. Putting 100% of the baseline margin at risk for poor performance should keep DCC focused on achieving and exceeding its targets.

There have been a number of issues with DCC's performance which has resulted in baseline margin being reduced or disallowed by Ofgem. We support the proposal contained in the consultation, on the basis that we are not satisfied with the performance of DCC and its Service Providers; it has had a material impact on our ability to rollout smart meters and has led to us incurring a significantly increased cost of deployment.

DCC should be fairly incentivised for providing a good level of service to its customers but it must also be fairly penalised for poor performance. This penalty should reflect the impact of the failure on suppliers and consumers.

We agree a number of performance measures could be updated or introduced to take more account of the impact upon DCC Users and consumers. Examples include:

- Volumes and timings showing the success of Over the Air (OTA) Firmware Upgrades
- Prepayment Top –Up success
- Change of Supplier (CoS) within allowed timescale
- Technical Commissioning time
- Install and Leave

Q8. What are your views on our proposed position on DCC's project performance?

We agree that Ofgem should impose a Baseline Margin Project Performance Adjustment on the basis of missed milestones and failure to deliver a suitable R2.0 solution. However, the value of the reduction (£0.093m, 74% of the total possible £0.124m) does not reflect the severity of the impact of this failure on Users. This needs to be borne in mind when considering DCC performance and the setting of incentives for future projects.

It is disappointing that DCC only submitted results for six of the eight milestones described in the R2.0 BMPPAS. It is not clear why they have not submitted results for the remaining two. This level of performance is unacceptable and further explanation should be sought by Ofgem.

Q9. What are your views on our proposed position on DCC's switching performance?

We do not support the proposed position on DCC's switching performance. Insufficient evidence has been presented that would enable us to agree that the DCC achieved the Transition Milestones, or that it should retain all margin associated with those milestones.

It is noted that the incentive regime for the Transitional Phase of the Switching Programme was modified in January 2019 via a Change Request, CR-E26 (Change to the date of Incentivised Milestone 3). The apparent result of this change was that Transition Milestone 3 was split into two milestones; 3a (Centralised Switching Service (CSS) Contract Award) and 3b (Service Management Contract Award). We have not been able to locate any detail regarding this Change Request, although it is referenced on the Switching Programme External Change Control Log, and in the Data Communications Company (DCC): Regulatory Instructions and Guidance (RIGs) published in July 2019. It is not evident why this Change Request was raised, why the original milestone was split, or what the details of the two new milestones that replaced it are.

The consultation notes that Milestone 3a (CSS Contract Award) was approved by Ofgem on 12 February 2019. The communications from the Switching Programme, however, indicate that the appointment of Landmark as the CSS Provider occurred in May 2019. The Switching Delivery Group met on 14 May 2019; at that meeting the DCC reported that the CSS procurement had now been concluded, and the contract had been awarded to Landmark Information Group Ltd. It is not clear how this announcement aligns with the approval date for CSS Contract Award noted in the consultation, or on what basis any approval might have been given in February 2019.

The level of margin achieved by DCC from the Switching Programme is significant, and paid by consumers. While it is correct that the DCC is rewarded for achieving its milestones, the process by which this is determined requires more transparent.

Q10. What are your views on our assessment of DCCs application to adjust its baseline Margin?

We agree with Ofgem's proposal to reject four of the five new drivers put forward by DCC. We recommend Ofgem examines the Facilitating Additional Services driver in more detail to see if the £1.877m cost could be reduced further.

All of these activities were speculative on DCC's part, and whilst some of them were subject to stakeholder engagement, they were not part of a formal arrangement. DCC has been paid for undertaking these activities even though they do not have approved business justification, so they should not form part of the baseline margin.

Whilst we accept Baseline Margin is at risk, we would like confirmation that DCC's margin, including any adjustment, is truly 100% at risk; considering that some activities lack detail of how success would be measured e.g. SMETS1 preparatory work.

In the absence of further evidence we do not accept the £11.046m adjustment proposed to the Baseline Margin for additional work activities carried out in RY18/19, RY19/20 and RY20/21. This evidence would need to include Business Cases signed-off by stakeholders, the SEC Panel, or Ofgem.

EDF Energy remains supportive of the Baseline Margin adjustment mechanism in principle. However, we regard the current 15% level as being too high a baseline margin to be paid to DCC, even before taking into account the impact of DCC delays upon suppliers and consumers.

Q11. What are your views on cost uncertainty in relation to Baseline Margin applications and the process for dealing with this issue?

We support Ofgem's proposal to reduce Baseline Margin by £2.970m, reducing DCC's application to £8.076m between RY20/21 and RY22/23.

We agree that DCC should not be able to recover Baseline Margin on costs that have not been incurred as a result of work not having been done, or because DCC has overestimated the cost associated with the work. Any Baseline Margin paid where activities have not been fully completed must be returned to stakeholders.

We remain concerned at the continued level of cost uncertainty surrounding activities such as SMETS1 and R2.0. It is unacceptable for stakeholders to incur sharp increases in charges once an activity has commenced as a result of poor cost estimation by DCC.

Baseline Margin should not be applied where costs have increased due to factors within DCC's control, rather than due to external events outside of DCCs control.

Ofgem must ensure DCC is explicit in providing full details about the costs incurred. The steps it has taken to provide further transparency around the arrangements for incurring costs going forward are positive but the DCC must go further in providing detail as to why costs beyond those needed to maintain base-case business are needed.

Material changes must be adequately communicated to DCC Users, and we would like to see further clarification from the DCC to understand why costs are fluctuating.

Q12. What are your views on our assessment of DCC's application to adjust its ECGS?

We agree with Ofgem's proposal to adjust ECGS by a total of £13.204m related to reductions to the Data Services Provider (DSP) contract, provided that these savings were not simply the removal of a contracted service from the schedule of activities provided by the DSP.

It is appropriate for DCC to expect a share of 'external contract' savings, where it has funded the risk associated with seeking the saving, at the level determined in their licence. It is inappropriate for DCC Users and their customers to fund both the risk investment and a portion of the reward, especially as there are no controls to limit DCC's exploration of savings or provide visibility of the investment needed to achieve the savings. There is not a process for consideration of the wider business impact on SEC parties through consultation or engagement. External gain share projects should be subject to identification and joint assessment with DCC Users, the SEC panel and Ofgem before any investment is made.

Ofgem should consider investigating whether DCC's costs associated with delivering the saving should be deducted from the ECGS. Currently, DCC gets paid to seek and deliver the saving, as well as receiving a proportion of the actual saving achieved. There is no consideration of whether the cost of achieving the change may exceed the 'gain' or that DCC may benefit regardless of whether any gain is made.

EDF Energy
December 2019