



Applicants for the DCC licence,
future DCC service users and
other interested parties.

*Promoting choice and value for
all gas and electricity customers*

Direct Dial: 020 7901 7147
Email: laura.nell@ofgem.gov.uk

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Dear Colleagues,

Regulation of the Data and Communications Company for smart meters

As part of the government's policy to roll out smart meters across Great Britain by the end of 2019, it has created a new licensed activity to provide data and communications services to smart meters. The Data and Communications Company (DCC) will have an important role in providing secure communications between energy suppliers, network operators and authorised third parties on the one hand, and compliant smart metering equipment in domestic and certain non-domestic premises on the other. The DCC will develop and deliver these services through its data and communication service providers. The DCC will be responsible for managing its contracts with its service providers to ensure that service users receive value for money. The purpose of this letter is to provide clarity on our role in respect of the DCC to interested parties, particularly those that are participating in the DCC licensing competition.

The competition to appoint a DCC licensee (hereafter referred to as the DCC) is now underway and the Department of Energy and Climate Change (DECC) expects to grant the licence in summer 2013. Thereafter, Ofgem will have regulatory oversight of the DCC and the Secretary of State for Energy and Climate Change will retain only certain time-limited powers with respect to the DCC.

Our role

Ofgem regulates the gas and electricity markets in Great Britain¹. We are an independent regulator and protecting energy consumers is our first priority. As part of this role we regulate the monopoly companies which run the gas and electricity networks.

The government is responsible for the current phase of the Smart Metering Implementation Programme, including designing and putting in place the new regulatory obligations in relation to the DCC and licensed service users. Ofgem has an important role in ensuring that the interests of consumers remain protected, both during the transition to smart metering and in the enduring framework. DECC is responsible for drafting the DCC licence and we have provided advice during the development of the draft².

We will play a key role in monitoring and, where appropriate, enforcing compliance with the new regulatory obligations in relation to the DCC and licensed service users. We will

¹ Ofgem is governed by the Gas and Electricity Markets Authority (the Authority), which consists of non-executive and executive members and a non-executive chair.

² The draft DCC licence is available at <http://www.decc.gov.uk/assets/decc/11/consultation/smart-meters-security-risk-assess/6895-gov-resp-cons-dcc-lic-ann-1.pdf>

proactively monitor the effectiveness of the regulatory framework and will be responsible for maintaining and updating it to ensure that it continues to operate in the interests of consumers. We may decide to provide guidance on regulatory matters where we consider it appropriate to do so. We are also responsible for overseeing changes to the regulatory framework to facilitate the DCC's evolving role.

DCC regulation

The DCC will be governed by its licence which will set out its core obligations, restrictions and entitlements. It will also be bound by the Smart Energy Code (SEC) which will constitute the DCC's contractual relationship with its users and will enable them to gain access to DCC services. The DCC will have a range of obligations to both customers and industry that it must fulfil under the conditions of its licence and the SEC.

We will monitor the DCC to ensure it abides by its licence conditions. If we suspect that the DCC may have contravened or may be contravening its licence we may decide to launch an investigation, in line with the enforcement priorities set out in our Enforcement Guidelines³. If the DCC is ultimately found in breach of these conditions, the options available to Ofgem include issuing an enforcement order to ensure the DCC complies with its licence conditions, and/or imposing financial penalties of such an amount as is reasonable in all of the circumstances of the case⁴. We also have a role in maintaining the regulatory framework such that it continues to operate in the interests of customers, for example by approving modifications to industry codes and by proposing licence modifications.

We are committed to allowing the regulatory arrangements that have been established for the DCC to bed down and we recognise that a period of stability is needed for the DCC to be established and reach a steady state in its operations. We recognise that the price control and incentive arrangements the DCC agrees with DECC through the licence competition should be allowed to take effect and inform the longer term development of the DCC's incentive regime.

Over time we anticipate refining and improving the financial incentives that the DCC is subject to, as we deepen our understanding of what constitutes good performance based on information gained from the DCC's operational experience. Any such refinements would be given effect through modifications to the licence provisions regulating the revenues that the DCC is entitled to recover. In developing such incentives, we will have regard to established best practice in regulatory design based on our experience of regulating other energy sector monopoly businesses whilst recognising the specifics of the DCC's role.

We recognise that the DCC may offer different categories of services and we support the need for the progressive implementation of those services. The draft DCC licence obliges the DCC to provide core and elective services and permits the DCC to propose value added services where it considers it appropriate subject to its licence requirements. We agree with the government that in the early stages the DCC should focus on establishing a stable operational environment for core and elective services.

The terms of value added services are subject to regulatory oversight and will require the Authority's consent before they can be implemented. Clearly, the interests of gas and electricity consumers will be a key factor in assessing whether or not to give consent to any value added service. Given that value added services are made possible by the infrastructure that gas and electricity consumers are funding, we would expect proposals to deliver real benefits to consumers. We would also expect no risk of adverse impacts on the provision of core or elective services. The DCC must act within the law and any other regulatory requirements that may apply when providing services that also involve other sectors. The DCC will also be responsible for obtaining any other consents needed from other regulators in other markets when providing such services.

³ <http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20guidelines%202012.pdf>

⁴ This could be up to 10 per cent of turnover of DCC.

Good regulation would generally involve a proportionate balance of ex ante incentives and ex post scrutiny. The limited role for ex ante incentives during the early stages of the DCC implies a greater weight on monitoring and ex post scrutiny. The Management Order powers conferred on Ofgem in the absence of special administration arrangements for the DCC at this stage also require a greater emphasis on monitoring the DCC (more widely than monitoring in regards to incentives)⁵.

We will develop our detailed approach to monitoring the DCC and designing its reporting requirements in relation to its licence obligations in the coming months. In doing so, we would expect to make use of information provided by the DCC in the licence application process to inform our approach to the future assessment of its costs.

Next steps

We will continue to engage with the government and other stakeholders over the coming months in preparation for our new regulatory functions. We will have an observer role, not a decision making role, in the DCC licensing competition to ensure a smooth transition from the regulatory design phase into the practical application of the framework once the DCC is licensed. We will also continue to advise the Government where there is ongoing development of the regulatory framework for the DCC, for example the SEC. Where we consider it appropriate in light of our duties, we may also issue guidance in relation to particular requirements that the DCC will be subject to under its licence.

Should you have any questions in relation to this letter, please contact Laura Nell (laura.nell@ofgem.gov.uk 020 7901 7147). Participants in the DCC licence competition should direct questions to DECC via the Bravo tendering portal, who will pass them to Ofgem for consideration.

Yours faithfully,

Andrew Wright
Senior Partner, Markets

⁵ These powers are contained in Licence Condition 42 (Management Orders for the Licensee) of the draft DCC licence.