



Financing arrangements for DCC1 and DCC2 during Business Handover

Smart DCC Response

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Executive Summary

It is important to facilitate a robust financial transfer between DCC1 and DCC2¹ and ensure clarity regarding DCC1's activities following the Transfer Date. In our response, we have set out practical suggestions to ensure these arrangements are robustly captured within the regulatory framework and implemented effectively in an economically efficient manner.

We do not support Ofgem's Proposal 1 to increase the financial security provided as per Condition 26 in the SMCL1 to address liabilities that may arise after the Transfer Date because this would increase costs to DCC customers and there are minimal risks of liabilities arising once the Authorised Business has been handed over. There has been no justification presented for the need to increase the value of the financial security provided. We also oppose Proposal 2 for ring-fencing arrangements that would result in DCC2 retaining margin, overhead and gainshare owed to DCC1 until the end of the Smart Meter Communication Licence (SMCL1) given that Ofgem have not quantified the potential liabilities. We will work with Ofgem to explore their risk perception and obtain (from Ofgem) a clear definition of the potential future liabilities.

The omission of quantification of both any future liabilities or any required increase in the surety bond within the current consultation undermines the ability of all stakeholders to respond appropriately. Ofgem's existing consultation does not provide sufficient information to allow informed responses and thus breaches the Government's principles² for good consultation. On this basis, it is vital that Ofgem re-consults on these proposals (supported by appropriate materiality assessments) before proceeding to conclude on these matters.

1 Introduction

We are pleased to submit our response to Ofgem's consultation³ on the financial arrangements for DCC1 and DCC2 during Business Handover that was published on Friday 24 October 2025.

The remainder of this document is structured as responses consistent with the chapters and questions in Ofgem's consultation.

2 Policy gaps and proposals

2.1 Financial Handover Arrangements

This section sets out our understanding of Ofgem's proposals for the financial arrangements between DCC1 and DCC2 to apply from the award of the SMCL2 (expected 1 March 2026) to the expiry or revocation of the SMCL1 (anticipated at licence expiry on 22 September 2027).

We agree that there should only be one Charging Statement in force at any time from DCC under the Smart Energy Code (SEC) as this minimises the impact on customers of the Authorised Business. On this basis:

- DCC1 will retain responsibility for the Charging Statement until the Transfer Date (1 November 2026⁴) with the last invoices to customers in October 2026; and
- DCC2 will issue an initial Charging Statement prior to the Transfer Date with its first invoices to customers in November 2026.

¹ In this response we adopt Ofgem's DCC1/DCC2 nomenclature so Smart DCC Ltd is DCC1. We also use the term DCC to reflect the SEC obligations that transfer from DCC1 to DCC2 on the Transfer Date.

² <https://www.gov.uk/government/publications/consultation-principles-guidance/consultation-principles-2018>.

³ <https://www.ofgem.gov.uk/consultation/financing-arrangements-dcc1-and-dcc2-during-business-handover>.

⁴ Please note that as 1 November 2026 is a Sunday, it may be prudent for the Transfer Date to be Monday 2 November 2026.

There should be no 'price shock' event for customers of the Authorised Business at the point of handover i.e. DCC1 should set charges for the period from April 2026 to March 2027 based on a budgetary view that allows for a seamless cash flow transition between DCC1 and DCC2. In line with this principle, we agree that DCC2 costs should be recovered by DCC1 and passed through to DCC2 from the point of Licence Award. The alternative approach, which would involve DCC2 initially borrowing funds followed by a price adjustment in November 2026 when DCC2 starts to directly recover its costs, would have a significant impact on customers. To set charges reflective of DCC2's costs between 1 March 2026 and 31 October 2026, DCC1 needs a prudent budget from Ofgem (based on information from DCC2 bidders) for inclusion in the existing Charging Statement updates.

DCC1 will continue to have licence obligations it must deliver under SMCL1 from the Transfer Date until expiry of the SMCL1 on 22 September 2027; it is vital that an effective and efficient route exists to provide DCC1 with:

- funding for any costs directly incurred (e.g. an external auditor);
- access to information within DCC2; and
- support from DCC2's personnel.

