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Action:	For Decision
Acronyms and Defined Terms SEC Glossary	

Ofgem Consultation – DCC Review Phase 2: Determination of Allowed Revenue

1. Purpose

This paper provides the Panel with a draft response to the Ofgem consultation on DCC Review Phase 2: Determination of Allowed Revenue. A copy of the consultation can be found using the following link: [DCC Review Phase 2: Determination of Allowed Revenue | Ofgem](#).

The Panel is requested to approve the draft response contained in Annex 1 of this paper.

2. Background

Ofgem is in the process of reviewing the regulatory framework for the DCC in preparation of the expiry of the Smart Meter Communication Licence in 2027. In the consultation, Ofgem are consulting on developing a new design for an ex-ante cost control framework. This will be implemented for DCC under the Successor Licence. Ofgem are also proposing a transition towards ex-ante business planning under the current licence

3. Recommendations

The Panel is requested to **AGREE** the draft response in Annex 1 may be submitted to Ofgem subject to any comments and final agreement with the Panel Chair.

Christopher Thompson

SECAS Team

21 January 2025

Attachments

- Annex 1 – Draft Panel Response

Annex 1 – Draft Panel Response

Angela Love - Chair SEC Panel
Smart Energy Code Company Limited
77 Gracechurch Street
London, EC3V 0AS

XXXX
Via email DCCregulation@ofgem.gov.uk

XX January 2025

Ofgem Consultation – DCC Review Phase 2: Determination of Allowed Revenue

Dear XXX,

We are pleased to respond to your consultation on your proposals for an ex-ante price control regime for the DCC.

We broadly agree with the proposals set out in your consultation. We are of the view that a DCC ex-ante price control regime should be transparent and easy to understand as this will build confidence of stakeholders in the process.

We are also of the view that there should be an opportunity to consider the progress of the DCC against its forecasts through the price control year to identify and mitigate any potential shortfalls against the ex-ante forecasts. In this regard we are of the view that the Customer Challenge group would be beneficial, however the group would need to meet regularly and have access to requisite information from the DCC. The group should have some powers to determine the DCC way forward.

We would be happy to engage further, to assist with any clarifications. Please do not hesitate to contact SECCo Head of Code and Regulatory Strategy, Alina Bakhareva at alina.bakhareva@seccoltd.com.

Yours Sincerely,

Angela Love

Chair – SEC Panel

Q1. What are your views on our proposal to move towards a multiannual, ex-ante cost control with uncertainty mechanisms? Do you agree with our proposal to require from DCC a costed Business Plan to form part of its cost control submission?

The SEC Panel has for many years been calling for the DCC to move to an ex-ante regime. We are therefore pleased to see this becoming a reality. Under the current arrangements SEC Parties have limited opportunity to understand or comment on the costs the DCC incurs, whilst (for licensed Parties) being obliged to pay charges that increase year on year. Moving to an ex-ante cost reporting regime must deliver improved engagement and transparency, to SEC Parties, of the costs that are incurred to deliver the services.

The current ex-post reporting arrangements do not provide sufficient transparency for SEC Parties. To deliver the full benefits of an ex-ante regime, we believe that a reporting mechanism should be in place which is straightforward for all stakeholders to understand, as this will aid transparency and provide confidence in the structures and governance supporting the arrangements. We understand that this will provide challenges for the DCC as they will be required to operate in a pre-agreed cost envelope, but we believe this will be a useful discipline to take forward in the future years of the development of the not for profit arrangements of the future DCC Licensee. We acknowledge that some flexibility will be required to enable the regulatory framework to accommodate changes in the market that influence the DCC Systems, and the technologies used by the DCC. We are also of the view that industry should be afforded the opportunity to provide a more immediate consideration and review of the DCC's expenditure, ideally on a monthly basis. We note that this would add an administrative burden on Industry, but we are of the view that the potential money saving that could result from greater scrutiny on DCC expenditure would make this a burden that provides significant advantages.

The continued role of dual governance for the DCC via DESNZ direct programmes and industry changes via the SEC, brings an element of risk in relation to the predictability of the costs and service delivery from the DCC. We expect that the current 4G Communication Hub and Network programme and Virtual Wide Area Network solution to be the last pieces of work to be delivered via the Transitional Governance arrangements and would expect once delivered that the powers set out in Section 88 of the Energy Act 2008 would expire with no further extension beyond 2028. It would be helpful for both the DCC, and all Stakeholders, to have a clear indication that this is the case. We anticipate that any new programmes will be subject to SEC Governance and accordingly that the costs will be reported with greater transparency to Stakeholders, including via the new ex-ante arrangement.

We agree that the DCC should be producing a costed Business Plan as part of its cost control submission as this will provide clarity for stakeholders as to the future costs as well as providing the DCC with a plan to which it will be required to adhere. We would encourage any processes that will provide transparency to industry of the DCC costs for the upcoming financial year as well as future years. Please note our response to question 2 below.

