SEC Panel response to the DCC Price Control Consultation: Regulatory Year 2018/19SEC Panel Response to Ofgem Consultation on DCC Price Control for Regulatory Year 2018/19

1 Context

The SEC Panel is pleased to have this opportunity to respond to Ofgem's consultation on the DCC Price Control for Regulatory Year 2018/19.

Consistent with the Objectives of the SEC, and the SEC Panel's duties defined in the SEC, the SEC Panel oversees on behalf of SEC Parties how the requirements and obligations in the SEC are being satisfied: The Panel therefore believes it is appropriate to provide Ofgem with a view of how DCC's services and performance are viewed from the User perspective, and we have concentrated on that in this response. In general, we have not commented in great detail on the specifics of the costs and financial submissions from DCC: however, we believe our response should provide useful context for the consideration of these.

This response first highlights some important themes, which may be relevant to a number of the questions in the consultation. These have been illustrated by specific examples: we have not sought to comprehensively list all instances of a particular type of occurrence.

Next, the response includes a number of comments for specific questions in the consultation.

We have sought to focus this response on the Regulatory Year 2018/19. However, we note that in some cases the DCC's submission apparently refers to subsequent activities. Consequently, in some instances, we have provided observations on more recent activities: in such cases we have explicitly identified these.

As you will understand, this response is from the SEC Panel: whilst sent on behalf on the Panel, you should not infer that it represents the view of each individual Panel member.

Further, it is not intended to be a formal consolidation of the views of all SEC Parties. It is anticipated that SEC Parties will make their own responses, which may well differ in content and emphasis from this response.

2 Important Themes

2.1 Introduction

The SEC Panel would like to highlight the important themes highlighted below. It would be fair to say that the preponderance of these remarks tends to highlight what the Panel see as shortcomings. We hope this will provide useful context for Ofgem since, perhaps understandably, DCC's submission appears to emphasise positive achievements. The SEC Panel strongly believes that openly discussing and addressing what may be seen as difficulties is the right approach and will lay the foundations for a strong future partnership between DCC and SEC Parties.

The SEC Panel does acknowledge the considerable efforts made by DCC and its staff during the Regulatory Year: nonetheless, the SEC Panel believes the most useful input the SEC Panel can make to the consultation is, generally, to highlight outcomes, seen from the User perspective. In a few cases we have also made observations regarding good practice.

Finally, in this introduction, we note that DCC have highlighted the change in nature from predominantly programme delivery to service provision. We accept such a change was underway in the Regulatory Year in question. The SEC Panel note concerns that, in reality, this transition to live happened too quickly, and before stable services were firmly established. Indeed, that the delivery of Release 2.0 is still awaited, services in the North Region are far from acceptable, and Enrolment & Adoption of SMETS1 meters is in the early stage of a multiphase migration process all reinforce this view. However, we would emphasise that DCC services were understood to be live and operational during the Regulatory Year, and operational performance should therefore be judged against the enduring requirements in the SEC, rather than any implicit derogated standard reflecting the transition.

2.2 Engagement with SEC Parties and Service Users

In the Regulatory Year

The SEC Panel's view is that DCC engagement with SEC Parties and Service Users was not of consistently adequate quality and transparency. The Panel recognises that DCC may have faced demanding challenges in meeting overall smart metering programme objectives, and that the priorities of Users may not always have aligned with these overriding objectives. Nonetheless, the Panel believes that DCC could have achieved a better relationship with Users through an increased emphasis on open, structured and systematic engagement with Users. Had they done so, they might have received more understanding and less criticism from Users.

Examples to illustrate this theme:

(a) Communication to Parties and Users through the lifecycle of development proposals and business cases has sometimes been patchy, fragmented and incomplete. The path for discretionary projects from initial concept through to endorsement for implementation has not clearly and systematically involved Users and SEC subcommittees: as an illustration, SSC and SMKI PMA do not feel they have been involved as they should. Users have sometimes been unclear as to whether and when their formal opinion on, for example, requirements definitions, has been sought.

