Issued via e-mail

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Dear Ayena

DCC Price Control Consultation RY2018-2019

Thank you for circulating the consultation material relating to the aforementioned consultation. npower welcomes the opportunity to consider and respond to the proposals set out. It is difficult for us to make a judgement on whether these costs are economic, fair and efficient as we do not have all the evidence provided to Ofgem from DCC (in keeping with previous price control reviews).

Whilst generally prepared to accept the assurances raised at face value, there are still general concerns at Ofgem's approach. Clearly there is a backdrop of continued escalating costs and concerns at missed milestones with impacts to customer service and the Smart Deployment Programme which should not be treated lightly.

Our full responses to the consultation questions can be found with annexe (A) below, but by way of summary;

1. We are relying on Ofgem to take all reasonable steps to ensure that Suppliers are properly safeguarded to ensure costs do not continue to soar. Whilst it is appreciated that DCC has to be accorded an operating margin to attract investment, it seems clear that that any penalty imposed can be absorbed within that margin without impact on their costs. Given that DCC can also call on resource from within their operating group, we believe that the penalties themselves would not incentivise DCC to major performance improvement.

2. As a monopoly service organisation (and which is part of a wider group that it can call on to resource), it has an unfair advantage by enjoying a much higher margin over suppliers who operate in a competitive market and who are subject to a much lower margin under a rigorous price cap. This was an issue raised within our 2018 responses and not dealt with. In addition, there are areas where DCC have not delivered programme milestones or services in full; the approach to economic penalties in these circumstances also seems not to reflect that applied to Suppliers under the Enforcement Guidelines.

3. It is inadequate for DCC just to say that the significant growth in internal costs (38%) is justifiable simply by virtue of the provision of additional services that were needed. As indicated by Ofgem, there is no specific mention of cost inefficiencies going forward. DCC needs to be more transparent about [its] costs when consulting on (and justifying) new spend proposals and how the DCC plan to operate within budgetary forecasts to actuals.

4. The Operational Performance measures attained do not reflect continued poor customer experience and should be reviewed. Many service requests are not being processed correctly by DCC.

5. DCC to provide greater transparency on shared service arrangements now and into the future.

6. DCC to evidence and justify its application for an adjustment to its baseline margin.

I trust this response meets your approval and I am available to discuss any relevant matters at your convenience if needed via the details shown.

Yours sincerely

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Annexe A: Responses to questions

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

1. As previously stated, it is difficult to make a judgement as to whether these costs are economic and efficient as we do not have sight of all the evidence presented by DCC to Ofgem regarding their management of the sub-contracts with the Fundamental Service Providers (FSPs).

2. We are (in general) prepared to accept at face value the assurances that Ofgem have expressed regarding the evidence that DCC have provided around their actions to ensure that the changes required of the FSPs are “economic fair and efficient”. It is, however, difficult to understand how certain external costs can be considered economic and efficient, e.g. Arqiva when we observe 20-30% failure rates in CSP (N), without having an understanding of any economic penalties within the specific contracts.

3. The Consultation suggests that DCC are carrying out their obligations with respect to managing the FSPs in a satisfactory manner. However, it is a concern that DCC have not been able to demonstrate and provide further evidence around their assessment of risk, or that they have failed to take account of overhead costs in their cost benefit analysis.

4. Finally, we note that we cannot comment on whether the External Costs are actually economic and efficient in the broadest sense of these words. This is because the costs base is to a large extent, defined by the FSP sub-contracts and whilst there is some element for negotiation in the cost of new scope, the question that is really being asked in this consultation is whether the DCC contract management process has been sufficiently rigorous and robust and we are unable to opine on this without wider transparency.

Question 2: What are your views on our proposals on DCC’s approach to benchmarking of staff remuneration?

5. We rely on Ofgem’s review of permanent staff costs to determine whether they are economic, efficient, market-averaged and justifiable.

6. We are encouraged that DCC has further reduced their reliance on contractors during the year (and this restriction should continue), but agree with the concerns around the contractor premiums. It would not be deemed economic or efficient to benchmark at the maximum market rate identified by the external IT recruitment consultancy.

7. It is not clear in the consultation as to whether the splits in paragraph 3.19 are compiled utilising the maximum market rate as the benchmark or a process similar to the one applied to permanent staff. We would have concerns therefore that it appears that DCC may be paying significantly higher than an actual true mid-point benchmark rate. An inflated contractor rate would also derive a Baseline Margin premium which would be a concern.

8. Consequently, we support the proposal to disallow £0.539m of contractor costs in RY18/19 as not economic, efficient or justifiable.

Question 3: What are your views on our proposal to disallow all costs associated with the external service to develop a KPI Dashboard?

9. We agree with the position to disallow all external service costs associated with the development of a KPI dashboard as there does not appear to be enough clarity demonstrated around the additional value.

10. Where internal resource has the capability and there is a possibility of overlap or duplication of work, we would look for DCC to demonstrate more clearly the need to engage with external services and demonstrate clear lines of scope on the end product compared to other ongoing development activity.

11. Consequently, we support the proposal to disallow £0.455m of external service costs in RY18/19 as not economic, efficient or justifiable.

Question 4: What is your view on our proposal to disallow variance in forecast internal costs?

12. It is very disappointing to see that DCC's Internal Costs were 38% higher for the Regulatory Year 2018/19 than forecast a year previously. Suppliers operate their businesses from known or assumed positions within the competitive environment; financial escalations of this magnitude can have serious commercial consequences on the viability of suppliers and the service and products they deliver to end-to-end customers.