Q2. What are your views on the length of the cost control cycles under the Successor Licence? What are your views on the interaction between the Business Development Plan and a costed Business Plan?

There is a need to balance a long-term strategic view that will ensure that there is little or no surprise for SEC Parties (and ultimately consumers) who pay for the Services, with a simple and transparent budget setting process.

A long term strategic view of costs and resources required to deliver against an annual budget and more granular monthly reporting of costs incurred versus forecast should deliver the transparency and oversight.

A long-term strategic view could include annual budgets which are refined over time, as the requirements become better understood. This would in effect provide an annual costed business plan and business development plan in one place, which could be provided to Parties to review. We are of the view that this approach will be more simplistic and will benefit understanding for stakeholders while enhancing transparency. We are also of the view that this will be less of an administrative burden on the DCC.

The DCC would need to provide sufficient evidence to support its forecast and strategic objectives and report against its progress on a monthly basis against the forecast spend and resources needed.

Any overspend would need to be explained clearly to Parties and, if necessary, a contingency fund (overdraft) would need to be called upon with costs adjusted for the remainder of the period. In cases where the DCC has underspent, the value should be returned to SEC Parties through a reduction in DCC costs for the following year.

Q3. What are your views on the outlined general approach towards determining efficient forecast costs?

With a formal budget setting process as described in question 2, the forecasting of expected costs should be a process that is reasonably accurate and therefore an efficient means by which a strategy can be delivered. The DCC should provide Parties with all the evidence required to explain why the forecasted costs and resources are needed for each year of its strategic business plan. We do note that due to the nature of the service that is provided by the DCC, there may be challenges that arise that fall outside of the forecasted costs. For these specific circumstances, there should be provision within the cost control regime to manage costs appropriately.

An issue remains with the level of service provided versus the costs incurred by the DCC and its Service Providers. The DCC is a contract management entity. The contracts it has in place with its Service Providers should through appropriate incentivisation provide the mechanism to deliver the high quality of service that is expected by SEC Parties. The current Ofgem price control mechanism reflects that all too often this does not occur. We are of the view that the DCC should not be receiving reward for failure and nor should its Service Providers.

From the information that we observe through the current price control regime, where there is a poor service provided, there is limited financial impact on the DCC and its service providers. The pain is felt by its customers and ultimately end consumers. The repercussions of poor service must be felt by the Service Providers providing the substandard services and equally where good service is provided there should be appropriate rewards. The DCC should have the flexibility within its contract management functions to deliver the services its customers expect and have the tools at its disposal to ensure failure is not rewarded through the contractual terms and relationship with those service providers. The DCC should however be sufficiently incentivised through its staff remuneration package to attract and maintain good talent which will in turn ensure delivery of exceptional services from the service providers the DCC manage.

Q4. What are your views on flexibility within DCC's Allowed Revenue? At what level should DCC be afforded flexibility to manage overspend/underspend?

The vast majority of costs of the DCC are from external Service Providers. The flexibility needs to be in the contracts themselves to enable DCC the correct tools to leverage the performance levels that are required from those Service Providers. Flexibility from a budgetary perspective needs to account for potential unforeseen events or perhaps where the proposed strategic business plan has not delivered the expected outcome.

DCC remuneration should be based on the risk and reward of the delivery of firstly the services to its customers and end consumers, and secondly the efficient and effective delivery within its forecasted and agreed budget plan cycle.

Q5. What are your views on our proposal to allow DCC to access working capital through a contingency set at 2% of its annual Allowed Revenue? Would this level of contingency be sufficient to manage risks to DCC's ability to finance its Mandatory Business? What are your views on the risk and benefits of cash v accruals-based reporting of Price Control information?

Suitable contingency is required for unexpected events. However, the means by which the level of contingency is drawn down needs suitable planning and governance applied. The current approach is for the DCC to spend as it deems fit and then to justify the expenditure through the Ex Post price control procedure. Under an ex-ante regime, regular monitoring and reporting of spend against forecasted budget should ensure there are very limited circumstances where contingency spend is a surprise.

We agree that as a starting point 2% seems fair as a means to ensure that the DCC sufficient funds at its disposal to meet any unexpected fluctuations in expenditure. We note that the DCC currently manages this and with the experience of operating for a number of years, they should be able to ensure that there is a limited need for contingency.

Q6. What are your views on the proposed three types of Uncertainty Mechanisms?

As noted in previous questions, regular reporting and review of the DCC forecast versus actual spend should provide a degree of control and transparency as to how and where any contingency is required to be spent. There needs to be appropriate governance around the DCC access to contingency funding to avoid unnecessary access to additional funding thereby avoiding surprise costs through the ex-ante price control procedures.

Option A – We are of the view that this is not an ideal solution as Parties have a right to know what charges are to be expected from the DCC through their business planning. This option appears to give the right to the DCC to adjust its charge as it feels appropriate which would therefore require careful oversight from either the Code Manager or some other entity as well as Ofgem. We are of the view that the DCC should not be able to amend their charging at will without robust regulatory oversight.

