Citizens Advice

Tricia Quinn
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Dear Ms Quinn,

Consultation on the DCC price control

This consultation was prepared by the Consumer Futures team within Citizens Advice. It has statutory responsibilities to represent the interests of energy consumers in Great Britain. We welcome the opportunity to provide a submission on Ofgem's assessment of DCC's reported costs from its first year, and its application to change its baseline margin values.

Summary

Given that DCC will be spending roughly £2bn funded from consumers' energy bills over the twelve years of the licence, as well as providing vital services to enable the smart meter rollout, we see this first price control as an essential opportunity to set the bar high and secure lasting value for money. The proposals go some way towards this and we broadly support Ofgem's approach. There are, however, certain specific points within the proposals where we would question if consumers are getting a fully fair deal, as explained in our detailed comments below.

More generally, we would highlight that the underlying dynamic of this price control is potentially skewed against consumers. DCC clearly have a strong incentive to argue for a higher allowance, and since these costs would affect all users equally and be passed on to consumers, they will have a minimal effect on those users' competitiveness. This removes any clear counterweight of advocacy within industry to offset DCC's position. With this in mind, we would hope that Ofgem's attitude would always be to give consumers the benefit of the doubt where any doubt in this price control exists (as it inevitably does, especially at this early stage of the licence term). Under the current proposals our assessment, detailed below, is that DCC seems perhaps to be benefitting from Ofgem's caution.

Detailed comments

We recognise that the new and unique function of the DCC makes an ex post approach to the price control the best option at this stage. At the same time, we are keen to see a transition to a fully ex ante control as soon as possible. A revision of forecasted costs upwards by £71m after only half a year of operation, with more than 90% proposed allowed, does not bode well for consumers getting a good deal from an ex post arrangement. Although we recognise this is partly for reasons beyond DCC's control, an ex ante approach would give more certainty for stakeholders and a stronger mechanism for keeping costs under control. We would hope to see this in place by 2016/17 at the latest, in the absence of pressing reasons otherwise.

One of the areas on which an ex ante approach might provide more rigour is the judgement of economic and efficient spending. Even after open and competitive tendering, we would ask if anything more can be done to go beyond the assumption identified in the consultation that the costs contained in the Licence Application Business Plan (LABP) are economic and efficient. Otherwise, there is a risk of one-way pressure, where there is potential for these costs to rise but never to fall. The same is true of the costs of DCC's external contracts. A broader benchmarking methodology would be beneficial. The attitude that 'we have scrutinised the cost of this contract and consider these forecasts to be economic and efficient since the contract was competitively procured' excludes the possibility of any inefficiency in procurement. This seems particularly questionable since DCC has not yet been required to make its procurement assessments available.

Ofgem should have a plan in place to recover inefficient costs if these assessments are found to be inadequate. But even then, such corrections would be second best to avoiding over-generous decisions in the first place. With this in mind it is worrying that in several areas DCC is being allowed extra costs with the caveat that reporting and justification still need to be improved, with the prospect of resultant revisions. This affects both internal and external costs.

Within internal costs, Annex 3 for example describes how increased staff costs within the finance centre do not reflect the possibility that new roles required at start-up might not be required once DCC is operating in a steady state, nor that 'the risk of this type of inflation should have been reflected in DCC's bid margin'. Nonetheless, the proposed decision is to allow the cost of these roles for the whole term, only excluding increases in salaries and benefits against LABP, and 'to consider this more closely at future reviews.' On the external side, the consultation proposes to allow the entire £38m despite recognising that DCC's reporting has not yet been sufficient to demonstrate that external contracts were procured economically and efficiently. We recognise that deciding on these costs is extremely difficult with the partial information available at this stage, but all the same, the decision to give the DCC the benefit of the doubt in this way risks lasting consumer detriment. A preferable approach where some information is still to come would be to compromise. We support the decision to disallow the increased shared service charges, but here the decision actually seems clear cut: consumers would get a better deal if Ofgem was more confident in disallowing costs elsewhere. This early in the licence term, it seems unlikely that this would damage DCC, which could always be compensated if and when it provides justification of the proposed costs.

