

Dr Alan Whitehead MP
Shadow Minister for Energy and Climate Change
House of Commons
London
SW1A 0AA

Date: 21 January 2019

Dear Dr Whitehead,

This letter is in response to the House of Commons Parliamentary Question you tabled on 18th December (Written question – 203200) in relation to the level of margin and bonus awarded to the Data Communications Company (DCC) for the Interim Centralised Registration Service.

Level of margin

DCC's activities in relation to the Interim Centralised Registration Service fall into two phases, the Transitional Phase and the Design, Build and Test phase. We set the level of margin separately for each phase.

Transitional Phase

We consulted on a margin and incentive regime in November 2016¹ with a decision and direction issued in March 2017². These documents set out the full criteria and methodology adopted in determining the margin.

The criteria and methodology used to determine the margin level were based on the statement from our May 2016 document on DCC's role within the Switching Programme³ that DCC can reasonably expect a margin for its Switching Programme activities which is commensurate with the degree of associated risk. As DCC is asset-light, a return on sales approach was adopted with the margin level determined based on external bench-markers of expected market returns for activities similar to those being carried out by DCC and the specialist skills provided by DCC.

Following consultation on this analysis we concluded that 12% was the appropriate margin level. This represented the maximum margin level that DCC could earn on economically and efficiently incurred costs. A portion of the margin was placed at risk against three incentivised milestones with 12% representing the amount that could be earned if all three milestones were successfully met.

¹ <https://www.ofgem.gov.uk/publications-and-updates/minded-position-margin-and-incentives-dccs-role-within-transitional-phase-switching-programme>

² <https://www.ofgem.gov.uk/publications-and-updates/decision-margin-and-incentives-dccs-role-within-transitional-phase-switching-programme>

³ <https://www.ofgem.gov.uk/publications-and-updates/final-proposals-dcc-s-role-developing-centralised-registration-service-and-penalty-interest-proposals>

Design, Build and Test Phase

We consulted on this in October 2018⁴ and are currently reviewing the responses. We expect to issue our decision and direction on this in spring 2019.

The criteria and method to determine the margin was the same as above. There are still a limited number of comparators to DCC's role during DBT. It was felt that the closest comparator was DCC's during the Transitional Phase of the Switching Programme.

We are yet to make a decision but the consultation proposed 12% as the maximum level of margin that could be earned economically and efficiently incurred on Internal Costs. The majority of DCC's costs are likely to be External Costs which 0% margin is earned on. The actual margin earned on combined costs is likely to be much lower than 12%.

A significant portion of this margin (likely >75%) will be placed at risk against a series of milestones meaning that the 12% margin will only be earned if all time and quality milestones are met.

Capped discretionary reward

We have proposed that DCC could receive a capped discretionary reward from the authority where it can be demonstrated that it has gone out of its way to deliver quality higher than that set out within the Retail Energy Code and that this is delivering real benefit to the programme and end consumer. We propose capping this at a fixed value – potentially in the region of £150-200k. This would be mirrored with a capped penalty of the same value if DCC is unable to deliver the set standard within the planned timelines. Criteria used in setting any reward cap we will take in to account the potential cost and benefit to consumers along with consultation responses received.

Bonus

No bonus, other than the potential capped discretionary reward described above, has been proposed or awarded to the DCC for the Interim Centralised Registration Service.

I hope this letter addresses the questions you raised – but if I can be of further assistance, in this or any other matter, please don't hesitate to let me know.

Yours sincerely,



Dermot Nolan
Chief Executive

⁴ <https://www.ofgem.gov.uk/publications-and-updates/switching-programme-regulation-and-governance-way-forward-and-statutory-consultation-licence-modifications>