Decision

DCC Price Control: Regulatory Year 2018/19

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Overview:

The Data and Communications Company (DCC) is required to report Price Control Information by 31 July each year (report). It must report in accordance with the Regulatory Instructions and Guidance that we publish.

Each July, DCC can also propose an adjustment to its Baseline Margin and External Contract Gain Share values. We assess these proposals and determine whether any adjustments are justified.

In October 2019, we consulted on our proposals following a review of the report and information submitted by DCC in July 2019 for the Regulatory Year from 1 April 2018 until 31 March 2019.

This document sets out our decisions and the reasons for them on the costs DCC reported under its price control for the Regulatory Year 2018/19 and its application to adjust the Baseline Margin and External Contract Gain Share values under the Licence.

Alongside this document we have published notices of our Price Control Decisions and Determinations and Directions relating to the calculation of Allowed Revenue set out in the Price Control Conditions in the Licence.

DCC, its service users and other interested parties should read this document.

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Executive summary

DCC has an essential role to play in the energy market. It is important that DCC receives sufficient funds to play its role well, and it is equally important that we hold DCC to account for delivering value for money and high quality services. Through the price control, Ofgem is seeking to ensure that DCC continues to be able to make the required investments to deliver a good quality of service, whilst also focusing the organisation on delivering an efficient operation.

These are our final determinations for the DCC price control for the regulatory year 2018/19 (RY18/19). Our decisions reflect our conclusions on the economic and efficient level of costs incurred in RY18/19 and in the cost forecasts, DCC's performance under the Operational Performance Regime (OPR) and Baseline Margin Project Performance Adjustment Scheme (BMPPAS), adjustments to the Baseline Margin (BM) values set out in the licence and the External Contract Gain Share (ECGS) term. Our final determination follow from our assessment and October consultation on DCC's costs, performance and relevant notices.

Cost Assessment

Following our decision, in RY18/19 total costs (excluding pass-through costs) were £375m, £77.8m or 26% higher than forecast last year. Over the Licence term, total costs (excluding pass-through costs) are now forecast to be £3.59bn, an increase of £719m, or 25%, compared to last year's forecast. The variance in costs can be attributed to new scope activities, cost of additional activities not fully scoped becoming clearer, changes in project specifications and additional testing.

After considering all consultation responses, including that from DCC, we have determined that a total of £1.088m incurred Internal Costs in RY18/19 (including the associated shared service charge) as unacceptable. Our determination on Unacceptable Costs includes levels of remuneration for some DCC contractors that have not been justified and the costs of an external service procured to deliver a KPI dashboard.

We have determined a total of £218.4m increase in forecast Internal Costs (RY21/22 onwards) as unacceptable. DCC has not justified these costs, and we consider these costs are not sufficiently certain to include in DCC's future Allowed Revenue. DCC did not highlight any efficiency and headcount reduction plans, which we would expect to see in future price control submissions. We will in the future also expect DCC to provide fuller assurance around the trade-offs they make in contract negotiations and robust evidence of how DCC's new customer engagement approach has been applied to inform decision-making.

We welcomed the commitment by DCC in its response to the RY17/18 consultation to "undertake an in-depth review of Capita Shared Services to provide greater assurance of their value for money." We remain concerned about the ongoing lack of clarity over the services that should be provided under the Shared Service Charge and expect DCC to share the results of its ongoing review before the next price control submission.

Performance Incentives

All of DCC's Baseline Margin (including adjustments) is at risk against one of DCC's performance regimes. This was the first year in which DCC's performance was assessed under the OPR and BMPPAS.

We have considered the responses received and our consultation position remains unchanged. We have determined an additional reduction to DCC's Allowed Revenue of £1.267m compared to DCC's submission to us, resulting in a total reduction of £1.305m due to DCC's performance issues in the CSP North region under the OPR, and £0.093m due to DCC's performance under the R2.0 BMPPAS in RY18/19.

Separately to the BM, DCC receives margin on the Switching Programme, which is at risk under a separate performance regime. The first milestones of this performance regime were assessed this year. We determined that DCC met Transition Milestones 1, 2 and 3a and therefore should retain the margin associated with these milestones. The final values these milestones represent in terms of margin retained will be finalised when the Transitional Phase concludes.

Baseline Margin

The Baseline Margin (BM) adjustment mechanism was included in the Licence to recognise the uncertainty and risk of DCC's Mandatory Business over time. It is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business under the Licence.

DCC applied for an £11.05m adjustment to its Baseline Margin (BM) for RY18/19 to RY20/21 for increases in the volume and complexity of work caused by both new drivers and drivers previously identified by DCC. Following consideration of the consultation responses, our position on DCC's application for adjustments to its BM remains unchanged.

We have directed a reduced adjustment of £8.08m to reflect:

- the price control decisions on unacceptable costs.
- parts of DCC's application, where we have not seen sufficient evidence of a material change that could not have been foreseen, or for which the driver does not appear to meet the conditions in the Licence.
- reduction in DCC's application by an amount proportionate to costs which have not been incurred, but for which DCC has previously been awarded Baseline Margin.

External Contract Gain Share

The DCC Allowed Revenue formula includes an ECGS term that allows for an upward adjustment to DCC's revenue in recognition of a reduction in External Costs that DCC helped achieve. Between RY15/16 and RY18/19, DCC has secured cost reductions of £99.5m in External Costs based on DCC's ECGS applications, and brought benefits of £53.1m (53% of total cost reductions) to DCC's customers through lower charges.

DCC applied to adjust this term for RY20/21 to RY25/26 reflecting a reduction in External Costs as a result of savings from further refinancing agreement for the fundamental service providers' set-up charges. Following consideration of consultation responses and the additional evidence provided by DCC, we have changed our position. We are no longer rejecting £0.197m relating to the SMETS1 programme and instead we are awarding the full ECGS Adjustment of £8.21m.

Allowed Revenue Decision

Our decisions on the various components outlined above results in a total Allowed Revenue over the entire licence period of £3.850bn (including pass-through costs). Please see Appendix 1 for Allowed Revenue as proposed by DCC and the impacts of this year's decision.

OPR review

DCC's performance is critical to the success of the smart meter rollout and enabling suppliers to provide a good service to their customers thereafter. We are currently reviewing the OPR as we are concerned it may not be providing the best targeted incentives to DCC, and may not be reflecting customer experiences. In response to our consultation question, we received a range of views on how the OPR can be modified to better incentivise DCC to provide a good service to its customers and deliver upon its objectives.

We will be publishing a working paper shortly setting out emerging thinking on the OPR review. We plan to publish a consultation in spring 2020 and publish the decision by the end of 2020. This will allow the new OPR to take effect in RY21/22.