(b) Responsiveness to Consultation Results. Users have observed that it was not always apparent that DCC have given the appropriate weight to their responses to consultations. Whilst it is understood that DCC may not always be able to adopt the proposals of Users, it is felt that in some cases a reasoned explanation of the choice of course of action has been lacking. In short, accurate, clear, and timely feedback has been lacking.

(c) Failure to update business cases or review business cases once it is clear that material delays or changes to costs are being incurred, eg., Production Proving Function, SMETS1 E&A, R2.0.

(d) Failures to properly engage with the SSC, prompting the SSC Chair to complain by email itemizing the shortcomings.

Nevertheless, the Panel notes that there are examples of good engagement:

(a) the interim process developed for managing SSI enhancements was good. This involved detailed consideration of candidate requirements by a DCC-managed customer group, followed by consideration and endorsement by the SEC Operations Group, under authority delegated by the SEC Panel.

(b) Contribution to the SEC Operations Group. The SEC Panel appreciates that DCC sought to actively and positively participate in the SEC Operations Group from its inception. It should be said, however, that the quality of contributions has been variable across topics.

(c) Presentation to the TABASC and other groups on the need for, and approach to 'NextGen' communication hubs.

Subsequent to the Regulatory Year

The SEC Panel notes that:

(a) DCC have now set out a much more structured overall approach for engagement, but it is as yet too soon to say how well this will succeed. Whilst acknowledging the attention now being paid to this topic, the SEC Panel is not yet clear about how DCC intends to engage with the SEC Panel and its subcommittees in this process, and DCC should explicitly set this out. We note with interest DCC's intent to deliver tools such as the customer portal. However, DCC must not passively rely on User initiative to access the material made available through this: there should also be systematic and active communication to the right User representatives for each topic.
(b) The new engagement strategy identifies a DCC convened customer forum as the focal point for the consideration of business cases, costs, financial matters (such as charging), and also, in effect, programme planning and prioritisation. This is a broad spread of functions and DCC should consider how this one forum will be informed and supported to deal effectively with all these matters, and enable all SEC Users to be able to participate in some form.
(c) Unfortunately, the enduring process for managing SSI enhancements, which replaced the interim process, has not to date been as successful. DCC have had some difficulty in complying with the governance requirements which they had a major role in drafting.
(d) DCC have continued to engage positively with the SEC Operations Group, and in some respects have improved their responsiveness to User requests from that Group. An example of this is the improved Incident Management Process, and, in particular communications to Users whilst incidents are in progress.
(e) DCC has continued to engage pro-actively with other groups, including TABASC, SSC, SMKI PMA, TAG, and provide valuable input to the agendas of each of these governance areas. There have been some improvements in engagement with the SSC.
(f) Regrettably, DCC did not provide Users and the SEC sub committees the opportunity to comment in advance on the NextGen RFI before it was finalized and published.

Concluding Remarks

The Panel believes that clear, structured and open engagement between DCC, its Users, and SEC Parties generally is key to the development of User confidence and a mutually productive relationship between DCC and SEC Parties. The SEC Panel observes that whilst clearly defined processes and tools are an important aspect of good, open engagement, the behavior of responsible individuals, which may be influenced by corporate culture, is equally important.

The SEC Panel supports the idea that this area, because of its importance and its pervasive impact, should be considered for future incentivisation.

2.3 Transparency and Engagement about Planned and Actual Expenditure

This is one particular aspect of engagement (see Section 2.2), which is worthy of further emphasis.

In the Regulatory Year

The SEC Panel believes that SEC Parties did not receive adequate information from DCC on proposed expenditure. A possible consequence of this is that DCC may not receive unqualified and active support for their proposals, and, consequently, execution and delivery may well suffer.