Ofgem is right to hold DCC to account for its failure to meet IM5, the submission of DSP interface specifications. Even if the delays in this area involve other parties as well, DCC should be penalised for failing to build the necessary contingency into its business plan and the serious delay this may lead to in consumers receiving their smart meters. That such a key deadline has been missed so early in DCC's existence raises a question as to whether the implementation milestones incentives are strong enough, and whether the relatively small disallowance of £0.315m is sufficient. Subtracting this from the baseline margin of £1.8m, this still leaves a return for 2013/14 of more than 11% of DCC's allowed revenue, a high figure for a period where key milestones have not been met.

Furthermore, the consultation document states that the £0.315m IM payment can be earned back if IM12, the commencement of Initial Operational Services, is met on time. This raises two concerns. First, it is not clear from the Smart Meter Communication Licence how the margin adjustment for IM12 is related to IM5 (unlike IM14, which appears explicitly designed as a chance to recoup the cost of IM11, 12 and 13 being missed). Second, if IM12 is to be pushed back from the delivery date of 30 September 2015, this is likely to be in part due to the delay to IM5, so allowing the IM5 adjustment to be recouped just because IM12 is met seems overly lenient.

Penalties more generally could also be strengthened. We note that the fourteen IM penalties add up to 100% of the Baseline Margin Implementation Total, meaning that if DCC was to miss thirteen and meet one they would still be rewarded for its performance. When the next framework for incentives is being agreed, a better calibrated arrangement, where the penalties for missing each are greater but the composite effect is capped at 100%, would provide for a better sharing of risk between the DCC and consumers.

In the post-implementation incentive framework, we are keen to see incentive measures that reflect the marginal benefit delivered for consumers. We have previously expressed concerns about financial outperformance becoming the 'default' outcome in the context of gas and electricity distribution and transmission and it is critical that this does not emerge in the arrangements for the DCC. Performance should not be over-rewarded nor over-counted – something that appears a risk given the similarity of the four support incentives that are proposed (service user satisfaction, service delivery, development and improvement, and value for money).

We also believe more clarity is needed on how the value for money incentive will interact with the assumption in the price control that LABP costs are already efficient. If it is felt that an incentive might discover further efficiency, then every effort should be made to achieve this through greater scrutiny and benchmarking in an ex ante control, before resorting to incentive payments.

In terms of the process for the review of the remaining milestones, it might be preferable to give stakeholders a chance to engage more actively, rather than leaving it to the DCC to conduct the review and then consult on its proposals. This would lead to a more RIIO-like approach in which stakeholder engagement takes a central and early part in setting the arrangements. Any variations to due dates and implementation criteria should be developed in collaboration with DCC's users and consumer groups.

Facilitating stakeholder engagement should also be a key consideration of DCC's reporting requirements. Citizens Advice is currently examining how well consumers are served by the reporting arrangements under the RIIO price controls, and one early finding that should apply equally to DCC's reporting is that the form and accessibility of reports is as important as their content. To achieve transparency, it is not enough to put the numerical data for that reporting period online. Reports should be proactively disseminated, and the methodology for calculating any change in allowed revenue clearly explained. We will be happy to comment on this further in forthcoming consultation on changes to DCC's RIGs.

The decision not to adjust DCC's baseline margin is clearly correct. The fact that DCC has applied for an adjustment on the grounds of activity carried out by third parties and financing information that was already available when the contract was awarded implies an opportunistic attitude that does not sit well with delivering best value for money for consumers. DCC's bid to increase the shared services costs paid to Capita, together with the non-competitive interest rate at which it borrowed working capital from its parent company mentioned in Annex 3, does raise concerns for consumers that will need to be addressed by Ofgem as part of the regulatory process.

Please do not hesitate to contact me if you would like to discuss this submission further.

Yours sincerely,

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