Option B1 – We are of the view that it makes sense to allow the DCC some flexibility, but there should be a limit on the amount and the circumstances in which this occurs. 5% seems like a considerable amount of money to allow the DCC to charge at its discretion. The DCC has been operational for a number of years and should have a good idea of any potential uncertainties that it might face and it should therefore be able to effectively manage this and provide educated estimates and calculations to ensure that a large percentage of not required to manage uncertainty.

Option B2 – We agree that this option is appropriate and that DCC should be in a position to manage its business appropriately to ensure that it is not required to draw more money than the 2% under this option.

Q7. What are your views on the reopener process, criteria and risks? What are your views on the trade-off between allowing DCC a more flexible approach to receive additional Allowed Revenue?

We are of the view that the most important aspect of the price control regime should be to have the DCC's expenses transparent and predictable as well as to limit any unnecessary expenses. We agree that there is a need for a reopener for exceptional events, for example, where the strategic plan has not delivered the expected outcome, or an unforeseen event has occurred resulting in overspend.

Q8. Do you agree with our proposal to require that all of DCC's Authorised should be carried out on a not for profit basis?

Yes, we are of the view that the DCC should be run on a not for profit basis which would include all of its Authorised Business both permitted and mandatory. There should therefore be no exceptions.

Q9. What are your views on the proposal to allow DCC to apply for ringfenced funding to enable potential development of commercial or innovative services?

Innovation and value added services should be enabled so that the DCC may grow and ensure that it remains relevant. The costs should be clear and upfront, with a specific purpose (project / programme) that has been defined for delivery. Income derived from innovation should be returned to SEC Parties and consumers in the form of reduced overall operational costs. DCC remuneration arrangements with its staff and service provider contracts should enable suitable risk and reward.

Q10. Do you agree with our proposal to remove the ECGS mechanism from the Successor Licence? What are your views on considerations to introduce open ended or set stretch efficiency targets on DCC in respect of its External and Internal costs for a future cost control cycle? What other mechanisms or approaches could be effective to drive cost efficiencies?

We agree that there should be a cost sharing incentive model on the DCC. Where the DCC is not for profit, none of the incentives should be for the benefit of the DCC as an organisation. We are of the view that efficiency by the DCC should be targeted at DCC staff and that they should be rewarded for being efficient and not the actual business as it is not for profit.

We are of the view that the B2/C2 option would seem to be appropriate. The DCC Board should be able to set the incentive targets, noting the structure of the DCC Board that Ofgem set out in its DCC Review: Phase 1 Decision. Such an approach is therefore contingent on the DCC having sufficient independence to ensure a fair stretch efficiency target.

Q11. What are your views on the proposed measures to be considered as part of any targeted incentive model on senior managers and staff?

We agree that any incentives should be targeted at senior management and staff.

We are of the view that these incentives should be targeted and that senior management should have more accountability in the form of greater rewards for success but also greater consequences where ex-ante forecasts are not met or for any other failures by the DCC.

Q12. Do you agree with our proposal to set up a customer challenge group under the SEC to have a role in the business planning process?

We are of the view that as a principle this should be wider than just the business plan, and there should be consideration of the costs of the DCC on an ongoing basis, ideally on a monthly basis. Of utmost importance is a transparent approach which takes into account the concerns of Parties as this is severely lacking in the current model.

We are also of the view that it is important that the Customer Challenge group has some powers that will enable it to be more than a rubber stamping authority. The DCC should be required to provide relevant information, with the group having the ability to challenge information provided and provide meaningful advice that the DCC has to consider in its approach.

Q13. What are your views on the Group's membership? Do you agree with our outlined core and non-core membership model?

Our interpretation of the proposals is that Ofgem is proposing the creation a finance subcommittee of the Panel which will be established with an Independent Chair. The terms of reference for the group should be flexible so that interested Parties may be invited if not a full member.

Q14. What are your view on the presented considerations for the scope, focus and responsibilities of the Group?

The scope should cover the overall strategy of the DCC, its business plan to deliver, and regular review of its spend against its forecast. Meetings may need to be confidential (or part confidential) due to the nature of the discussions.

Q15. Do you agree with the proposed outputs of the Group?

In addition to a report, the group should regularly review progress against the DCC forecast providing a means for insight into the spend of DCC. The Group should be in a position to effectively review the spend and consider the explanation provided by the DCC of any variation. This means that the DCC must be sufficiently transparent with the information that it provides to allow the group to perform its function effectively.

Q16. What are your views on our proposed implementation approach, the requirements on the first Business Plan and the interaction with the current Price Control process?

We are disappointed that there will be no ex-ante price control submissions prior to DCC2 coming into effect. We note that the DCC have been spending money on preparing to move to an ex-ante regime, however from the content of this consultation it is apparent that this will not take place until DCC2 is in place. We note that the DCC has already spent money on moving to the ex-ante price control regime and we would like to understand whether these are now sunk costs as well as confirmation that no money will be spent on further consideration of the ex-ante process until it is appropriate to do so.