We agree that DCC2 should recover (from customers of the Authorised Business) the costs for the residual DCC1 activities required after the Transfer Date until expiry of the SMCL1 on 22 September 2027 (such as the final Price Controls). DCC2 and DCC1 should settle final ex post price control outcomes on a net basis (margin compared against disallowance and cash may flow either way).

To deliver these residual activities, DCC1 will also need to rely on DCC2's personnel and systems. We propose that DCC1, DCC2, DCC1's owner, and DCC2's owner enter into a legally binding cooperation agreement setting out how this will work in practice. The cooperation agreement would also cover initial handover activities between award of the SMCL2 and the Transfer Date. We have already provided Ofgem with a draft of this cooperation agreement.

DCC2 costs are subject to an ex ante regime and we will update the initial ex ante Business Plan Report to include cost estimates for DCC1's residual SMCL1 activities.

Given payments will flow both ways, we propose that DCC1 and DCC2 enter into a binding financial agreement consistent with the requirement in Condition 43.16 of the SMCL1. We are currently preparing a draft of this agreement for Ofgem's review.

In summary, we are committed to working with DCC2 to ensure financial handover is implemented in an effective and efficient manner in line with Ofgem's expectations which limits the impact on DCC's customers.

2.2 Proposal 1 – Increase in Financial Security

DCC1 does not support any increase in the financial security provided under Condition 26 in the SMCL1 given the consequential cost impact on DCC's customers.

Condition 26 of the SMCL1 requires DCC1 to procure financial security at a level agreed with Ofgem, set at £10m. DCC1's owner provides DCC1 with a Parent Company Guarantee (supported by a Letter of Credit) setting out the capital placed at risk by DCC1's owner. This £10m reflects the risk position agreed at award of the SMCL1 to ensure DCC1 would remain a going concern and pay its service providers in the event DCC's customers defaulted on their bills. However, since the £10m Parent Company Guarantee was put in place, robust payment arrangements coupled with a comprehensive credit cover regime have been implemented, effectively removing any risk to DCC1 from non-payment by its customers. Increasing the Parent Company Guarantee will mean DCC1's owner will need to place additional capital at risk. DCC1's owner has advised us that there are cost implications arising from any increase which cannot be quantified at this time given

that Ofgem have not set out their views on the quantity of liabilities. DCC1 will work with Ofgem to explore alternative financial security arrangements if required.

In August 2025, following a direction from Ofgem, the financial security arrangement was extended to 22 September 2027. The existing charging regime in the SMCL1 and SEC provides assurance that DCC1 is financially stable. The purpose of the Condition 26 financial security is to provide additional assurance from DCC1's owner that DCC1 remains financially stable. We note that the existing financial security has not been utilised since establishment in 2013. The cost of the existing Condition 26 financial security is provided in an economically efficient manner and funded within DCC1's Allowed Revenue.

Condition 26 allows Ofgem to direct that the existing financial security is increased. Ofgem have indicated that they plan to seek an increase to address liabilities that may arise after the Transfer Date without quantification. Any increase in the amount of financial security provided would cost more compared to the existing arrangements; leading to an unwelcome and unnecessary uplift in DCC1's charges to customers.

There are two purposes for the financial security provided pursuant to Condition 26 in the SMCL1:

- to ensure liabilities that arise during the Handover Period (set out in Condition 43 in the SMCL1) can be fully met; and
- to ensure that any administrator appointed for DCC1 (e.g. following an insolvency event) has the financial means to deliver the ongoing smart metering services.

Ofgem wrote to DCC1 on 30 September 2025 to give notice that the Handover Period is from 1 October 2025 to 22 September 2027. Thus, Ofgem's consultation on 24 October 2025 to increase financial security for the Handover Period is retrospective and should not proceed. For example, it may have been appropriate for Ofgem to assess the potential liabilities during the Handover Period when it extended the SMCL1. Furthermore, the requirements in Condition 26.14 are not currently met; there are currently no material changes to the DCC1's Authorised Business that would warrant an increase. In fact, there is less than a year to go to the Transfer Date and DCC1's Authorised Business is now reducing.

