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Dear Andrew,

Consultation on DCC Price Control: Regulatory Year 2017/18

Citizens Advice has statutory responsibilities for representing the interests of energy consumers in Great Britain. This consultation response is completely non-confidential and may be published on your website. We are thankful to Ofgem for discussing this consultation with us ahead of our response and if you would like to discuss any matter raised in more detail please do not hesitate to get in contact.

We are largely supportive of Ofgem's proposals in this consultation to drive down the costs requested by DCC. As we made clear in our response to the December 2017 consultation¹, the underlying framework of this price control potentially risks significant cost downsides to consumers and DCC have strong incentives to push for higher allowances. Consequently, it is imperative that Ofgem act to ensure that consumers benefit from this price control and that all allowed costs are economically and efficiently incurred. Costs that are not should be excluded from the future calculation of allowed revenue.

We have long called² for a transition to a fully ex ante DCC price control. This would give more certainty for stakeholders and a stronger mechanism for keeping costs under control. We would be interested to see Ofgem's reasoning for not moving to such a

¹<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-consultation-responses/dcc-price-control-consultation-regulatory-year-2-01617/>

²<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-consultation-responses/citizens-advice-response-to-ofgms-consultation-on-data-communications-company-dcc-price-control/>

framework before now, as well as any plans it has for doing so in the future or at what *measurable point* it would consider it appropriate to do so.

We believe there to be a number of relevant components of the proposed RIIO-2 price control that could be incorporated into the DCC price control, especially those relating to enhanced stakeholder engagement. We consider these components to offer significant improvements in the way that the DCC price control allows for adequate cost scrutiny and assessment of the quality of stakeholder engagement performed by DCC. To date, DCC's approach to stakeholder engagement has been remarkably poor, and we are surprised to learn that despite this issue being raised last year, DCC have delivered no progress on this to date. We recognise that DCC have, this month, opened a consultation on improving their engagement with customers and stakeholders. This is welcome, however we are disappointed that this appears to be the only action on this crucial issue in over a year. We strongly encourage DCC to review our 2018 report³ on stakeholder engagement, and the enact the relevant recommendations made as soon as possible. We would be happy to work with Ofgem and DCC to develop this.

We have commented on these matters in further detail below in our answers to the questions in your consultation.

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

We agree with Ofgem's implicit view that External Costs *should* be incurred economically and efficiently. They are the primary driver of consumer costs associated with DCC's service and therefore it is crucial that they remain as low as possible, whilst enabling the delivery of a quality service.

However, given the available evidence, we are not in a position to assert whether or not these costs have indeed been incurred economically or efficiently. As noted in the National Audit Office's 2018 report⁴ on the smart meter roll out, along with energy suppliers (who would otherwise be particularly well placed to scrutinise the costs and

³Strengthening the voice of consumers in energy networks' business planning, 2018, available here: <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/strengthening-the-voice-of-consumers-in-energy-networks-business-planning/>

⁴<https://www.nao.org.uk/wp-content/uploads/2018/11/Rolling-out-smart-meters.pdf>

benefits of the DCC's services), we are prevented from scrutinising the DCC service providers' costs because details are redacted on grounds of commercial confidentiality.

In line with the improved financial scrutiny provided by the Challenge Group (CG) in the enhanced stakeholder engagement component of the RIIO-2 price control, we strongly encourage Ofgem to set up an equivalent process for scrutinising DCC's costs as soon as possible. This would permit third party scrutiny of all DCC's costs, potentially allowing for a view to be taken on whether their External Costs are economic and efficient. Further, given the importance of all cost variations being adequately explained and evidenced in DCC's submissions, Ofgem should consider and consult on how this process can be improved.

On the efficiency of these costs, we note that no efficiency gains were identified in the Communication Service Providers' (CSP) contracts in RY17/18 (stated in Appendix 2). We would welcome commentary from Ofgem specifically on whether opportunities were missed in this respect, as continual efficiency gains should be a staple of all price control components.

Question 2: What are your views on our proposals on DCC's Internal Costs?

We are broadly in support of Ofgem's views on DCC's Internal Costs. However, the continued and significant disparity between DCC's claimed costs and those that Ofgem deem as legitimate is a concern.

In the RIIO-2 price control, Ofgem is proposing to penalise companies where they fail to provide accurate and quality cost assessments in their Business Plans, even when there is only one company in a sub-sector. We would like to see Ofgem implement a similar mechanism for the DCC price control, and we anticipate an explanation if such an approach is not implemented. Without such improvements, Ofgem inhibits its ability to control prices at an efficient level, as the behavioural incentive for DCC will be to continually raise costs - even where they are unwarranted, as evidenced by Ofgem's significant and abundant disallowances of costs in this round.

Question 3: What are your views on our proposals on DCC's approach to benchmarking of staff remuneration?

As noted in para 3.27, there are no similar and commercially-available benchmarking databases for contractors, so we cannot take a meaningful view on the underlying validity of DCC's approach to benchmarking with the wider market.

We agree that DCC's proposed 50% "contractor premium" appears unjustified. Given the past discrepancies between DCC's claimed costs and those that Ofgem deem as legitimate, DCC's proposal to derive an appropriate premium in part on its own internal records is not recommended and could be considered inappropriate.

Question 4: What are your views on our proposals for Shared Services?