1. Introduction

Context

1.1. DCC is the central communications body licensed to provide the communications, data transfer and management required to support smart metering. It is responsible for linking smart meters in homes and small businesses with the systems of energy suppliers, network operators and other companies.

1.2. Under the DCC regulatory framework, we have a role in ensuring that DCC's costs are incurred economically and efficiently. We review DCC's costs and performance after the end of the Regulatory Year in which the costs were incurred, as well as forecast costs that DCC deem certain enough to include in its forecast Allowed Revenue. This approach is referred to as an 'ex-post' price control. DCC must submit price control information by 31 July following each Regulatory Year in line with the Regulatory Instructions and Guidance (RIGs).[1] Price control reporting covering the Regulatory Year from 1 April 2018 until 31 March 2019 was submitted on 31 July 2019.

1.3. Over the licence term the majority of DCC costs are incurred by its Fundamental Service Providers (FSPs), comprising of the Communication Service Providers (CSPs) and the Data Service Provider (DSP), who are responsible for delivering the data and communications services to support smart metering, and were appointed through a competitive tender process. One of DCC's key responsibilities is to effectively manage these large external contracts and ensure value for money and good quality service for consumers. The costs incurred by the FSPs are referred to as External Costs within DCC's allowed revenue.

1.4. All other costs incurred by DCC in relation to the provision of the service are either Internal Costs, Pass-Through Costs[2], or costs associated with the Centralised Registration Service.[3]

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[1] https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2019

[2] Principally the cost of the Alternative HAN Company and the Smart Energy Code administration secretariat.

[3] Centralised Registration Service refers to the switching programme

1.5. In each Regulatory Year an amount of additional revenue, over and above the sum of the Internal Costs and External Costs is included in the Allowed Revenue – this is the Baseline Margin. Each July, DCC can propose an adjustment to its Baseline Margin values. We assess this proposal and determine whether to adjust the values agreed when the Licence was awarded. DCC's Baseline Margin is at risk against its performance previously under the Implementation Performance Regime (IPR) and now against the Operational Performance Regime (OPR) and government directed Project Performance Regimes. We determine the outcome of this performance as part of our price control assessment.

1.6. Separately, DCC receives a percentage margin on the Centralised Registration Service programme. This margin is subject to a separate performance regime.

1.7. DCC also submitted an application to amend the ECGS term of its Allowed Revenue following External Cost savings. The ECGS is a mechanism within the price control for DCC to apply to increase its Allowed Revenue recognising its instrumental role in reducing External Costs.

Our decision making process

1.8. The DCC Price Control process can be viewed in the wider context of helping to achieve Ofgem's key priorities:

- Enabling a better functioning retail market which protects the interests of consumers;
- Facilitating change in the energy system to enable competition and innovation; and
- A smarter, more flexible energy system to facilitate decarbonising at lowest cost.

1.9. As required by the DCC Licence[4], our assessment of DCC costs is grounded in comparing DCC's incurred costs and revised forecast with DCC's Licence Application Business Plan (LABP) and the previous year's forecast. Our guidance document[5] sets

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[4] Licence condition 37 of the Smart Meter Communication Licence
[5] https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures-2019

out the approach in detail and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient.

1.10. We published a consultation in October 2019[6] with our detailed proposals concerning RY18/19, and conducted a stakeholder meeting on the consultation in November 2019. This document sets out our decisions on DCC's:

- Economic and efficient incurred and forecast External Costs and Internal Costs for RY18/19 (Section 2 and Section 3);
- Performance under the Operational Performance Regime (OPR) (section 4);
- Performance under the Switching incentives regime (section 4);
- Application for an adjustment to its Baseline Margin (Section 5);
- Application for an adjustment to External Contract Gain Share (Section 5);

1.11. We received 14 responses, including one confidential response. All non-confidential responses are published on our website.[7] We have fully considered all responses received to our consultation. We have summarised the key points received from the consultation and provide an explanation of the reasons for our decisions in light of these.

1.12. Please note that we may provide feedback to DCC directly on the detailed points it raised in its consultation response.

1.13. A Notice of our price control decision, determinations and directions accompanies this document. We also include a Notice providing DCC with a direction so that it can reflect our decisions in its next Charging Statement.

1.14. For further context to these decisions please read this document alongside our October 2019 consultation. The consultation document describes how DCC's costs have changed since the previous year and outlines our view on whether we think DCC's explanation in its price control submission justifies the cost variances. It also

[6] https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201819
[7] Ibid.

summarises our proposals on whether to accept DCC's application to adjust the BM and ECGS terms.

Related Publications

1.15. The 2018/19 Price Control Consultation Document is at: https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201819

1.16. The DCC Regulatory Instructions and Guidance 2019 is at: https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2019

1.17. The DCC Price Control Guidance: Processes and Procedures 2019 is at: https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures-2019

1.18. The DCC Licence is at: https://epr.ofgem.gov.uk/Content/Documents/Smart%20DCC%20Limited%20-%20Smart%20Meter%20Communication%20Consolidated%20Licence%20Conditions%20-%20Current%20Version.pdf

Your feedback

1.19. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

Please send any general feedback comments to smartmetering@ofgem.gov.uk.

2. External Costs

Section summary

Respondents broadly agreed with our assessment of DCC's External Costs. However, respondents raised concerns about quality of service failings, delays, and increased SMETS1 programme costs. From the information provided by DCC we consider that the External Costs reported under the price control in RY18/19 were economic and efficient. However, we expect DCC to ensure its contract management processes are robust, strengthen its approach to customer engagement and increase transparency wherever possible.

Questions

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

Proposal at consultation: We consider incurred and forecast External Costs are economic and efficient as reported in RY18/19.

Decision: Remains unchanged from consultation proposal.

Respondents' views

2.1. Respondents broadly supported our proposal, whilst noting that they were unable to make their own assessment of whether these costs were incurred economically or efficiently due to the lack of information that was available to them. It is therefore important that Ofgem is satisfied that DCC's External Costs have been thoroughly scrutinised in order to provide assurances that they were incurred economically and efficiently.

2.2. One respondent disagreed with our assessment, highlighting concerns with the costs associated with Arqiva and poor performance in the North region. This concern was also raised by several other respondents, who questioned the justification for increasing costs in light of poor performance and sought further information. Respondents also noted that some Change Requests could have been avoided through better customer engagement, and that delays had led to increased costs.

Reasons for our decision

2.3. We acknowledge that it is difficult for respondents to fully assess DCC's performance, as respondents have poor visibility of DCC's External Costs for commercial confidentiality reasons. In order to be as transparent as possible, our October 2019 consultation contained information on the main Change Requests, the SMETS1 programme, and the negotiations to secure new contracts with the SMETS1 service providers.