Condition 24 of the SMCL1 requires DCC1 to secure the resources, including financial, necessary to operate its business effectively and fulfil its legal and licence obligations. Under Part B of this Condition, DCC1 must provide a financial declaration confirming its Board expects the existing financial security will not be used in the next twelve months and that it can continue funding its activities under the SMCL1. As set out in the 2025 DCC1 Annual Report, the Directors confirmed it was appropriate to adopt the going concern basis, meaning they expect the company to continue operating normally with sufficient resources. When preparing the Annual Report and Accounts, this assessment included modelling potential downside scenarios through to March 2027. This is supported by the Certificate of Financial Resources provided by DCC1 as per Condition 24 in the SMCL1.

Costs incurred to meet liabilities arising during the Handover Period will be included in the charges to customers through the Charging Statement. If a material increase in costs is agreed, there would be an amendment to the Charging Statement to reflect this. This approach ensures sufficient cash is available to settle liabilities; thus, there is no need to increase the financial security provided by DCC1.

Given our existing plan that all cash/liabilities will transfer from DCC1 to DCC2, the risk of financial liabilities not being met is extremely low. Ofgem have presented no justification (or analytical assessment) to quantify the need to increase the value of the existing financial security above the existing £10m i.e. Ofgem have not stated their required value nor the method of calculation. DCC1 will continue to provide evidence to Ofgem to demonstrate there is minimal risk such that there is no need to increase financial security. At a working level, DCC1 has engaged with Ofgem to illustrate the minimal risk profile given the approach to financial handover and the existing protections within the charging regime in the SMCL1 and the SEC.

Because it is not possible to properly comment on the impact of the proposals due to the absence of information, Ofgem should re-consult on Proposal 1 and quantify the financial liabilities that it believes may not be met to justify their proposal for an increase. This consultation should include an impact assessment of the costs and benefits of their proposal. Aligned to the Government's consultation principles, this further consultation will allow all stakeholders to be fully informed and provide meaningful responses.

In summary, DCC1 believes it has the means to cover financial liabilities arising during the Handover Period given the approach to financial handover and the existing financial security in place. Thus, an increase in the existing financial security provided by DCC1 is not needed.

2.3 Proposal 2 – Ringfencing

DCC1 strongly disagrees with the proposed ringfencing approach and therefore does not support Proposal 2.

Ofgem's proposal for ringfencing is entirely one-sided i.e. Ofgem requires DCC1's owner to continue to meet disallowances in full without any corresponding offset for margin payments due to DCC1's owner. DCC1 has proposed that all cash balances and liabilities move from DCC1 to DCC2 on the Transfer Date to provide a balanced and equitable approach. DCC1's proposal eliminates the risk that liabilities arising from the final price control determinations (applied to DCC1) are not met and removes the need for any ring fencing. Additionally, this delivers a secure starting cash flow position for DCC2.

Ofgem has not documented the liabilities that they are trying to protect against with the proposed ringfencing. Ofgem should re-consult on this proposal alongside Ofgem's quantification of the liabilities to allow for meaningful responses to be provided by all stakeholders. Given the information presented in the current consultation, DCC1 does not support the ringfencing approach in Proposal 2.

3 Current SMCL Pre-TD recovery pathway

3.1 Ofgem Question 1 DCC2 Cost Recovery Mechanism

Q1. What are your views on the proposed mechanism to enable DCC2 to recover necessary Business Handover costs prior to Transfer Date?

Having a single charging regime is a prudent approach for recovery of Authorised Business cost; it would be inefficient for DCC2 to start charging customers before the Transfer Date (1 November 2026) and equally challenging for DCC1 to continue charging customers post-handover until revocation of the SMCL1 in September 2027. To deliver this approach both DCC1 and DCC2 would need to operate charging regimes in parallel.