Some examples are:

(a) The SEC Panel discovered that estimated costs for Modifications presented by DCC did not include the full costs of testing and deployment. This omission both undermined confidence in the cost estimates being presented, but also cast doubt upon the assessment of the business cases for Modifications. Further, in some cases, costs quoted for changes have clearly been “prices” apparently entirely divorced from any feasible basis in actual costs of resources required or assets employed.
(b) The SEC Operations Group on a number of occasions sought information on the costs of the production proving development. This information was not provided. It is recognised that DCC may be constrained in providing fully detailed information, but it is not clear why some arrangement could not be offered to provide the SEC Operations Group with an overall briefing.
(c) Increased charges as a result of delays or changes to DCCs approach, where these variances were not presented in advance of being incurred and not justified as either contributing positively to a business case or debated with users on the merits of continuing with the activity concerned, eg., R2.0 SBCH/DBCH, SMETS1 E&A, Production Proving.
(d) Increased charges as a result of planning to undertake work that has not been subject to review with Users, eg., Automated Testing, KPI dashboard, etc..
(e) Lack of any visibility in respect to ‘benefits realisation’.

Subsequent to the Regulatory Year

(a) It is recognised that the engagement strategy set out by DCC seeks to improve transparency on costs and expenditure, and the SEC Panel hopes this will be actively progressed by DCC.
(b) The enduring governance provisions for managing SSI enhancements involves the SEC Operations Group reviewing costs. DCC did not feel able to provide specific cost information to support this process. Whilst the sums involved to date are small, the difficulty encountered in satisfying the governance requirements do not set an encouraging precedent.
(c) The lack of justification and debate with users regarding the significant expenditure on resources in future years, that Ofgem proposes to disallow

Concluding Remarks

Since DCC is a regulated monopoly whose services are fully paid for by its customers who must, in turn, recover these costs from consumers, it is essential that:

(a) An effective and structured mechanism must be found and demonstrated to allow SEC Parties to understand and, as appropriate, constructively challenge proposed DCC expenditure. DCC should be prepared to adjust their proposed engagement strategy if it is found ineffective in this regard.
(b) Cost transparency in itself is not sufficient. It must be coupled closely with an informed assessment of business benefits: User benefits can only be properly assessed by Users.
(c) The subsequent delivery of estimated benefits from projects must be actively tracked over an appropriate period of time. Whilst recognising that this may be difficult to do, the outcomes should provide a valuable input into Ofgem’s OPR process.
(d) The question as to what extent the efficiency and effectiveness of project expenditure should be actively reviewed (for example, by SEC Parties) *during* the course of a project should be explicitly addressed.

Finally, looking forward, the SEC Panel notes that DCC expect to actively develop further services outside the core SEC requirements. In those circumstances, transparency on costs and expenditure will become even more important.

2.4 The Quality of DCC's Services

The SEC Panel believe it is important that Ofgem are informed of the general User view of the quality of services delivered by DCC. We note that DCC's submission highlights the achievement of delivering the operational services: the SEC Panel acknowledges this work, but feels it must be tempered by an understanding of the significant operational difficulties that Users have encountered and continue to encounter, for example as a result of issues in CSP-N, and from the lack of product assurance in respect to Communication Hubs.

Management of Service Providers

We understand that in assessments of service quality, the question arises as to what extent DCC are in a position to influence outcomes, given the constraints of the commercial arrangements in place with Service Providers.

In the Regulatory Year

The SEC Panel had little visibility of either the commercial arrangements with Service Providers or the efforts DCC have made to align Service Provider performance with SEC requirements. Consequently, the SEC Panel cannot usefully comment on whether DCC has adequately applied good contract management practice. However, the SEC Panel can comment on the quality of service delivered by the Service Providers, overseen by DCC: these observations are given later.