2.4. While we recognise that not all information can be made public, we are satisfied with the level of explanation and evidence DCC provided to us for the cost variances in RY18/19. It is our view that DCC provided sufficient justification on the SMETS1 programme and associated Change Requests. We are satisfied with DCC's evidence on driving good commercial outcomes through due diligence processes, and efforts to seek efficiencies through alternative delivery methods.

2.5. In its consultation response DCC also committed to providing fuller assurance in future price control submissions 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 the contract.

2.6. We continue to explore ways in which to share as much information as possible with stakeholders. Following our stakeholder meeting in November, DCC committed to providing further details on contract management and headcounts by programme at the upcoming quarterly finance forums, and we encourage stakeholders to make full use of these forums.

2.7. We encourage DCC to take note of the concerns raised regarding delays leading to increased costs, specific cost elements and Change Requests, and improving transparency to stakeholders, particularly around contract negotiations.

2.8. We are exploring how the OPR, which puts DCC's Baseline Margin at risk, could be modified to optimise the performance incentives on DCC. Section 4 summarises views given in consultation responses on how the OPR metrics could be modified to better incentivise DCC to provide a good service to its customers and deliver upon its objectives.

3. Internal Costs

Section summary

The majority of respondents broadly agreed with Ofgem's assessment of the DCC's internal costs. This chapter summarises respondents' views and states our final decision.

We consider, based on the information provided by DCC and other respondents, a proportion of internal costs not to be economic and efficient. We have therefore determined these costs as unacceptable costs under the Licence. As such, we direct that £1.088m from DCC's internal costs in 2018/19 are unacceptable and that £218.4m should not be included in internal cost forecasts.

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

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

Question 4: What are your views on our proposal to disallow all variance in forecast internal costs?

3.1. DCC's 18/19 price control submission stated that internal costs over the whole licence term were forecast to be £443.2m.

3.2. For the majority of costs, DCC has provided sufficient justification and evidence for the costs incurred in RY18/19. However, our cost assessment has revealed some incurred costs which we do not consider to be economic and efficient. We also consider that a significant proportion of DCC's forecast costs are not sufficiently certain enough for us to allow as forecast Allowed Revenue at this stage.

3.3. Under Licence Condition 37, costs that we find were not economically and efficiently incurred by DCC are described as "Unacceptable Costs". In respect of such costs we are required to direct whether Unacceptable Costs are to be excluded from any future calculation of DCC's Allowed Revenue, or to accept an undertaking from DCC on how it will manage Unacceptable Costs and future procurement of relevant service capability.

3.4. DCC did not propose an undertaking therefore we determine that £1.088m of DCC's incurred and £218.4m of DCC's forecast internal costs are unacceptable, such that DCC's internal costs over the whole Licence term are £224.8m.

Payroll Costs

Proposal at consultation: Insufficient evidence was provided on any robust internal governance process to recruiting contractors and appropriate use of benchmarking to determine rates, as a result of which we proposed to disallow £0.539m of contractor cost in RY18/19.

Decision: Remains unchanged from the consultation proposal.

Respondents' views

3.5. The majority of the respondents generally supported our approach. Most of the respondents expressed strong concern about the continued increase in full time employees (FTE) numbers. Three respondents suggested benchmarking the number of staff needed to operate as a "lean and agile" Licence holder of similar stature and responsibility. One respondent suggested that DCC benchmark headcount against comparable communications-providing organisations.

3.6. Several respondents said that DCC should be more transparent on their FTE projections and suggested that DCC should offer more detail regarding the division of FTE between specific projects and business as usual (BAU) activities. DCC should be more explicit in assigning projected headcounts and staff splits to specific current and proposed programmes such as the Next Generation Communication Hubs and Automation of Testing.

3.7. Three respondents pointed out that the whole remuneration package must be benchmarked and not just the basic salary, as high bonuses or significant additional benefits all add to staff costs. One respondent further added that for the kind of projects DCC delivers, it is anticipated that bonus payments would occur for delivery. Thus the gap in the benchmark (by not including bonus and any other benefits which are part of the whole remuneration) still does not provide transparency as to whether salary payments for permanent staff or contractual staff are fair and reasonable.

3.8. One respondent noted that benchmarking could overstate staff remuneration if job descriptions shared with the independent recruitment consultancy inflate responsibilities or have little resemblance to the actual role undertaken. A sample check of the Hayes benchmark, job description and role undertaken by an individual was suggested to ensure that DCC's benchmarking method itself was robust.

3.9. One respondent highlighted the perverse incentive to high payroll costs as increased internal costs adds to Capita's overhead charge, at 9.5% and possibly to DCC's baseline margin.

3.10. One respondent said that DCC should be able to hire to an appropriate level and transparency and benchmarking should not restrict this activity. However, the respondent agreed that DCC should implement robust internal processes and there is a lack of transparency that must be addressed.

3.11. One respondent considered that DCC has taken adequate measures to ensure the timely recruitment of appropriate staff at justifiable rates; another was pleased to see DCC focussing on reducing the number of contractors in relation to permanent staff.

3.12. In response to the consultation, DCC provided additional evidence in the form of individual justifications for those contractor roles for which we have proposed to disallow the costs falling above reasonable market rates. They have justified only those roles for which pay is more than 10% above the 50th percentile of the generic benchmark.

Reasons for our decision

3.13. We have reviewed the responses we received, including the additional evidence provided by DCC. We have not received sufficient evidence to change our consultation position.

3.14. As we stated in last year's consultation and decision documents and in the consultation document for DCC price control RY18/19, we expect DCC to apply a consistently robust approach to recruiting contractors and we expect DCC to provide evidence of the internal processes it follows and the decision making process especially when remuneration exceeds 50th percentile of the generic benchmark. In the absence of any additional evidence as to the robustness of DCC's recruitment processes, we are unable to conclude that the disallowed contractor costs which fall above benchmarked market rates were economic and efficient.

3.15. The additional evidence provided by DCC demonstrates that the roles have been filled to meet genuine business need. While it is possible that some or most of the costs may be economic and efficient, we have not received enough evidence or the assurance to conclusively decide that the payments above reasonable market rates were made by following a systematic and robust internal process and can thus be considered as economic and efficient.

3.16. When providing additional evidence DCC noted that it provided the wrong benchmark range for some of the roles. This was a concern raised by one of the respondents that if the benchmarking method is not robust enough, it can lead to devaluing or inflating the benchmarked rates. In future, we expect DCC's internal recruitment process to include sample checks of the benchmarks used, job description and the actual role undertaken by an individual to avoid such errors.

3.17. We note respondents' concerns on the transparency around bonus payments. In future price control submissions, we would expect more justification around bonus payments, given that DCC has also launched a new Retention Bonus Scheme.