Thus, we support the proposal that DCC1 funds efficiently incurred DCC2 costs within the Regulated Revenue collected under the SMCL1. DCC1 will promptly pay invoices levied by DCC2 where the regulatory approval is clearly understood based on an 'approval' direction from Ofgem that accompanies each invoice from DCC2.

Whilst the proposed approach for DCC2 funding prior to the Transfer Date is an expansion of the existing processes by which SECCo and AlTHAN Co receive funding via DCC1, Ofgem should note that these are established undertakings with known budgets over a three-year period whereas DCC2 will be a start-up in these first few months. Therefore, to enable this financing to be successfully implemented with minimal impact on customers of the Authorised Business, Ofgem will need to obtain from DCC2:

- initial cost estimates for the January 2026 Indicative Charging Statement; for this to be workable, DCC1 will require the figures (along with a cash flow forecast) by 15 December 2025; and

- final cost estimates by 28 February 2026, aligned with the Price Control determination adjustment for the Charging Statement to apply from 1 April 2026.

Ofgem will need to be mindful of the variance of outturn DCC2 costs compared to the estimate provided in March 2026. For example, a material (but nevertheless approved) increase in outturn DCC2 costs (due to an unforeseen but legitimate additional requirement) may lead DCC1 to need an urgent amendment to the Charging Statement. Alternatively, DCC2 may spend significantly less than planned (with such expenditure deferred to after the Transfer Date); in this circumstance it would be unreasonable for DCC1 to be penalised for 'over-recovery' of cash between 1 April 2026 and 31 October 2026. These are risks for Ofgem to oversee/manage in partnership with DCC1 and DCC2 following award of the SMCL2.

Finally, there is a cash flow management implication for this proposal. The existing collection of revenue is flat across each Regulatory Year as per the Charging Methodology (where the prices are determined to be equal in each month of the relevant Regulatory Year e.g. Section K5.4). However, the current assumption is that, in combination, the DCC1 Charging Statement and the DCC2 Charging Statement will fix prices across the period 1 April 2026 to 31 March 2027 i.e. customers will not experience a price change event when the Charging Statement moves from DCC1 to DCC2 at the Transfer Date. Thus, it is vital that we gain early insight into the expected DCC2 spending (including the profile of costs) up to the Transfer Date to support cash flow planning.

3.2 Ofgem Question 2 Pass-Through Costs Definition

Q2. Do you agree that the proposed modification to the definition of Pass-Through Costs accurately and sufficiently captures the policy intent? Do you have any views on the wording of the proposed modification?

We support the proposed amendment to the definition of Pass-Through Costs (PTC_t) in SMCL1 as prescribed in the consultation.

DCC1 would not make any payments to DCC2 without a correctly presented invoice. It is important that any DCC2 invoice received by DCC1 is covered by a specific direction from Ofgem approving the expenditure given that DCC1 will not be able to validate the activities related to each DCC2 invoice. We would follow the existing Purchase Order process i.e. Ofgem would be asked to approve each Purchase Order before the invoice is raised; this will help us to alert if there is any requirement to overspend against forecast. Clearly, each DCC2 invoice would be raised under the legally enforceable financial agreement established pursuant to Condition 43.16 in the SMCL1. This agreement will need to set out payment terms and other relevant conditions (including the Purchase Order process). We consider it prudent for there to be an obligation on DCC2 in the SMCL2 to enter into the agreement established pursuant to Condition 43.16 in the SMCL1.

Given the 'not-for-profit/not-for-loss' status of DCC2, this safeguard protects against economically inefficient expenditure from DCC1 to DCC2 prior to the Transfer Date given that there will be no scope for subsequent disallowance of such costs. Within the drafting of SMCL2, Ofgem should also consider the controls between DCC2 and Ofgem regarding such planned expenditure and include a dispute resolution regime.

3.3 Ofgem Question 3 Allowable DCC2 Handover Costs

Q3. What are your views on the criteria for allowable DCC2 handover costs?