From a pure contract management perspective, we note the following examples of where management of service providers by DCC should have been stronger:

(a) It was noted that CSPs were allowed to develop and enlarge a list of Comms Hub exceptions. The CSP is allowed to exclude the Comms Hubs on this list from performance metrics. We believe this list, which grew to thousands of entries, should have been explicitly verified and challenged by DCC.

(b) For most of the year, there was no evidence that DCC, before proposing additional maintenance activities, vigorously challenged the length and number of the outages proposed by the Service Providers. This was improved late in the year.

(c) It was not obvious how urgently DCC were responding to service failures by Service Providers. We acknowledge this may have been happening behind the scenes.

(d) Support of the Modifications process. The SEC Panel has not seen convincing evidence of determined and successful efforts by DCC to reduce the sometimes unbelievable cost quotations from Service Providers for implementing change.

The SEC Panel understand that DCC has progressively amended, added to and renegotiated the original SP contracts, but we have no insight into whether these changes reflected the need to improve performance or set a higher standard for the delivery of new requirements, eg., SMETS1 E&A, R2.0 etc..

Further, as noted in the consultation, we understand that DCC has placed a considerable number of additional contracts. The SEC Panel have been provided with no assurance by DCC that these arrangements properly reflect User requirements, or incorporate good practice measures such as SLAs and KPIs, and that these, in turn reflect User priorities as expressed in SEC.

Subsequent to the Regulatory Year

The SEC Panel has now seen some evidence, for example at the SEC Operations Group, of DCC's intention and determination to improve the performance of Service Providers. However, so far this visibility has been largely on an ad hoc basis.

Regarding the examples of weak contract management quoted above, we can now acknowledge an improved picture:

(a) At the insistence of the SEC Operations Group, DCC are now taking a much firmer stance in dealing with Comms Hub exceptions proposed by Service Providers
(b) DCC have now developed and are trialling a much improved planned maintenance process. One aspect of this is that DCC have insisted that Service Providers reduce their requests for outages.
(c) DCC have (in confidence) described some of the determined actions they are taking to make Service Providers deliver a better quality of service. Whilst the success of this must be judged on outcomes, the SEC Panel acknowledges that DCC is now acting vigorously to attempt to improve service quality.

Concluding Remarks

The SEC Panel believes that in principle there is something of a choice to be made.

Either

(a) DCC is seen, in its contract management role, as ultimately responsible for the service quality delivered by its contracted Service Providers

or

(b) DCC is assessed on its application and execution of good contract management practice

It may be that different areas of DCC responsibility might be considered as falling under either (a) or (b), or indeed, that some DCC activities might be assessed under both approaches.

The SEC Panel's view is that it is DCC's responsibility to achieve alignment between Service Provider performance and the requirements set out in the SEC, and the extent to which this has been achieved should be an important consideration for Ofgem.

Further, whilst the confidentiality of commercial arrangements is acknowledged, the SEC Panel believes it should be possible to find a mechanism through which DCC can brief Users on key features of contracts directly relevant to them, such as how SEC requirements are met, and how compliance is assured (such as through SLAs, KPIs and other contract management good practice)

The Services

In the Regulatory Year

The quality of service delivered was disappointing in a number of important respects. Some examples are given below:

(a) There have been serious shortcomings in relation to work in the security area: the Chair of the SSC found it necessary to email DCC to itemise about 9 major failings needing attention. These matters ranged from poor engagement with and support to the SSC to failure to promptly address material security shortcomings.
(b) Users were not provided with adequate certainty regarding the schedule for delivery of *communications hubs*. Further, the in-service quality of Comms Hub firmware is questionable. It was clear that various defects existed in delivered production devices: the Panel takes the view that the level of defects was higher than should reasonably have been expected, and that this materially affected the operations of some Users.