3.18. Following our stakeholder meet on DCC price control held in November 2019, DCC said that it will provide a breakdown of headcount by programme at its quarterly finance forums. We encourage stakeholders to participate in these forums and DCC to share information on headcount by current and proposed programmes.

3.19. We reiterate the need for a robust internal recruitment process with the right checks and balances to ensure recruitment is economic and efficient. We remain open to exploring, with DCC, options around the establishment of an auditable recruitment process.

External Services

Proposal at consultation: Insufficient evidence was provided to justify the development of the KPI dashboard through external services when in the same year CR1014 costs were incurred and TOC implemented a KPI dashboard - as a result of which we proposed to disallow all costs associated with the external service to develop a KPI Dashboard, which amount to £0.455m.

Decision: Remains unchanged from the consultation proposal.

Respondents' views

3.20. All respondents except DCC supported our approach. Several respondents pointed out that DCC did not engage with its customers on the development of the KPI dashboard. It was suggested that DCC should engage with users on projects meant for and paid by its users ahead of the project's development.

3.21. Two respondents pointed out that with DCC's headcount and expenditure on external services growing, DCC should sufficiently justify any further procurement through a business case and industry engagement where possible.

3.22. Several respondents agreed that where internal resource has the capability and there is a possibility of overlap or duplication of work, DCC should justify the need to procure external services and demonstrate clear lines of scope for the service being procured relative to other ongoing in-house development activity.

3.23. Two respondents pointed out that the Technical Operations Centre (TOC) is a valuable capability and a KPI dashboard will be a useful part of this capability. They however agreed that unless DCC can provide further evidence of how the procurement created additional value for the TOC, the costs to develop the KPI Dashboard should be disallowed.

3.24. In response to our consultation position, DCC stated that the KPI project was designed to test the benefits of moving from monthly KPI reporting to real time analysis and performance management. DCC further added that the KPI project created the core dashboards and the underlying data engines for TOC. The KPI project also informed the development of an underpinning data strategy for DCC and helped align all the requirements for information into one place.

Reasons for our decision

3.25. We have reviewed the responses received, including the additional explanation provided by DCC. We have not received sufficient evidence for us to change our consultation position.

3.26. In its Price Control submission, DCC stated that the procurement for the KPI dashboard under the Corporate Management cost centre was to create the monitoring tool which would enable its senior management (ExCo) to monitor progress and identify risk areas and that the dashboard replaced a tactical solution already in place. DCC's response to the consultation differs from this and DCC has not provided any explanation for this difference.

3.27. DCC states that the KPI project created the core dashboards and the underlying data engines for the TOC and that these functionalities could not have been developed within BIMI (a business information management tool). In addition to the KPI project costs, under the Programme cost centre DCC reported BIMI change request costs (CR1014) amounting to £0.248m which facilitated the establishment of the TOC's 'Monitoring and Alerting – Strategic' project.

3.28. In its submission and response to the consultation DCC did not establish the links between the different costs incurred under various categories and cost centres which contributed to the KPI dashboard produced through the TIX and EDAM tools of the TOC Programme. We are therefore unable to conclude on the true scale of expenses incurred in establishing the KPI dashboard for TOC and if all elements of it were value for money.

3.29. We are unable to reconcile the conflicting information provided by DCC as part of its submission and response to the consultation. Moreover, in the absence of any additional evidence demonstrating clear lines of scope and establishing clear value for money links between the KPI project, the costs associated with CR1014 and the KPI Dashboard being produced under the TOC, we maintain our consultation position to disallow all costs associated with the external service to develop a KPI Dashboard.

Forecast costs

Proposal at consultation: Insufficient justification was provided for the variance in internal forecast costs (including SMETS1 and Switching costs) from RY21/22, as a result of which we proposed to disallow all variance in internal forecast costs (including the associated shared services costs) from RY21/22 which amount to £235.9m.

Decision: Remains unchanged from the consultation proposal. However, to account for a mathematical error the disallowed amount is now revised to £218.4m.

Respondents' views

3.30. DCC did not disagree with our position and stated that it aims to provide accurate forecasts and reduce the volatility of cost movement, however the threshold of certainty is not always met due to the level of change that DCC and the wider industry is subject to. DCC further noted that the forecasts being shared with its customers on a quarterly basis are only included within the annual price control submission if they meet the appropriate level of certainty.

3.31. All other respondents explicitly supported our proposal to disallow all increases in forecast costs from RY21/22. Respondents were concerned about the accuracy of DCC's forecast costs, the level of increase in DCC's forecast costs and absence of any planned cost efficiencies.

3.32. Several respondents noted that it is not very clear what proportion of the rise in forecast costs are due to new or additional services and one respondent raised concern around the basic core service offering being repackaged as additional services. One respondent therefore suggested that DCC should explicitly classify forecast costs into categories of costs required to keep the DCC at a 'steady state' of base-level operations and costs required for any future expansion of the DCC remit.

Reasons for our decision

3.33. Our decision to disallow the increase in forecast internal costs from RY21/22 to the end of the Licence term remains unchanged from our consultation position.

3.34. Since publication of our consultation, we noted an error in the calculation of the variance in forecast internal costs and have therefore revised the disallowed amount from £235.9m to £218.4m.

4. Performance Incentives

Section summary

This section covers DCC's performance under the Operational Performance Regime (OPR), any relevant Baseline Margin Project Performance Adjustment Schemes, and the Switching incentive regime.

In our consultation, we proposed to increase the reduction to DCC's Baseline Margin (BM) due to DCC's performance under the OPR by £1.267m (from DCC's submitted £0.038m to £1.305m). We also proposed no changes to the reduction DCC submitted due to its project performance (£0.093m of the total £0.124m in RY18/19) and switching performance.

Following consideration of the consultation responses our positions remain unchanged.

In our consultation document, we announced our intention to review the OPR, and sought stakeholder views on how the OPR could be modified to better incentivise DCC. We have summarised the responses we received in this section. We have also set out the next steps in developing the new OPR.

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

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?

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?

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

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

Background

4.1. All of DCC's BM (including adjustments) is at risk against one of DCC's performance regimes.

4.2. DCC's performance in RY17/18 was not assessed through a performance regime as the IPR had concluded and the OPR was yet to begin. All of the Baseline Margin recovered in RY17/18 is being put at risk across RY18/19, RY19/20 and RY20/21.

4.3. This year is the first year in which DCC's performance is being assessed by the Operational Performance Regime (OPR), and by a Baseline Margin Project Performance Adjustment Scheme (BMPPAS). All of DCC's BM is at risk under these performance regimes.

4.4. Separately to the BM, DCC receives margin on the Switching Programme. This Switching margin is at risk under a separate performance regime. The first milestones of this performance regime have been assessed in this year.