Having a set of clear and unambiguous criteria for what constitutes economically efficient expenditure by DCC2 prior to the Transfer Date is prudent.

In Section 3.11 of the consultation, Ofgem has set out criteria covering the activities that DCC2 could be allowed to incur from award of the SMCL2 to the Transfer Date as follows:

- setting up of internal governance, including the constitution of the Board and onboarding of a senior executive team;
- setting up of internal systems required for mobilisation;
- procurement of legal and commercial expertise to support contract novation, regulatory compliance and the transfers of assets;
- security accreditation and essential dual-running of systems where unavoidable to protect service continuity;
- structured knowledge transfer and TUPE-related onboarding support and recruitment where necessary; and
- audit and assurance linked to handover deliverables.

Primarily it is for bidders for the SMCL2 to consider such criteria. However, as we are committed to a successful handover, we have some suggested additions for Ofgem to consider when concluding on the criteria as follows:

- it may be economically efficient for DCC2's shareholder to incur such costs in the short term e.g. DCC2's shareholder employs personnel that are seconded into DCC2 prior to the Transfer Date rather than DCC2 establishing employment systems that it will then need to merge with the equivalent DCC1 arrangements from the Transfer Date onwards;
- DCC2 will incur business insurance costs that will increase from award of the SMCL2 as the business starts to take on liabilities;
- DCC2 will need to undertake a range of regulatory registrations e.g. HMRC, The Pensions Regulator, Information Commissioner's Office etc.; the magnitude of such costs will rise once DCC2 becomes an employer; and
- DCC2 may need dedicated short term office space until the Transfer Date.

Finally, there may be some such activities (that DCC2 is proposing to undertake) that have already been initiated or completed by DCC1 (in the context of preparation related to Condition 43); it will be important that the co-operation agreement covers the management of such activities and ensures appropriate responsibility for each relevant activity/deliverable.

4 Successor SMCL post-TD recovery pathways

4.1 Ofgem Question 4 DCC1 Cost Recovery Mechanism

Q4. What are your views on the proposed mechanism to enable DCC1 to recover necessary costs for mandatory activities after Transfer Date and for pre-agreed assistance by DCC2 to be considered Mandatory Business under the Successor Licence?

We agree with Ofgem's assessment that DCC1 should be reimbursed for efficiently incurred costs that arise after the Transfer Date, where such costs relate to activities performed pursuant to the SMCL1. Given the approach to business handover, it will also be vital for DCC2 to make staff available to provide assistance and data access to DCC1 in order to effectively and efficiently discharge such legitimate SMCL1 activities. Classifying such activities as an obligation within the Mandatory Business in the SMCL2 would provide regulatory certainty and Ofgem should make such amendments before concluding on the SMCL2.

Consistent with our response to Q2, each DCC1 invoice would be raised under the legally enforceable financial agreement established pursuant to Condition 43.16 in the SMCL1. This agreement will need to set out payment terms and other relevant arrangements e.g. the purchase order process. Alongside the financial

agreement, as we've previously outlined to Ofgem, we propose that a legally binding cooperation agreement is entered into by DCC1, DCC2, DCC1's Shareholder, and DCC2's Shareholder. This agreement would govern all matters where the four parties need to work together to ensure an effective and efficient handover of the Authorised Business. It would also allow escalation of any disagreement to Ofgem for final resolution.

Given the ex-ante approach to expenditure for DCC2, Ofgem are now inviting DCC1 to propose estimated amounts for DCC2 activities and costs that will apply from the Transfer Date. Such information is required to be included in the SL Business Plan Report and SL Price Control Information that is presently being prepared prior to submission by 31 December 2025 pursuant to Conditions 34A and 34B in the SMCL1. These elements would then be subject to an Ofgem consultation/determination before the Transfer Date. We are supportive of that approach and note Ofgem's expectations set out in Section 4.9 of the consultation document.

