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Dear Anna

DCC Price Control: Regulatory Year 2019/20

EDF 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 and solar generation, 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 aims to help Britain achieve net zero by 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 DCC's costs where they have not been incurred economically and efficiently. It is disappointing that we seem to be in a similar position every year, with DCC costs being disallowed on the basis of insufficient supporting evidence. While we recognise that DCC has made a number of improvements in the way that it incurs and justifies its costs, there is clearly still some progress to be made.

It is hard to see how DCC's External Costs, which form the majority of the costs in the scope of the price control process can be regarded as being economic and efficient given the operational issues that we have experienced, especially in the CSP North region. These External Costs are significant and have increased year on year, far beyond the forecasts made as part of the award of the DCC Licence. We have not seen a commensurate improvement in the service we receive from DCC's service providers, making it hard to regard these costs as being fully justified.

DCC's internal costs, and especially their staff costs, remain an area of concern. We welcome Ofgem's proposal to disallow costs in number of areas, including contractor costs, staff remuneration and commercial operations. It is, however, disappointing that DCC felt that these costs could be justified in the first place, given the focus on this area in previous price controls and the feedback they had received previously.

It is disappointing that there is no clear path set out for moving from the current ex-post regulatory framework to an ex-ante model. It has previously been thought that there was too much uncertainty about the costs DCC would incur to be able to be able to implement ex-ante cost control. Given how long DCC has been operating and the stage we have reached in the rollout, we would expect that this uncertainty would be greatly reduced. Ofgem should consider whether it is an appropriate time to move to an ex-ante approach, or at least set out a clear roadmap for the transitioning to this approach.

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 Paul Saker 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

DCC Price Control: Regulatory Year 2019/20

EDF's response to your questions

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

We are concerned by the proposal to consider DCCs' External Costs as economic and efficient.

Based on the information provided it is difficult for us to assess whether all of DCC's External Costs have been incurred in an economic and efficient manner. We rely on Ofgem to challenge the information provided by DCC and to ensure that all costs are fully justified, especially as External Costs are the largest element of DCC costs by some margin.

We and other DCC Users have experienced ongoing issues with DCC's performance over the period in question, and especially with CSP North. It is hard to understand how all External Costs could be fully justified given the problems with one of DCC's core service providers, problems that have had a direct impact on our ability to roll out smart meters to a significant proportion of our customers. DCC's external costs continue to rise beyond the forecasts year after year, which places significant burden on its customers, however we are yet to see a corresponding improvement in operational performance. We urge Ofgem to request DCC to improve its overall forecasting process, adding rigor and control, and apply the relevant onus on DCC to deliver aligned to the forecast as far as practicable.

As well as these operational challenges, key changes such as the enrolment of SMETS1 meters, DCC's Release 2.0 and the provision of Dual Band Communications Hubs (DBCHs) are frequently delivered late or delayed. If the DCC's External Costs can be fully justified against the background of these ongoing issues, there would seem to be a more fundamental issue in how those costs are incurred and assessed.

Given Ofgem's concerns regarding aspects of DCC's contract management and procurement processes, it is hard to see how External Costs could be fully justified. DCC's use of letters of instruction and adherence to the change management process have been identified as specific areas of concern. While the revised OPR will help to incentivise best practice; it is surprising that the failure to follow best practice during the period in question has not resulted in any disallowances.

It is also hard to understand how the costs related to the delivery of change could have been economically and efficiently incurred, given DCC's poor performance in this area. The costs associated with delivering changes, and especially those that go through the SEC change process, are much higher than we would expect. It also takes far too long to progress and implement changes. It is hard to understand what is driving these costs and delays as DCC's contractual relationship with its service providers is not particularly transparent to SEC Parties. The high costs associated with the SEC change process have become a barrier to delivering changes that would benefit SEC Parties and consumers and must be addressed as a matter of urgency.

Q2. What are your views on our proposals on DCC's approach to benchmarking of staff remuneration for both contractor and permanent staff?

Staff costs form a significant proportion of DCC's internal costs, and as such they must be appropriately incurred and deliver value for money. While DCC does appear to have made some progress in this area since last year, further work is required to ensure that these costs are truly economic and efficient.