Operational Performance

Proposal at consultation: Direct an additional reduction to DCC's Allowed Revenue of £1.267m due to DCC's performance under the OPR, resulting in a total reduction of £1.305m due to DCC's performance under the OPR, and £0.124m due to DCC's performance under the R2.0 Baseline Margin Project Performance Adjustment Scheme in RY18/19.

Decision: Remains unchanged from the consultation proposal.

Context

4.5. The OPR was initially consulted on in March 2016 and the final decision and direction was published in September 2017.

4.6. The OPR consists of five equally weighted performance measures: two Service User Measures (SUM) and three Service Delivery Measures (SDM). Table 4.1 lists the five measures and their subdivisions.

Table 4.1 Operational Performance Measures

<table>
<tr><th>Measure</th><th>Area of reporting</th><th>Metric</th><th>Weighting</th></tr>
<tr><td>SUM1</td><td>DCC service desk</td><td>Percentage of incidents resolved within Target Resolution Time</td><td>20%</td></tr>
<tr><td>SUM2a</td><td rowspan="3">Communication Hubs</td><td>Percentage of Communications Hubs delivered on time</td><td>10%</td></tr>
<tr><td>SUM2b</td><td>Percentage of Communications Hubs accepted by customers</td><td>5%</td></tr>
<tr><td>SUM2c</td><td>Percentage of Communications Hubs not faulty at installation</td><td>5%</td></tr>
<tr><td>SDM1a</td><td rowspan="2">DCC WAN coverage</td><td>All CSP contractual milestone dates met</td><td rowspan="2">20%</td></tr>
<tr><td>SDM1b</td><td>Percentage of first time SMWAN connectivity at install</td></tr>
<tr><td>SDM2</td><td>Core service requests</td><td>Percentage of service responses delivered within Target Response Time</td><td>20%</td></tr>
<tr><td>SDM3</td><td>Service/System Availability</td><td>Percentage availability of Data Service, User Gateway, Service Management System and Self Service Interface</td><td>20%</td></tr>
</table>

4.7. These OPR performance measures are derived from the performance measures reported to the SEC and described in DCC's Performance Measurement Methodology.

4.8. In its RY18/19 price control submission DCC submitted a reduction in its BM (BMOPA value) of £0.038m due to its performance under the OPR relating to SUM2a. DCC noted that the CSP-N missed one of its coverage milestones (which impacted its performance under SDM1) but proposed no reduction to its BM.

4.9. At consultation we proposed to reduce DCC's Allowed Revenue by £1.305m through the BMOPA term for its performance under the OPR. This represented a reduction of £0.038m related to SUM2a and £1.267m related to SDM1, and was £1.267m more than the reduction proposed by DCC. The proposed reduction reflected a direct quantitative application of the OPR methodology, taking into account the missed coverage milestone in CSP-N under SMD1.

4.10. We also consulted on an alternative option of a decreased reduction with regards to SDM1 of £0.317m as DCC argued that the impact of the missed milestone was minimal. We sought additional evidence from DCC and its stakeholders on the impact, so that we could consider whether there were sufficient grounds for us to move away from the default position.

Respondents' views

4.11. All respondents who commented on this position, except DCC, supported our proposal to reduce DCC's Allowed Revenue by £1.305m.

4.12. DCC provided us with additional evidence to support its position that it should not lose margin in relation to SDM1. It reiterated that only one milestone was missed and attempted to quantify the impact of the missed milestone. DCC stated that coverage levels were 1.25% below target (112k below the target of 8.75m delivery points) and resulted in 51 failed installs due to no SMWAN out of the 29.5k installs performed in the region over the relevant period. DCC also explained that it worked with the CSP-N to resolve the issue, resulting in the milestone being met three months late. DCC provided quotes from two customers stating that the impact was low and that other issues in the region were of greater concern.

4.13. Six respondents highlighted that the CSP-N's performance has been very poor in general, such that this issue was not isolated and was in fact one of many.

4.14. Four respondents stated that the poor performance of the CSP-N made it difficult to quantify the impact of the missed milestone, and that the real impact of the missed milestone cannot be assessed absent of the many other issues in the North. The respondents explained that this is because these other issues were more severe and prevented suppliers from rolling out meters in areas impacted by the missed milestone.

4.15. Five respondents stated that they have no record of ever being informed of this issue. In addition to this, another customer expressed this point in one of the quotes from customers provided by DCC.

4.16. Finally, one respondent believed that in this instance there is little justification for changing the assessment of this metric for being unfavourable to DCC, when no changes are being made to other OPR metrics which, in their view, favour DCC.

Reasons for our decision

4.17. We have reviewed the responses we received, including the additional evidence provided by DCC. We believe that there is insufficient evidence for us to change our consultation position.

4.18. We accept DCC's argument that it worked with the Communications Service Provider in an effort to reduce the delay meeting the milestone and that, when considered in isolation, the impact of missing the milestone was relatively small.

4.19. However, we need to have sufficient evidence to justify moving away from the default position of the OPR (which is to reduce the BM by the full £1.267m related to SDM1 because of the missed coverage milestone). Having now considered stakeholders' responses to the consultation we do not believe it is appropriate to narrowly focus on the impact of the missed milestone given that the overarching purpose of the OPR is to drive DCC to deliver a good service to its customers. Therefore we are looking at the broader context of the issue.

4.20. There are two particular issues of concern that have been highlighted in stakeholder responses that have factored in our decision:

4.20.1. There are wider issues with performance in the North region. DCC's customers told us that the quality of service provided by CSP-N has been unacceptable in a number of areas. DCC is accountable for the performance of its service providers, but this missed milestone is the only aspect of this poor performance that has been captured by the OPR.

4.20.2. DCC did not inform its customers of the missed milestone at the time it occurred. In the RY17/18 price control, we stated that we expect DCC's engagement with its customers to be transparent, which includes both costs and performance. Clearly DCC did not follow this principle with regard to its engagement on this issue.

4.21. Therefore, considering the full context of the situation, there is insufficient justification for us to modify the default OPR position of reducing the retained BM by the full value associated with the SDM1 milestone £1.267m.

4.22. Regarding SUM2a (percentage of on-time communication hub deliveries), in the absence of any additional evidence we maintain our consultation position (the default position of the OPR) to reduce the retained BM by £0.038m.

4.23. Therefore, as there are no changes to our consultation position the BMOPA term is calculated to be £1.305m.

Project Performance

Proposal at consultation: DCC submitted its performance values for R2.0 project. The total reduction in the BM this year is £0.093m, 74% of the total possible £0.124m. In addition, DCC will have its BM reduced by a minimum of £0.386m across future years because of the missed milestones. We identified no issues with DCC's reporting of its performance in the R2.0 project. We note that DCC has performed poorly in meeting the milestones set out in the BMPPAS.