13. There is a significant growth in internal costs that appears to be driven by additional programme complexity and scope and we are concerned that this is a somewhat vague umbrella under which to seemingly justify cost increases with appropriate governance and oversight.

14. It would be particularly disappointing if activities that should be part of DCC's basic core service offering were being repackaged as additional services in order to justify extra cost allowances. We look to Ofgem for assurances that this is not the case now and in the future.

15. Finally, we support the observation made in the consultation that DCC have made no specific mention of cost efficiencies going forward. It is essential that DCC activities are not simply seen as a "cost plus" exercise, and it is disappointing that long term payroll levels remain flat from RY21/22 without reference to efficiencies or as certain projects draw to a close. We support the proposal to disallow such costs from RY21/22.

Question 5: What are your views on our proposed position on DCC's operational performance?

16. Although DCC met the majority of Operation Performance Measures, some of these measures do not adequately reflect the overall performance of DCC. Many customers are having a poor experience of smart metering as service requests and responses are not being processed correctly by DCC. For example, the percentage of service responses delivered

within Target Response Times (SDM2) has been met, but Install/commission and firmware management activities continue to be impacted by the failure to receive responses from devices that have been installed. DCC acknowledges that this is an issue and it is investigating why they are failing to process device responses within target response times during busy periods, resulting in suppliers received unexpected volumes of E21 DCC Alerts (Communications Failure – No Response Received from Device). This demonstrates that Operation Performance Measures need to be reviewed to ensure that they monitor critical elements of DCC that affect customers.

Question 6: What are your views regarding DCC's failure to ensure all CSPs met their contractual milestones and our proposed performance adjustments in response to this?

17. Failure of the CSP to meet coverage requirements in the north region significantly affected npower's ability to release candidates for smart deployment. Customers lost out on benefits of smart metering during this period and missed out on opportunities to receive better information about their energy consumption and control costs. Npower released the deployment constraints related to Wide Area Network (WAN) coverage on the affected sites once the CSP provided coverage and updated in the WAN Matrix.

Question 7: 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?

18. The reporting obligations for the SDM'S to ensure that the monitoring and reporting, reflects the experience of users of the DCC system. The development of the Technical Operating Centre (TOC) and its rollout to customers including manufacturers is welcome. This system now provides a valuable source of data allowing customers to evaluate all aspects of installation performance and Data quality.

19. As noted in Q5 there needs to be greater focus on the underlying performance impact of all aspects of technical development either through Comms hubs upgrades or through migration systems development activity. These need to be included in the analysis of operating performance as they can lead to substantial on costs and these delays should be transparent in their impact on performance and costs. Therefore this is a key area for modification and improvement.

20. Equally the purchase of goods from DCC has posed a number of issues for suppliers in implementing deployment programmes which have been impacted by technical delays and derogation dates.

21. Reporting on overall stock levels should enable DCC to negotiate shorter lead times with its major suppliers and explore vendor managed stock options with them to ensure purchasers are not penalised by technical issues outside of their control .There are no current short/medium term options for balancing stock across the Industry until the order window closes from month to month which does not allow purchasers to manage risk effectively

Question 8: What are your views on our proposed position on DCC's project performance?

22. We support Ofgem's position on DCC's R2.0 project performance. Delays in the delivery of Single Band and Dual Band Communications Hubs in UIT environments and the availability of production Dual Band Communications Hubs has affected npower's ability to deploy and operated smart metering in many customer premises.

Question 9: What are your views on our proposed position on DCC's switching performance?

23. We support Ofgem's position on the DCC switching performance

Question 10: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

24. The Baseline Margin adjustment was included in the DCC license to compensate DCC for material changes in certain aspects of its Mandatory Business and as with previous periods a number of adjustments have been requested this year. Clearly Ofgem has scrutinised these applications in detail, and to a large extent we have to rely and trust such scrutiny as without having sight of the detail behind each one it is difficult to make an informed judgement on the merits of each application. However, there does seem to be a lot of applications and whilst a number of these have been rejected or revised, our main concern is that this is seen as a negotiating process whereby many applications are made in the hope of some being approved. We rely very much on Ofgem's scrutiny to gain comfort that this is not the case.

25. We understand that this process operates under the terms of the DCC License, and therefore if the criteria for a margin adjustment are met then this has to be approved, but as with previous years we are concerned that DCC is able to increase its margin at a time when industry costs continue to rise.

26. Consequently, we support the proposal to make the relevant adjustments to the Baseline Margin.

Question 11: What are your views on cost uncertainty in relation to Baseline Margin applications and the process for dealing with this issue?

27. We agree that there needs to be an element of balance when considering uncertain costs in the Baseline Margin to ensure that appropriate incentives exist to drive cost efficiencies. The overarching principle should always remain that Baseline Margin should not be earned on costs that have not been incurred.

28. The consultation comments that DCC have provided insufficient, or no, grounds for some of the applications which further support the view that this may be seen as a negotiating process. Also, if insufficient, or no, grounds are given then this could be construed as over inflation of the base position rather than genuine uncertainty.

Question 12: What are your views on our assessment of DCC's application to adjust its ECGS?

29. It would appear from the consultation that DCC have met the criteria for External Contract Gain Share, and provided that Ofgem are satisfied that DCC have played a key role in securing the adjusted level of savings then it is appropriate for DCC to have a share of the benefits. We therefore support the assessment of the DCC application subject to it meeting Ofgem scrutiny and oversight.

30. It should be noted that whilst the savings and benefits are substantial in this area and therefore welcomed, there is still a question as to why these were not recognised during the initial contracting period and therefore what risk may exist in future or other current contracts.