(c) The availability and reliability of *core services* were not satisfactory. In particular, serious incidents (either Category 1 or Category 2) were too frequent for an operational service: this had a material impact on Users' own operations. Further, the metrics defined in the SEC and reported by DCC frequently showed a failure to achieve Minimum or Target Service Levels in some service areas. It is acknowledged that the defined set of metric needs reconsideration and improvement in the light of operational experience[1]: nonetheless, it does seem clear that services were not being consistently delivered according to the defined SEC standards. Indeed, Users have on a number of occasions reported that the metrics do not fully reflect the difficulties they have encountered.

(d) Services in the CSP North Region, in the view of Users, suffered very severe deficiencies, which seriously constrained roll out.

(e) The DCC *Support to the Modifications Process* was disappointing. The elapsed time to carry out impact assessments was frequently excessive, and estimates of costs to implement change were alarmingly high and only costed to the Preliminary Integration Testing stage, which excludes System integration, user testing, and release implementation costs. The SEC Panel's view is that the time and cost of assessing and implementing Modifications has formed a material barrier to change. DCC's failure to report full costs of Modifications has been highlighted earlier (see Section 2.3)

(f) *Comms Hubs Logistics* had a number of shortcomings. In particular, the returns process did not operate successfully at all for most the Regulatory Year. This meant that Comms Hubs suspected as faulty were not subjected to the proper triage process, and hence, any defects remained unassessed. Furthermore, it became clear that DCC had not implemented a bulk returns process for Comms Hubs: it is the Panel's view that this is a SEC requirement.

(g) *The Self Service Interface* was found to be not fit for purpose and a significant programme of improvements was undertaken, under the auspices of an interim process approved by the Panel and overseen by the SEC Operations Group. These improvements were carried out effectively by DCC, with suitable User involvement. However, the question should be asked as to whether SEC Parties should bear the cost of this reengineering work, since the original implementation was significantly deficient.

(h) *Additional Maintenance on Infrastructure* During the year, DCC stated to the SEC Panel that they had identified a programme of additional, essential maintenance that they strongly recommended should be undertaken to improve the resilience and reliability of the service infrastructure. The SEC Panel accepted the DCC's submission that this was necessary: the programme of additional maintenance lasted several months, with frequent service outages. It was executed reasonably efficiently, under the supervision of the SEC Operations Group. There were queries at the extent and necessity of the additional planned outages, and whether these were declared to protect achievement of SLAs. Further, Users reported a material impact from the service outages. They also questioned why such an extensive maintenance programme, apparently correcting serious deficiencies in the implemented infrastructure, was necessary, and who should bear the costs of this work.

Subsequent to the Regulatory Year

(a) There have been some improvements in the matters highlighted by the SSC chair, but some remain outstanding.

(b) The delivery schedule and the *in- service quality of Comms Hub Firmware* still presents challenges for Users.

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[1] The SEC Panel has commissioned a project to address this. DCC are actively participating in this work.

(c) The *availability and reliability of core services* remains unsatisfactory, with Category 1 and 2 incidents being unacceptably frequent.
(d) Services in the *CSP North Region* have improved to some extent, although recently concerns have been reported about the ability of the network as currently configured to deal with the current level of Alerts without service degradation. It is acknowledged that Alerts are at an unexpectedly high level, but it is not clear that the CSPN acted sufficiently promptly to optimise the configuration of the network for the operational circumstances.
(e) Achieving efficient and fast *implementation of change* remains a challenge
(f) The DCC has decided to re engineer the *Comms Hub Logistics* processes and systems. The SEC Panel notes that the current capability does not meet the requirements defined in the SEC, so improvement work is required. However, the question arises as to who should bear the cost of this redevelopment, since the original implementation is clearly not fit for purpose. One consequence of the DCC plan is that the required bulk returns capability will not be available until September 2020.
(g) The *enhanced SSI* is proving to be much more user friendly.
(h) The *Additional Programme of Maintenance* may well have been necessary, as DCC said. However, it has not proven to be sufficient to prevent the serious Incidents which continue to cause service outages and service degradation
(i) DCC are now trialling a much improved approach to planned maintenance. We acknowledge that DCC have been proactive and forceful in demanding that Service Providers reduce their requested outage times.