We are supportive of Ofgem's proposals to disallow inefficient costs associated with DCC's Shared Services. However, unless Ofgem introduces a downside risk associated with such potential misallocation of consumers' money (beyond the costs simply being disallowed), then no incentive exists for DCC to improve in this respect. Therefore we encourage Ofgem to consider penalties where DCC's decisions in this component of the price control can be reasonably considered as inefficient.

Question 5: What are your views on our proposal to expect more robust evidence from DCC on how it has taken customer views into account in future price control submissions?

Question 6: What are your views on the processes that DCC should establish to enable meaningful customer input to decision-making?

We have answered Questions 5 and 6 together.

We agree with Ofgem's view that, in future submissions, DCC should provide more robust evidence of how it has taken into account the views and needs of its customers when making decisions that impact on the cost of customer services. There has been a lack of commendable progress on DCC's customer engagement to date, despite Ofgem's expectations being made explicit in the past. This merits more from Ofgem than simply further expectations that DCC work with the SEC Panel to develop procedures around gathering customer views.

Ofgem published its view in the RY16/17 price control decision document that it expected DCC to take note of customers' requests for greater engagement. However, this year's

consultation document makes clear that there have been reported issues relating to the timeliness, content and transparency of this engagement. Ofgem notes their expectation that DCC establish a structured set of arrangements to facilitate meaningful input from customers, however without this being stipulated in some way there doesn't seem to be an adequate incentive in place to encourage this needed improvement.

There are lessons to be learnt here from the RIIO-2 price control, specifically the role of Customer Engagement Groups in scrutinising the quality of companies' stakeholder engagement and the degree to which that engagement is reflected in business planning. This in itself helps to incentivise companies, on a reputational level, to improve their practices. We would urge Ofgem to consider implementing a form of this enhanced stakeholder engagement in the DCC price control as soon as possible. The findings from such added scrutiny should also provide helpful evidence to Ofgem on this necessary and important aspect of DCC's activities.

Finally, we hope Ofgem will reconsider its intention not to strengthen customer input into decisions and transparency around DCC's costs (see para 5.10), as is being implemented in RIIO-2 for network company costs via the CG. If not, we would like to see adequate justification from Ofgem for not implementing such enhanced scrutiny, which we view as necessary on account of DCC's continually rising costs, their unpublished service providers' cost details and the risk these pose to public perceptions and trust in the DCC price control.

Question 7: What are your views on our assessment of DCC's application to adjust its Baseline Margin?

There is insufficient evidence and detail in the consultation document for us to take a meaningful view on Ofgem's assessment of DCC's application to adjust its Baseline Margin.

We are broadly supportive of Ofgem's intention to not allow increased cost claims where the associated sub-drivers lack sufficient evidence or where they do not appear to meet the conditions for a Relevant Adjustment given in the Licence. The consultation document appears to provide no detail on the 13 remaining cases where Ofgem agrees with DCC, so we are not able to comment on these.

Question 8: In its submission, in support of its application for an adjustment to its Baseline Margin, DCC states that there has been a significant unanticipated change

in customer expectations, and in customer and service provider demands. What are your views?

We are unable to take a view on this until we are provided with more detailed evidence around this statement by DCC.

Question 9: What are your views on our assessment of DCC's application for External Contract Gain Share?

We have not been provided with enough detail on Ofgem's assessment of DCC's application for External Contract Gain Share to take a view.

Paras 6.25-27 appear to provide a brief and high level conclusion of Ofgem's assessment. We would encourage Ofgem to provide significantly more detail on its evaluation of this additional multi million pound cost, without which we are unable to take a view of the validity of Ofgem's assessment of it. Reiterating a point made earlier in this consultation response, our view is that moving to an ex ante price control would provide more certainty on DCC's costs and ultimately reduce those shouldered by consumers.

Question 10: What are your views on our proposal on DCC's over-recovery of revenue?

We do not consider that Ofgem's intention to simply encourage DCC to take steps to improve its estimates in the future go far enough. Without applying material incentives or providing more specific guidance in this respect, DCC are unlikely to make the changes that Ofgem require.

Having reviewed the detail provided in the consultation document, we are unsure as to why Ofgem has not proposed imposing penalty interest on DCC's over-recovered revenues. These revenues breach the threshold significantly, and whilst DCC has identified some factors that it considers could not reasonably have been anticipated (and that together have caused that breach), Ofgem's view (para 7.5) is that DCC did not make reasonable predictions of these costs. As Ofgem consider, in this respect, that DCC have not acted in accordance with reasonable expectations, then the Additional Funds and Interest Income components should not be disregarded.

If DCC's failure to reasonably predict costs causes them to breach the threshold, then the threshold penalty should be enforced in order to disincentivise similar cost inflations in future submissions. In this case, Ofgem's incentives (to reassess costs) contaminate the

incentive structure in place to promote DCC's accurate prediction of costs, which is a problem that should be reassessed in future. We look forward to Ofgem providing more clarification on why DCC's treatment of these costs have been regarded as reasonable when Ofgem state that they are not.

Further, we encourage Ofgem to revisit and justify the existing penalty interest rate of 3% above the Bank of England base rate (on any proportion of over-recovery that DCC has not justified). We would welcome some fresh commentary from Ofgem on whether this rate is an adequate deterrent, in the light of it not performing that function this time around.

I hope that you find this response clear, but I would be happy to discuss any matter raised within it in more detail if that would be useful.

Yours sincerely

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