Decision: Remains unchanged from consultation proposal.

4.24. The Secretary of State may create a BMPPAS which defines a Project and describes the incentive regime which determines the proportion of the BM associated with that Project that DCC retains. BM adjustments which are awarded to DCC for work associated with such a Project are held at risk by the BMPPAS incentive regime.

4.25. Any reductions made due to a BMPPAS incentive regime are made through the BMPPA term given in the Licence.

4.26. This is the first year in which a BMPPAS incentive regime has come into effect. The BMPPAS is in relation to the R2.0 project.

Respondents' views

4.27. Most respondents agreed with our consultation position and believed that DCC performed poorly in meeting the milestones for this project.

4.28. One respondent agreed that Ofgem should impose a BMPPA on the basis of missed milestones and failure to deliver a suitable R2.0 solution. However, the respondent argued that 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 end Users. The respondent highlighted that DCC only submitted results for six of the eight milestones described in the R2.0 BMPPAS.

4.29. Two respondents stated that DCC performance in the delivery of defect free Single Band and Dual Band Communications Hubs has affected their ability to deploy and operate Smart Metering in customers' premises.

4.30. Another respondent stated that they have not been able to conduct User Integration Testing on any Dual Band Communication Hubs from either of the CSPs and no plan or timeline is in place for when they will be able to start testing.

4.31. DCC agreed to our proposal.

Reasons for our decision

4.32. We have reviewed all the responses received. We maintain our consultation position and identify no issues with DCC's reporting of its performance related to the R2.0 project.

4.33. With regards to the value of reduction due to the missed milestones, DCC will lose margin in the next two years, a combined value of £0.386m across RY19/20 and RY20/21.

4.34. With regards to concern around the submission of only six out of the eight milestones as described in the R2.0 BMPPAS, 40% of margin depends on the last two milestones which are yet to be determined by the Secretary of State.

4.35. Therefore, as there are no changes to our consultation position the BMPPA term for RY18/19 is calculated to be £0.093m.

Switching

Proposal at consultation: DCC submitted evidence that it met Transition Milestones 1 (CRS Detailed Design), 2 (CSS Tender Packs Issued) and 3a (CSS Contract Award) which were subsequently approved by Ofgem and therefore on the basis of this evidence, DCC should retain all the margin associated with these milestones. We proposed to accept DCC's submission and that DCC should retain all margin associated with Transition Milestones 1, 2 and 3a.

Decision: Remains unchanged from consultation proposal.

4.36. We published our decision on the margin and incentives for DCC's role in the Transitional Phase of the Switching programme in March 2017[8]. An updated incentive regime which included the Design, Build and Test Phase of the programme was then consulted on, with the decision given in May 2019[9]. This is the first year in which milestones of the Switching programme have been assessed.

4.37. The margin and incentives for the Switching programme are entirely separate from the BM and the BM adjustment process.

Respondents' views

4.38. Most respondents broadly agreed with our consultation position. One respondent highlighted concerns around the level of competency within DCC to deliver the Switching programme and believed that DCC should adopt lessons learnt from other large programmes such as SMETS1 with respect to the programme plan, structure and level of resources required for delivery.

[8] https://www.ofgem.gov.uk/publications-and-updates/decision-margin-and-incentives-dccs-role-within-transitional-phase-switching-programme
[9] https://www.ofgem.gov.uk/publications-and-updates/decision-margin-and-incentives-dccs-role-within-design-build-and-test-phase-switching-programme

4.39. Another respondent expressed concern around the appropriate level of ringfencing of costs for the Switching programme and the Smart Metering programme, but welcomed steps taken by DCC to ensure costs are appropriately allocated through the price control process.

4.40. One respondent disagreed with our proposed position due to insufficient evidence to demonstrate that the DCC achieved the Transition Milestones, or that DCC should retain all margin associated with those milestones.

4.41. DCC welcomed our proposal.

Reasons for our decision

4.42. DCC submitted evidence that it met Transition Milestones 1, 2 and 3a and DCC submitted that on the basis of this evidence it should retain all margin associated with these milestones.

4.43. We have reviewed the responses received. We believe DCC have met Transition Milestones 1, 2 and 3a and therefore should retain the margin associated with these milestones.

4.44. The final values these milestones represent in terms of margin retained will be finalised when the Transitional Phase concludes in RY18/19. The final Transition Milestone (3b, Service Management Contract Award) will be assessed as part of the RY19/20 price control.

OPR Review

4.45. We are currently reviewing the OPR as we are concerned it may not be providing the best incentives to DCC, and customer experience could be better reflected. The aim of this review is to ensure incentives placed on DCC are adequate and effective. We asked stakeholders for their views on how the OPR could be modified to better incentivise DCC to provide a good service to its customers and to deliver upon its objectives.

4.46. We received a range of responses expressing views regarding the OPR and how it can be modified to ensure it incentivises DCC adequately and better reflects customer experiences.

4.47. Thirteen respondents addressed this question and expressed views on the OPR. All thirteen respondents, including the DCC, agreed with the need to review the current OPR framework. In reviewing those responses, we have identified a number of overarching themes: customer engagement; system performance; and the efficient delivery of change and management of service providers/contracts.

4.48. We have summarised respondents' views on the OPR review below. Respondents have identified key issues and suggested potential solutions to be considered in the OPR review. We are also publishing a working paper in early March 2020 which outlines these issues and possible areas to assess DCC's performance, to ensure it delivers good customer service and improves its performance levels.

Customer Engagement

4.49. The quality of customer engagement by DCC was underlined by nearly all respondents as a key area where further improvement is needed. Therefore, we are exploring options for incentivising better customer engagement through the OPR review. The working paper explores potential ideas for the introduction of financial incentives to drive DCC to engage with its customers effectively.

4.50. Some respondents highlighted that DCC should engage more effectively with customers when initiating new projects to ensure these projects meet the needs and requirements of customers and provide value for money. Other areas highlighted where DCC's customer engagement was considered to be lacking included in handling of change requests and ad hoc issues such as around Arqiva's performance in the north.

4.51. Furthermore, while respondents broadly welcome DCC's Quarterly Finance Forum, they also provided feedback for DCC on how improvements can be made, which has been shared with DCC.

System Performance

4.52. Nearly all respondents identified specific areas and metrics which could be assessed through the OPR to incentivise the right level of system performance by the DCC. These included both amendments to existing metrics and potential new metrics. The areas that were most commonly highlighted related to firmware, commissioning and Communication Hubs.