On this basis, we will prepare the necessary information setting out the costs for the SMCL1 requirements that are expected to endure beyond the Transfer Date. This will need to capture the extent of DCC1's reliance on DCC2's personnel and information (e.g. for service reporting) and where DCC1 expects to procure services from service providers (e.g. an auditor). Ofgem should note that DCC1 will need to place more reliance on consultancy support (compared to pre-Transfer Date activity) for price control matters as the DCC2's price control personnel will be mainly focused on the second Business Plan Report which is due for final submission to Ofgem on 31 July 2027. It should also be noted that DCC1 will have general corporate activities to undertake (e.g. VAT Returns). Our current working assumption is that the following elements will be required by DCC1 after the Transfer Date:

- personnel seconded from the DCC1's Shareholder (alongside consultancy support) to manage these activities after the Transfer Date and ensure general corporate compliance;
- prepare Corporate Governance Statement no later than four months after the Transfer Date (Condition 7 Part A - 7.4A);
- appointment of Sufficiently Independent Directors to retain DCC1 Board structure (Condition 9 Part E);
- appointment and various duties for the Compliance Officer (Condition 12);
- procure an Audit Report for Regulatory Accounts no later than four months after the Transfer Date (Condition 30 Part D - 30.10 (c));
- provide the Agreed Upon Procedures for the Appropriate Auditor no later than four months after the Transfer Date (Condition 30 Part F - 30.13A);
- publish Regulatory Accounts no later than four months after the Transfer Date (Condition 30 Part G - 30.14 (b));
- prepare and submit Price Control Information as per RIGS no later than three months after the Transfer Date (Condition 32 Part A - 32.4);
- prepare and submit Annual Service Report no later than three months after the Transfer Date (Condition 34 Part A - 34.3A);
- ensure financial security is in place until Licence Revocation on 22 September 2027 (Condition 26); and
- retain services of a Competent Independent Organisation.

To complete this cost estimation activity, DCC1 will need to work with Ofgem to confirm which Conditions in the SMCL1 (in whole or in part) will be disapplied from the Transfer Date. Ofgem should note that there are some complexities as detailed cost estimates for all aspects of these post Transfer Date requirements

may not be determinable by 31 December 2025 e.g. auditor fees for services in early 2027. As such, Ofgem should consider how budgetary variances for the residual DCC1 expenditure will be managed.

4.2 Ofgem Question 5 DCC1 Cost Recovery Definition

Q5. Do you have any comments on how best to reflect the proposed mechanism for DCC1 cost recovery post-Transfer Date in the Successor Licence?

We support the proposed amendment to the definition of Pass-Through Costs (PTC_t) in SMCL2 as prescribed in the consultation.

Consistent with our response to Q4, DCC2 should not make any such payment without a correctly presented invoice from DCC1 for each amount required. It is important that any DCC1 invoice received by DCC2 is accompanied by a specific direction from Ofgem approving the expenditure given that DCC2 will not be able to validate the activities related to each DCC1 invoice. Clearly, each DCC1 invoice would be raised under the legally enforceable financial agreement established pursuant to Condition 43.16 in the SMCL1.

5 Retention of funds pending final Price Control outcome

5.1 Ofgem Question 6 Liability Proposals

Q6. What are your views on our proposals (Proposal 1 and 2) to ensure potential liabilities, which may arise after Transfer Date, can be met?

5.1.1 Proposal 1 – Increasing Financial Security

DCC1 is opposed to Proposal 1; DCC1 is financially robust so there is no need for additional financial security. Furthermore, it would be economically inefficient to incur additional costs in this area given the consequential impact on customers and the minimal risk profile after the Transfer Date.