Concluding Remarks

The SEC Panel's view is that there were serious shortcomings in the quality of the DCC's services provided during the Regulatory Year. Moreover, it appears that in key areas, this unsatisfactory performance has continued. It is vital that all new contracts or contract amendments reflect the need for higher standards and performance that meet User expectations.

3 Responses to Specific Consultation Questions

Question 1: What are your views on our proposals to consider External Costs as Economic and Efficient?

In our view, the quality of what is delivered is a key component of assessing Economic and Efficient External Costs. It is not clear to us that the apparent service shortcomings we have identified have been fully recognised in the assessment. The lack of transparency in terms of 'External Costs' makes assessing this against a clear set of criteria, difficult to undertake, and the Panel recommends further analysis or interpretation by Ofgem to assure Users that DCC is spending 80% of its overall budget in an 'effective and efficient' manner.

We continue to be puzzled by the identification of a separate "Operate at Scale" cost category. We don't believe the overall scale of the SMETS2 arrangements has increased, and the consequences and requirements resulting from this should have been understood at the bidding stage.

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

We understand the need to challenge DCC on their policies in this area, and we welcome the transparency that has been achieved. However, we also believe that it is essential that DCC can recruit staff of appropriate quality and expertise when needed. On the evidence presented, we tend to the view that DCC have taken adequate measures to ensure the timely recruitment of appropriate staff at justifiable rates. We would observe that DCC has increased its overall staffing levels substantially in comparison to the LABP, and suggest that this may be a more critical area for consideration than benchmarking salaries.

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

We note that the TOC has proven to be a valuable capability and no doubt the KPI dashboard is a useful part of this capability. Nonetheless, we agree that this external cost should not be allowed unless DCC can provide further clarity on the justification of the cost and implementation method.

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

We agree with Ofgem's view that this variation should not be allowed. As presented, this annual increase appears to be an arbitrary extrapolation rather than a justified estimate. We are concerned that this is the second year that DCC has attempted to gain agreement to unjustified future costs.

We also agree that DCC should actively be seeking year on year efficiencies. In our view this should be increasingly achievable as operations become progressively more routine. However, the speed at which this will happen will be strongly influenced by the quality of the services implemented by DCC.

Further, we do not support the assignment of a shared service charge purely on a pro rata basis. The annual costs are sufficiently material to be explicitly explained and justified. The adoption of a pro rata methodology would appear to mean that any increase in Internal Costs will automatically increase the Shared Service Charge allocation, regardless of the service provided.

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

As explained in the earlier sections of this response, the view of the SEC Panel is that there were material shortcomings in the quality of the services provided in the Regulatory Year. Nonetheless, we have to accept that the assessment can only be based on the OPR as currently defined. We support Ofgem's view that a review of the OPR is necessary to ensure it properly reflects User experience; in support of this aim, the SEC Panel will continue to support the Metrics Review Project

As examples of our concerns about the current measures used in the OPR, we would mention the following:

(a) Communication Hubs Faults and Returns. Do SUM2b and SUM2c adequately capture the impact of there not being an operational Comms Hub returns process? How are defects in firmware accounted for in these measures?
(b) System/Service Availability (SDM3). Extensive discussions at the SEC Operations Group have established that the definition of availability in the SEC metrics is counter-intuitive: by the definition, it is quite possible for the system to be classified as available, but the service to be unusable by Users
(c) How is the outage time which was required for the essential additional maintenance programme (Section 2.4) accounted for in SDM3?

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?

We support Ofgem's position that it will disallow BM in accordance with the OPR. We see no justification for varying the assessment to favour DCC in this instance, when, in our view, DCC has benefited in other areas from the current OPR definition. Logic would suggest that consistency of application across the OPR measures is essential.