We agree that £1.272m of contractor costs should be disallowed as the DCC has not changed its approach in this specific area, despite clear messages from Ofgem that this was necessary. While we recognise that specialist skills will be required in some instances, there is no clear justification for the DCC to pay above reasonable market rates as consistently as they appear to have done.

It is disappointing that Ofgem has decided not to apply the new methodology to calculate the inefficiency of DCC's approach to benchmarking permanent staff hired in RY19/20, or to disallow £0.299m of costs even though there is clear evidence that this would be appropriate. We would encourage Ofgem to reconsider whether this disallowance would be appropriate for this regulatory year.

We agree with the concerns regarding the exclusion of bonus payments from permanent staff benchmarking. The levels of bonus payments noted in the consultation are, in our opinion, very high and form a significant proportion of the remuneration package for permanent staff. The levels of bonus payment are much higher than we would expect to see, and above what we would regard as being the industry average. There is no evidence that these bonuses are linked to performance or the delivery of tangible benefits to DCC Users.

Q3. What are your views on our proposals to disallow the cost of DCC's retention scheme?

We agree with the proposal to disallow the cost of DCC's retention scheme. We are disappointed that DCC felt that such a scheme was appropriate in the first place. The salaries levels and bonuses received by DCC staff are already generous, and in many cases above reasonable market rates. As a result, remuneration is unlikely to be a key driver for staff attrition rates; using a bonus scheme to attempt to retain staff would not seem to recognise or address the underlying cause of high turnover.

There is no clear link between the retention bonus and individual performance, and there appears to be little evidence that staff retention was improved. The scheme is a significantly costly approach to minimise turnover with little efficacy. The core issue of high turnover remains year on year which must be addressed by understanding the core drivers rather than costly retention schemes – this will only have a limited period of validity, before the scheme's efficacy dissipates, and a new level of monetary investment/incentivisation will be required to retain the staff.

We echo Ofgem's concern that those who seem to have benefitted most are DCC senior staff.

Q4. What are your views on our proposal to disallow the incurred and forecast costs associated with the product management team?

We agree with Ofgem's proposal to disallow the costs associated with the product management team. DCC's approach to any problem or task seems to be to dedicate additional resource to it, increasing the cost burden DCC's customers bear, rather than rather than seeking cost effective and efficient solutions.

The rollout of smart meters remains the key focus for DCC's users and will do or some time. It is not an appropriate time for the growth of the product management team or the expansion of DCC's service offerings through development of new initiatives. While we recognise that DCC services will need to evolve in the future to meet the needs of the changing market, we are concerned that this currently presents a distraction from delivery of DCC's core services. We are still waiting for the successful implementation of Release 2.0 and the delivery of functioning DBCHs, and SMETS1 enrolment is still ongoing. DCC must make sure that they are delivering their existing services to the level their users require and should not be focussing on new services until these enablers of the smart metering rollout have been fully delivered. Getting the basics right should be DCC's focus.

Q5. What are your views on our proposal to disallow the forecast variance of the Commercial Operations and Vendor Management teams?

We agree with the proposal to disallow the forecast variance of the Commercial Operations and Vendor Management teams.

We are concerned by the level of cost that DCC is incurring in regard to the Network Evolution project given that the exact scope of the programme is still to be defined. We are also yet to see a full business case and cost benefit justification. It must be ensured that money isn't being spent too early by DCC on the assumption that this project will be approved with the cost and scope that DCC has assumed. We are especially concerned that the approach that DCC is taking to this project will increase complexity by introducing new Communications Hub variants, when what we really need is more simplification.

Q6. What are your views on our proposal to disallow the incurred cost variance associated with Preston Brook?

We agree with the proposal to disallow the incurred cost variance associated with Preston Brook.

Q7. What are your views on our proposal to disallow all variance in forecast internal costs?

We agree with the proposal to disallow all variance in forecast internal costs, as DCC has failed to provide any justification for the increases beyond RY22/23. We note that this failure to provide proper justification is a theme across a number of aspects of this price control consultation, as it has been in previous years. There seems to be little sign of a material change in the way DCC engages with the price control process and the information it provides to support its forecasts.

We are concerned that the DCC's forecast costs for RY22/23 onwards show an average increase of £43m each year. DCC costs incurred to date are already far beyond what we could have expected when the DCC Licence was awarded, with the expectation that they will have more than doubled by the end of the Licence term. There is no sign that DCC will become more efficient or that this continual increase will either slow down or stop; there is certainly no indication that costs will ever reduce. There are clear opportunities for DCC to streamline internal operations, and ensure costs are robustly managed.