Under Proposal 1, Ofgem will direct DCC1 to increase the financial security provided as per Condition 26 of the SMCL1. Ofgem's rationale for this proposed action is to ensure that any liabilities which may arise after the Transfer Date can be met. However, Ofgem have provided no quantitative assessment to clearly demonstrate the extent of such potential liabilities during the Handover Period. Since 2013, the existing £10m Parent Company Guarantee from DCC1's owner (supported by a Letter of Credit) has never been utilised and DCC1 remains a financially stable organisation. The annual cost of the existing Letter of Credit has been legitimately included within DCC1's Allowed Revenue since 2013. Increasing the Parent Company Guarantee will mean DCC1's owner will need to place additional capital at risk. DCC1's owner has advised us that there are cost implications arising from any increase which cannot be quantified at this time given that Ofgem have not set out their views on the quantity of liabilities and required increase. As set out in our response to Proposal 2 below, we do not expect any residual liabilities to be material.

Ofgem's consultation on 24 October 2025 to increase financial security for the Handover Period is retrospective and should not proceed. Furthermore, the requirements in Condition 26.14 are not currently met; there are currently no material changes to the DCC1's Authorised Business that would warrant an increase. In fact, there is less than a year to go to the Transfer Date and DCC1's Authorised Business is now reducing. Thus, Ofgem should not proceed with Proposal 1. If Ofgem wishes to proceed further with this proposal, Ofgem must re-consult on Proposal 1 to provide quantification of the financial liabilities that may not be met (during the Handover Period) to justify their proposal for an increase. This further consultation must include a full impact assessment that sets out Ofgem's view of the potential liabilities offset against the increasing costs to DCC's customers and implication to DCC1's owner. This further consultation will allow all stakeholders to be fully informed and provide meaningful responses.

5.1.2 Proposal 2 –Financial Ringfencing

DCC1 has significant concerns regarding the proposed ringfencing approach and opposes Proposal 2.

DCC1 has already advised Ofgem that it is planned for all cash/liabilities to move from DCC1 to DCC2 on the Transfer Date. This envisaged handover approach is prescribed in the financial subsidiary document of the Business Handover Plan that has already been provided to Ofgem.

The proposal to modify the drafting in the SMCL1 to impose a duty on DCC1 to pay to DCC2, on Transfer Date, all margin components (i.e. Baseline Margin, Baseline Margin Adjustment, and External Contract Gainshare) for the Regulatory Year 2025/26 and the final Regulatory Year period from 1 April 2026 until 31 October 2026 would lead to a mismatch between the funding of determined disallowance for previous Regulatory Years (by DCC1's owner) which is currently offset by the collection of margin elements during the same period. DCC1 does not collect Baseline Margin Adjustment and External Contract Gainshare in advance of its determination. There may be subsequent minor amendments to the margin at risk due to performance related assessment which is a service credit arrangement (i.e. Baseline Margin Performance Adjustment) and only relates to margin at risk (i.e. excludes External Contract Gainshare). The margin reduction related to Baseline Margin Performance Adjustment fluctuates each year based on performance outcomes. For example, for Regulatory Year 2024/25 the margin was reduced by broadly 7% and therefore based on precedent and likelihood of previous final margin balances we do not see any grounds for ringfencing the full cash balances. Therefore, we do not believe there is any rationale to ringfence the full margin amount as envisaged by Ofgem.

DCC1 adopts an approach where it does not collect revenue for Baseline Margin Adjustment and External Contract Gainshare from customers until it has been accepted through determinations set by Ofgem. This means any application for Baseline Margin Adjustment and External Contract Gainshare for the Regulatory Year 2025/26 and for the period 1 April 2026 to 31 October 2026 would not have been determined until after the Transfer Date. Therefore, the associated revenue would not be collected from customers and so can't be ringfenced/transferred to DCC2. We expect that any application for Baseline Margin Adjustment and External Contract Gainshare for Regulatory Year 2025/26 and Regulatory Year 1 April 2026 to 31 October 2026 (which are finalised in the 2027 determinations and subject to performance adjustment) will be collected by DCC2 on behalf of DCC1 and used to offset any determined disallowances. Thus, the net amount of margin at risk vs disallowances is very small. Also, there is no Baseline Margin amount from September 2025 onwards, the original end date for the SMCL1 based on the LABP. Given that all cash will be transferred over as described, there is clear evidence why Proposal 2 (and Proposal 1) should be rejected. We consider that DCC1's cash balance transferred to DCC2 (in addition to the existing £10m Parent Company Guarantee) is sufficient financial security.

