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Paper Reference:	**SECP_90_1203_10**
Action:	**For Information**

DCC Price Control Conclusions: Regulatory Year 2019/20

1. Purpose

In October 2020, Ofgem published a consultation on their proposals for DCC price control Regulatory Year 2019/20. The Panel provided a response to the consultation. On 25 February Ofgem published their conclusions.

This paper sets out a summary of the Panel's response to the October consultation and the corresponding Ofgem conclusion.

The full Ofgem conclusions document can be found here.

2. Consultation Findings

2.1 External costs

This area covers DCC management of service providers. The DCC submitted £343m of costs in this section, which primarily relate to work undertaken on SMETS1 and SMETS2. Ofgem found the costs to be classed as economic and efficient.

Panel Response

The response noted that the Panel does not have visibility of the commercial arrangements to confirm if DCC has adequately applied good contract management practice. However, a measure of contract management is the quality of services provided, and therefore concerns over performance set out in the consultation should be considered as part of this metric.

Ofgem conclusion

Ofgem's position remains unchanged. They recognised the difficulty in being able to fully assess the performance when most of the information was confidential but hope changes to OPR will help better manage performance of contract management.

2.2 Internal Costs

Ofgem raised questions over the benchmarking of contractor's salary and costs associated with a retention scheme. They also raised concerns about the lack of clear justification for an increase in forecast cost; especially on setting up a new product management team.

Panel Response

The response welcomed the scrutiny applied but noted there is a need to ensure that the DCC can recruit staff with appropriate skills and experience. It is equally important to ensure that, within reason, such staff are retained to ensure a standard of service. However, since the Panel has not seen the evidence or analysis provided to Ofgem they defer to Ofgem's judgement in this area.

The Panel also supported Ofgem's decision to disallow the forecast costs, observing that a new product management team is not required, and focus should be on delivering core services. Furthermore, the lack of sufficient rationale for the forecast costs means they are not credible and should therefore not be accepted.

Ofgem Conclusion

Following the DCC providing further analysis and information, Ofgem have reduced the disallowance relating to the benchmarking and retention scheme from £3.771m to £2.847m. Additionally, after receiving further clarification about how the new product management team assists the delivery of core services, Ofgem are reducing the amount disallowed from £0.509m to £0.191m.

Ofgem reaffirmed their view that forecasts costs were not properly justified and have maintained that the full £4.654m in forecast costs are disallowed.

2.3 Performance Incentives

The DCC submitted a reduction in its margin of £0.840m relating to its performance under the OPR. However, Ofgem proposed to increase this figure to £1.644m due to OPR performance, specifically, for a missed coverage milestone in the north region.

Panel Response

The Panel set out a number of areas relating to DCC performance, both in the body of the response and in a detailed attachment. That information covered topics such as: service stability/quality, Incident management, CSPN and Comms Hubs returns.

Ofgem Conclusion

Ofgem have maintained their position to increase the reduction to DCC's Baseline Margin due to DCC's performance under the OPR by £0.804m (from £0.840m to £1.644m).

2.4 Baseline Margin

The DCC's Baseline Margin can be adjusted to compensate for material changes in the DCC's Mandatory Business. The DCC submitted an application for an increase of £10.795m to its Baseline Margin. Ofgem proposed lowering this to £7.521m (a reduction of £3.275m from the application) as it was felt that a number of services applied for under the Baseline adjustment were not a material variation or should have been anticipated by the DCC as part of their current activities.

Panel Response

The Panel support Ofgem's approach agreeing that many of the activities stated in the submission should have been foreseen and do not meet the criteria of "material changes to mandatory business". In particular, the Panel highlighted Network Evolution and questioned "Increased Security Requirements" since the activities relating to bringing DCC's IT infrastructure in-house were not due to any new or increased security requirements being introduced to the SEC.

Ofgem Conclusion

Ofgem have maintained their position for the majority of activities ruled out. However, the DCC provided further evidence regarding the SMETS1 discrepancy and as such this has now been allowed. Equally, Ofgem have allowed activities relating to DSP and now believe the DSP re-procurement constitutes a material variation from the LABP.

2.5 External Contract Gains Share

The External Contract Gains Share (ECGS) allows DCC an increase in Allowed Revenue for securing cost savings in a service provider contract that existed at licence award. DCC applied for a £3.812m ECGS adjustment. £3.062m of the application relates to savings created by refinancing DSP and CSP services. The remaining £0.751m related to savings from refinancing of Tranche 2 CHs.

Ofgem proposed to uphold the DSP and CSP element of the application, but disallow the portion assigned to CHs due to insufficient evidence of how CHs were originally costed.

Panel Response

The Panel welcomed that costs associated with contracts are actively being reduced, although noted they remain high. There was support for Ofgem's position to disallow Relevant Adjustment associated with financing of CHs on the basis that the Panel has also struggled to receive information on the costs of CHs as part of the Network Evolution business case and cost benefit analysis.

Ofgem Conclusion

Based upon additional evidence submitted by DCC, Ofgem have decided to change their position and are no longer rejecting £0.751m relating to CHs financing. The remaining elements of the application continue to be upheld.

3. Recommendations

The Panel is requested to **NOTE** the consultation summary.

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5 March 2021