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

There is a clear disconnect between DCC's operational performance as reported through the current OPR, and the day to day experience of the Users of its services. That DCC can be regarded as performing well in the OPR performance measures, however when we are having to deal with what we regard as poor performance only shows why the review of the measures in the OPR is urgently needed.

The operational performance issue we experienced during the period include:

- A significant number of Major Category 1 Incidents and Category 2 Incidents which would indicate a lack of system stability that we would not expect to see at this stage in the operation of DCC services
- Continual poor performance in the CSP North region which has caused delays to energy suppliers' ability to rollout smart meters in those areas, including to prepayment customers
- Issues with SMETS1 migrations that have delayed the enrolment of SMETS1 meters into DCC services

Q9. What are your views regarding DCC's failure to ensure all CSPs met their contractual milestones and its wider performance in the North region?

We agree with Ofgem's minded-to position to make a reduction to DCC's Baseline Margin of which is £1.644m, which is the full value associated with the SDM1 milestone.

As noted in the response to previous questions, DCC's performance in the CSP North region has continued to be poor during the period and has led to further delays to the rollout of smart meters to consumers in those areas. Specific problems include delays to the development of R2.0 Firmware, ongoing network stability issues and poor installation and commissioning times.

In the context of these wider and ongoing performance issues in the CSP North region we see no clear justification for the DCC retaining any of the Baseline Margin associated with the SDM1 milestone.

Q10. What are your views on our proposed position on DCC's project performance?

We agree with Ofgem's position on DCC's project performance and agree with its view that DCC has performed poorly in meeting the milestones set out in the Baseline Margin Project Performance Adjustment Scheme (BMPPAS).

The continual delays to Release 2.0 and the availability of DBCHs are clear indication that the incentive scheme has not driven DCC to achieve the required outcomes, and we are concerned that the same will apply to other projects with similar incentive schemes in place. Further thought needs to be given to how the DCC is best incentivised to achieve high performance and achieve key milestones, as the current incentive regimes are clearly not having the desired effect.

Q11. What are your views on our assessment of DCC's application to adjust its Baseline Margin?

We agree with Ofgem's proposal to disallow those elements of DCC's application where insufficient evidence has been provided of a material change that could not have been foreseen. We agree with the view that these should have been part of 'business as usual' activities and should not be regarded as 'new' costs. We are concerned that DCC continually seeks additional funding for activities that they regard as being an extension of their responsibilities, where we would regard them as being necessary to provide their core services to the standards we and our customers expect.

We continue to regard the current 15% level achieved by the DCC for its Baseline Margin as being too high in the context of an energy market where most of the DCC's customers are achieving either negative or very low margins.

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

We agree with the proposal to reject DCC's ECGS Adjustment application of £0.751m, on the basis that DCC has not provided sufficient evidence on how Communications Hubs were costed or included in the original external service provider contracts.

We support the concept of the External Contract Gain Share (ECGS). It is reasonable that the DCC is rewarded for achieving cost savings on behalf of its customers, as long as those savings are real and can be shown to be passed on to those customers. We welcome the efforts by the DCC to reduce costs, however it would be useful to understand the cost to the DCC of achieving any savings, in order to give a truer picture of the actual savings that have been achieved. It is not clear what proportion of DCC's internal costs relate to the achievement of the savings noted.

It is difficult for us to see the direct benefit of these savings in the context of continually escalating external costs, and an overall increase in DCC costs of 14% from the previous regulatory year. Until DCC's costs stop escalating and eventually reduce, it is difficult to see how the savings that are being claimed are being realised.

Q13. What are your views on our assessment of Delivery Milestone 1?

We agree with Ofgem's assessment of Delivery Milestone 1, and the proposal that DCC should lose all margin associated with this milestone. Based on the information provided, and our own engagement with the Switching Programme, there is no evidence that any of the delay to this milestone was outside of DCC's control.

The documentation associated with this milestone, and especially the CSS (Centralised Switching Service) interface specifications, were critical inputs for our internal Switching delivery programme. The delay to the provision of this documentation had a direct impact on our ability to progress our internal delivery, leading to resource being under-utilised and a need to re-plan our activities.

EDF
December 2020