4.53. We have been engaging with the SEC Operations Groups (SEC Ops) who are reviewing the SEC Performance Metric Review to ensure metrics capture and measure the correct outputs, which better reflect customer experience. We will be considering the metrics identified above by stakeholders in combination with those identified by the SEC Ops group for the new OPR.

Efficient delivery of change and management of service providers/contracts

4.54. External Costs make up the largest contribution to DCC'c total costs, and it is vital that DCC's contract management and delivery of change are efficient and provide value for money for customers. The OPR review explores whether this area should be incentivised through financial incentives, in order to drive DCC to improve its performance in this area.

4.55. Some respondents were concerned about the increasing change request costs, which are passed on to customers, and the transparency and customer engagement around these costs. One respondent highlighted concerns around DCC's contract management and whether amendments and changes align with customer requirements and priorities.

Next Steps

4.56. The working paper is due to be published in early March 2020 and will give an indication of our emerging thinking and the direction of travel of the OPR review. It will outline a range of areas of DCC's performance that could be incentivised and how this could be done for each area. We welcome your views on the working paper.

4.57. We plan to publish a consultation in Spring 2020 and publish the decision by the end of 2020. This will allow for the new OPR to take effect in RY21/22.

Please send any views regarding the OPR Review to smartmetering@ofgem.gov.uk.

5. Baseline Margin and External Contract Gain Share

Section summary

This section summarises DCC's application for adjustments to its Baseline Margin and External Contract Gain Share.

The Baseline Margin will be adjusted to reflect changes to DCC's Mandatory Business. Following consideration of consultation responses, our position on DCC's application for adjustments to its Baseline Margin remains unchanged. We have directed an adjustment of £8.076m.

The External Contract Gain Share will be adjusted to reflect the cost savings DCC has achieved through refinancing. Following consideration of consultation responses and the additional evidence provided by DCC, we have changed our position, no longer rejecting £0.197m relating to the SMETS1 programme and awarding the full ECGS Adjustment of £8.210m.

The total ECGS savings secured by DCC for customers between RY15/16 (DCC's first ECGS Adjustment application) and RY18/19 (including this year's application) is £53.128m which accounts for 53% of total cost reductions.

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

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

Baseline Margin

Proposal at consultation: Direct an adjustment to DCC's Baseline Margin of £8.076m (RY18/19 prices) for work being performed between RY18/19 and RY20/21. DCC provided insufficient evidence for three of the five new drivers it had identified, and so should not be awarded BM those grounds. DCC's BM should be reduced where incurred costs are lower than originally forecast. 15% is an acceptable margin for the core smart metering activities.

Decision: Remains unchanged from the consultation proposal.

5.1. The Baseline Margin adjustment mechanism allows DCC to apply for a Relevant Adjustment to the Baseline Margin values specified in Appendix 1, Condition 36 of the Licence. The adjustment mechanism is detailed in Appendix 2, Condition 36 of the Licence.

5.2. The Baseline Margin adjustment mechanism was included in the Licence in recognition of the uncertainty of the nature and risks of DCC's Mandatory Business over the Licence term. The adjustment mechanism is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business – including the volume, characteristics, risks and timescales of these activities. Greater detail on the conditions and requirements for a Baseline Margin Relevant Adjustment can be found in the RIGs,[10] and the processes and procedures document.[11]

5.3. DCC's Baseline Margin (including adjustments) is subject to DCC's performance regime under which its Baseline Margin may be reduced for poor performance. The Operational Performance Regime (OPR) began this Regulatory Year (RY18/19), and 100% of the Baseline Margin recovered this year is held to account either by the OPR, or by a Baseline Margin Project Performance Adjustment Scheme directed by the Secretary of State.

[10] https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2019

[11] https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures-2019

Respondents' views

5.4. Most respondents were supportive of our proposals for the Baseline Margin adjustment.

5.5. DCC accepted our proposal to reject the New Scope – Future DCC Activities driver and our reduction to the Facilitating Additional Relevant Services Driver.

5.6. DCC contested our proposed rejection of the Investing in Business Process Volume Management driver in regard to two of its components – EDAM Tools and BSS reconciliation.

5.7. DCC argued that the EDAM Tools are an improvement upon the BIMI tool DCC was initially using to support its regulatory reporting. DCC explained that it is more scalable, better able to manage the end to end service, supports customers around the clock, and is more cost efficient.

5.8. DCC explained that BSS Reconciliation is the most cost effective and accurate way of reconciling charging and billing for Comms Hubs than the current manual process as volumes have increased.

5.9. Four other respondents specifically supported our proposal to reject the Investing in Business Process Volume Management driver.

5.10. DCC also contested our proposed rejection of the Increased Demand for Customer and Stakeholder Engagement driver. DCC provided additional evidence that it has increased its level of customer engagement, and that some existing industry forums are being run on a more frequent basis.

5.11. Five other respondents specifically supported our proposal to reject the Increased Demand for Customer and Stakeholder Engagement driver.

5.12. Most respondents who commented supported our proposal that DCC should not recover Baseline Margin on costs that have not been incurred due to work not having been done, or because DCC has overestimated the cost associated with the work.

5.13. DCC stated that it supported our proposal, but also believes it should retain margin where activities are carried out more efficiently than initially planned and savings were realised by customers.

5.14. One respondent noted that the onus was on DCC to justify the retention of its margin in the case of any decreases in costs.

5.15. Another respondent stated they believed DCC should only receive BM for costs that are certain.

5.16. DCC does not recover Baseline Margin associated with work until after the costs are certain, however it must apply for Baseline Margin in the first Application Window after which the grounds arise and the costs are substantially more likely than not to occur.

5.17. One respondent contested that 15% margin is too high.

Reasons for our decision

5.18. We have reviewed the responses we received, including the additional explanation and evidence provided by DCC. We believe there is insufficient evidence for us to change our consultation position.

5.19. Regarding the Investing in Business Process Volume Management driver, we do not dispute that the EDAM Tools and the BSS Reconciliation are more scalable improvements to their predecessors. However, they do not meet the criteria for a Baseline Margin adjustment given in the Licence. The volumes of smart meters being rolled out are no greater than what was anticipated at LABP (when the original Baseline Margin was determined), therefore the need for more scalable tools and processes would always have been foreseen.

5.20. Regarding the Increased Demand for Customer and Stakeholder Engagement, we do not dispute that DCC's customer engagement activities have increased, nor that some of the existing industry forums have increased in frequency. However, we maintain the view that demand for customer and stakeholder engagement has remained fairly constant, and that DCC has begun to meet this demand where previously there was an engagement deficit. With regard to the increased frequency of forums, this is to be expected with the increase in the rate of the rollout.