We support the proposed amendment to the SMCL2 to require DCC2 to promptly settle the final amounts of Baseline Margin Adjustment and External Contract Gainshare (net of any other costs or liabilities e.g. disallowances) once Allowed Revenue is determined for the final SMCL1 Regulatory Years following a direction from Ofgem. This is vital to ensure that DCC1 is appropriately compensated for such matters prior to the expiry of the SMCL1.

Given that Ofgem have not provided any materiality assessment on the requirement for ringfencing, DCC1 considers that the current consultation hasn't provided sufficient clarity on Ofgem's proposals (including quantification of potential liabilities). As such, we propose that Ofgem should re-consult on Proposal 2. We will work with Ofgem to explore their risk perception and obtain (from Ofgem) a clear definition of the potential future liabilities.

5.2 Ofgem Question 7 Condition 41A in SMCL1

Q7. Do you agree that the proposed licence modification (introduction of LC 41A) accurately and sufficiently captures the policy intent? Do you have any views on the wording of the proposed modification?

We do not support the introduction of Condition 41A. This arrangement should be implemented via an amendment to Condition 43.16 to mandate that all cash balances and liabilities are transferred and then a final net settlement (margin vs disallowance) will follow once each final Price Control determination is made.

Notwithstanding our overarching objection, we have the following comments on the drafting.

There is no Baseline Margin amount from September 2025 onwards; thus, this amount will always be zero i.e. there can be no further Baseline Margin due to Capita (as DCC1's owner) under this component. There is Baseline Margin Adjustment and External Contract Gainshare for Regulatory Years 2025/26 and April 2026 to October 2026. However, the cash for these items is not envisaged to be collected from DCC's customers until after each element is determined by Ofgem.

External Contract Gainshare is not at future performance related risk so should not be in scope for any ringfencing. As previously described, this money will not be collected from customers ahead of determination by Ofgem.

DCC1 is working closely with Ofgem (and DCC2 in due course) to demonstrate the composition of cash balances and to confirm that revenue for Baseline Margin Adjustment and External Contract Gainshare has not been collected in advance. DCC1 wishes to ensure transparency and avoid misinterpretation of cash balances transferred to DCC2. Ofgem may wish to consider amendments to the RIGS (for both SMCL1 and SMCL2) for this purpose, and we will work to support Ofgem with any evidence they may require.

5.3 Ofgem Question 8 Changes to draft SMCL2

Q8. Do you have any views on changes that would need to be made in the draft Successor Licence?

In the interest of customers, DCC recommends that the proposed amendments to Condition 5 in SMCL2 allows DCC1 and DCC2 to agree on payment terms longer than one month, provided this is mutually agreed by all relevant parties. This flexibility would support practical financial arrangements post-transfer and manage cash flows accordingly. This would mitigate the risk that DCC2 needs to restate the Charging Statement to increase cash collected to meet a single significant invoice from DCC1.

The drafting in Condition 25 in the SMCL2 should be adjusted to reflect that the cash transfer from DCC1 to DCC2 is expected to include liabilities deferred from DCC1 that DCC2 will be responsible for settling. To ensure DCC2 has the necessary cash liquidity to meet these obligations, the associated cash should be deducted from the threshold calculation of DCC2's incremental 5% for working capital as per SMCL2.

DCC2 should also be provided with clear guidance from Ofgem on the evidentiary requirements needed to monitor such matters to ensure transparency and avoid misinterpretation of cash balances. Ofgem may wish to consider amendments to the SMCL2 RIGS for this purpose.

5.4 Ofgem Question 9 General Comments

Q9. Do you have any other views or concerns?

The schedule for entering into agreements related to these matters is not explored within the consultation. We consider that it is vital that both the Financial Agreement and the Cooperation Agreement should be signed within one month of the SMCL2 being awarded.