As a general point, we would advise caution on estimates of the impact on Users of service shortfalls. We understand, for example, that Users may well adjust their plans in the light of known service shortfalls: it is very difficult to say “what would have happened” had the service been fully available, and to estimate the impact caused to users who might need to move to sub optimal plans.

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?

This is being addressed in the metrics review project. We believe adjusting the metrics to clearly reflect Users’ business needs is essential. In the same vein, metrics need to be focused on service outcomes rather than be systems related. We also need to find a way of more effectively reflecting the quality of service: an example might be the number and business impacts of known defects in the operational service and in delivered Comms Hubs.

We also note that delivery of change needs to be made more effective and responsive, and we believe this should be considered for inclusion in the OPR.

More generally, our view is that encouraging effective engagement by DCC with SEC Parties and Users is important, and methods of encouraging this should be investigated.

Finally, and more generally again, we believe that Users and SEC Parties would take comfort from knowing that their priorities are being directly presented and understood unfiltered at Board level in DCC. This might, for example, be achieved by the appointment of an independent director to the DCC Board with appropriate communication channels to Users and SEC Parties. Ofgem might consider whether the establishment of such mechanisms could be encouraged in some way through the OPR.

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

We have no comment on this.

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

We have no comment on this.

Question 10: What are your views on our assessment of DCC’s application to adjust the Baseline margin?

We generally support Ofgem’s assessments on New Drivers:

(a) Clearly, account should be taken of any savings of rent accruing to DCC as a result of the move to Brabazon House

(b) We agree that there is no justification for citing an increased business process volume management, given that activity levels are far below what was anticipated at this time

(c) We agree that the impact of New Scope should be reconsidered when there is more certainty of costs.

(d) We support Ofgem’s view that demand for customer and stakeholder engagement has not grown to unexpected levels, but, rather has previously not been satisfied.

We have no comment on the assessment of the acceptable margin

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

We agree with Ofgem's view that DCC should not benefit from a Baseline Margin stemming from the estimated cost of work not done, or to an apparent cost reduction resulting from an initial overestimate of costs. We believe this is consistent with the approach used to allow DCC to benefit from the margin on increased costs for previously assessed drivers.

We agree with Ofgem's view that applications where no justification has been provided by DCC should not be allowed.

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

We agree with Ofgem's view that the new SMETS1 contracts awarded to existing Service Providers should not qualify under this provision, since presumably they are struck under the new arrangements from the outset.

The benefit accruing to DCC Customers from this innovation is welcome, and it is agreed that DCC should benefit from a share of the savings they have achieved. However, we would observe that DCC are funded to explore possible savings, and that there is no audit on this expenditure in comparison to the benefit delivered. DCC are both incentivised to seek savings at zero risk, and to reap a significant reward if successful.

There may be other factors which might influence how these total savings should be divided. For example, do the new arrangements carry any financial or commercial risks that are different from the previous arrangements? If so, where does this risk lie? The point being made here is that if DCC have executed a deal for which they carry no risk, then their share of the savings should be lower; on the other hand, if DCC were to be carrying some risk as a result of the new arrangements it would be appropriate for them to be rewarded accordingly.

Similarly, we would be interested to know whether there is the possibility that similar refinancing could be repeated at some point in the future.

We note the establishment of a team in DCC, and an external procurement, followed by executing the deal. We believe it would be good practice to transparently show the total costs of setting up these arrangements, also including any legal costs and any fees paid to intermediaries or the financier. Our assumption is that such costs will not be material in relation to the savings achieved, but it would be useful to have that confirmed.

Finally, while we do welcome the savings achieved here, we feel obliged to raise the question of senior management time and attention. We would simply note that events of default under the SEC have not always been satisfactorily managed from the point of view of recovering monies due from defaulting Parties. The socialised costs of defaults are material to SEC Parties. The Panel would like assurance that financial deals of the nature described here have not diverted senior management from, for example, overseeing the execution of the SEC credit management arrangements.