5.21. Regarding decreases in costs associated with previously awarded drivers in future submissions, we expect DCC to factor any decreased costs into its applications for Baseline Margin adjustments. We will consider any justification DCC provides as to why it should retain BM where costs have decreased.

5.22. We maintain our position that 15% is an acceptable margin for the core smart metering activities, as DCC's position and characteristics relevant to earning margin have not substantially changed since last year.

5.23. As there are no changes to the accepted drivers or changes to the cost assessment the Baseline Margin adjustment is calculated as £1.711m for work performed in RY18/19, £2.519m for work performed in RY19/20, and £3.847m for work performed in RY20/21. In total the Baseline Margin adjustment is £8.076m.

External Contract Gain Share

Proposal at consultation: Direct an adjustment to DCC's External Contract Gain Share of £8.013m across RY20/21 to RY25/26 on the basis of £30.642m of savings from refinancing agreements for set-up payments and reject £0.197m ECGS Adjustment relating to SMETS1 programme.

Decision: Direct an adjustment to DCC's External Contract Gain Share of £8.210m across RY20/21 to RY25/26. That DCC provided sufficient additional evidence related to the ECGS Adjustment for the SMETS1 programme.

5.24. The formula for DCC's Allowed Revenue includes an External Contract Gain Share (ECGS) term which allows for an upward adjustment to the Allowed Revenue where DCC has secured cost savings in the Fundamental Service Provider (FSP) contracts as detailed in Condition 39 of the Smart Meter Communication Licence. This is so that DCC has an incentive to seek and achieve cost savings in the FSP contracts. This term is zero unless DCC applies for a Relevant Adjustment to this term.

Respondents' views

5.25. Most respondents agreed with our proposals. However, some respondents highlighted the need for greater transparency of the contract terms and more information about the cost savings as mentioned in the consultation in order to provide a view on ECGS adjustment.

5.26. Two respondents questioned why suppliers should pay for the cost of achieving these savings as it should be incumbent upon DCC to deliver efficiently.

5.27. One respondent stated that all cost savings and efficiencies should be passed back to end consumers through the charges to suppliers.

5.28. DCC welcomed our proposal in allowing ECGS adjustment of £8.013m.

5.29. DCC contested our proposed rejection of ECGS related to SMETS1 programme. DCC provided additional evidence to suggest that the SMETS1 programme is directly related to changes to the existing DSP network to accommodate the SMETS1 service and the amendments to the current DSP network formed a fundamental part of the original DSP contract, as negotiated by the Department of Energy and Climate Change (DECC) in September 2013. DCC referred to Schedule 6.4 of the original contract which sets out the process for the Enrolment and Adoption of Foundation Smart Meters by DCC.

Reasons for our decision

5.30. We have reviewed the responses we received, including the additional evidence submitted by DCC in relation to ECGS adjustment SMETS1 programme. We have decided that there is now sufficient evidence to demonstrate that ECGS related to SMETS1 programme meets the conditions for a Relevant Adjustment. DCC have demonstrated they have made amendments to the original DSP contract as laid out in Schedule 6.4 and therefore we no longer consider ECGS adjustment related to SMETS1 programme as a new contract. Based on the additional evidence received, we have changed our position, no longer rejecting £0.197m relating to the

5.31. DCC has reduced costs for customers by negotiating with third party financial institutions and the FSP to agree lower interest rates for the set-up payments. This has led to a significant saving of £30.642m over the period from RY20/21 to RY25/26. It is important to note that these are cost savings, not deferred payments.

5.32. These cost savings are shared between customers, DCC and the FSPs, with customers receiving the largest proportion of the savings. For this ECGS adjustment, in total, customers are receiving 52% of the cost savings through reduced charges.

5.33. In future, when procuring services we expect DCC to assess the comparative benefits of other options against making changes to existing contracts and ensure value for money in terms of wider industry costs.

5.34. The ECGS is calculated as £2.758m for RY20/21, £1.229m for RY21/22, £1.151m for RY22/23, £1.248m for RY23/24, £1.418m RY24/25 and £0.406m RY25/26. In total, the ECGS Adjustment is £8.210m.

5.35. Between RY15/16 (DCC’s first ECGS Adjustment application) and RY18/19 (including this year’s application), DCC has secured cost reductions of £99.5m in the FSP contracts based on DCC’s ECGS applications, and brought benefits of £53.128m (53% of total cost reductions) to DCC’s customers through lower charges.

Appendices

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Appendix 1 - Determination Allowed Revenue (AR)

(£m)	RY18/19	RY19/20	RY20/21	RY21/22	RY22/23	RY23/24	RY24/25	RY25/26
LABP (18/19 prices)	163.873	202.403	234.379	238.794	235.497	242.149	250.019	105.746
Previous year (18/19 prices)	301.195	371.256	400.651	358.072	333.075	332.542	323.964	121.937
Submitted AR RY18/19	**373.583**	**410.839**	**537.832**	**516.377**	**478.873**	**475.371**	**472.849**	**205.501**
Cost Disallowances								
Baseline forecast internal costs	0.000	0.000	0.000	-36.719	-35.460	-35.486	-35.071	-14.559
CRS forecast internal costs	0.000	0.000	0.000	-3.449	-3.389	-3.389	-3.389	-1.412
SMETS1 forecast internal costs	0.000	0.000	0.000	-6.438	-6.438	-6.438	-6.438	-2.683
Benchmarking	-0.539	0.000	0.000	0.000	0.000	0.000	0.000	0.000
External services	-0.455	0.000	0.000	0.000	0.000	0.000	0.000	0.000
CRS (excluding shared services)	0.000	0.000	0.000	-3.449	-3.389	-3.389	-3.389	-1.412
Shared Services	-0.094	0.000	0.000	-4.100	-3.980	-3.983	-3.943	-1.638
Total cost disallowances	**-1.088**	**0.000**	**0.000**	**-50.706**	**-49.267**	**-49.295**	**-48.841**	**-20.292**
Performance Adjustment Reductions								
OPR	-1.267	0.000	0.000	0.000	0.000	0.000	0.000	0.000
CRS Performance	0.000	0.000	0.000	-0.469	-0.461	-0.461	-0.461	-0.192
Decision AR excluding BM and ECGS adjustments	**371.227**	**410.839**	**537.832**	**465.202**	**429.145**	**425.615**	**423.547**	**185.017**
Baseline Margin and ECGS adjustments								
BM adjustment (18/19 prices)	0.000	0.000	1.711	2.519	3.847	0.000	0.000	0.000
ECGS adjustment	0.000	0.000	2.758	1.229	1.151	1.248	1.418	0.406
Decision AR with BM and ECGS adjustments	**371.227**	**410.839**	**542.300**	**468.950**	**434.143**	**426.862**	**424.964**	**185.423**

Note: All values in RY18/19 price base