



Making a positive difference
for energy consumers

Stakeholders interested in
smart metering

Direct Dial: 020 7901 3132
Email: tricia.wiley@ofgem.gov.uk

Date: 6 June 2014

Dear Colleague

Data Communication Company (DCC) Regulatory Instructions and Guidance

We consulted on the draft Regulatory Instructions and Guidance (RIGs) for DCC, the central communications body appointed to manage communications and data transfer for smart metering. The consultation closed on 23 April 2014. The changes to the RIGs are in this letter, with a summary of consultation responses. We are also publishing the final RIGs and reporting templates. The main changes are listed in Appendix 1, and have been made to provide greater transparency, and more detail in some areas. If you have any questions on DCC price control or any of the issues in this decision letter please contact tricia.wiley@ofgem.gov.uk.

About DCC

DCC is a new monopoly licensee regulated by Ofgem¹. The Department of Energy and Climate Change (DECC) granted the Smart Meter Communication Licences² to Smart DCC Ltd³ on 23 September 2013, following a licence competition.

Price controls restrict DCC's revenues to counter its monopoly position. Because of DCC's unique nature and the new regime in which it will operate, costs must be incurred economically and efficiently. DCC will incur costs, pass these onto Service Users, and we will review these after the end of the regulatory year in which the costs were incurred, in our ex post review.

¹ The Office of the Gas and Electricity Markets Authority (Ofgem) supports the Gas and Electricity Markets Authority ('the Authority') in its day to day work. In this consultation and in the RIGs, 'we', 'Ofgem' and 'Authority' are often used interchangeably.

² The Smart Meter Communication Licences granted pursuant to Sections 7AB(2) and (4) of the Electricity Act 1989 and Sections 6(1A) and (1C) of the Gas Act 1986 (such licences together referred to as 'the licence' throughout).

³ Referred to as 'DCC' throughout.

DCC must compile price control reporting and submit it to us for each regulatory year by 31 July in the following regulatory year⁴. The first report is to be submitted by DCC by 31 July 2014. It will cover the first regulatory year from 23 September 2013 until 31 March 2014.

Overview of the RIGs

The RIGs form the basis on which DCC must report. They provide:

- a complete statement of the specified information which DCC is required to report
- the systems, processes, procedures for the recording and provision of price control information to the Authority
- the standards of accuracy and reliability that are applicable to recording the specified information (including different classes of specified information)
- explanations of the meaning of words and phrases used in defining price control specified information
- how the specified information must be recorded, and given to the Authority
- how the Authority will monitor and assess the DCC's compliance with the RIGs.

The competitive application process for the licence should have ensured the efficiency of the initial costs stated in DCC's Licence Application Business Plan⁵. The templates allow us to compare actual costs with those previously forecast. DCC will have to explain and justify any significant deviations from the forecast costs in the business plan or any updated forecast.

DCC has inherited some competitively-procured contracts from a government led competition. As the government negotiated these contracts, we expect the competitive procurement process it conducted to have delivered value for money. We expect DCC to control the costs that are in its reasonable control and influence. DCC will need to demonstrate, through its reporting that it has incurred contract costs and its own internal costs as efficiently and economically as possible, ensuring value for money.

The RIGs data will inform our ex post review, and together with information from other sources, for example on performance, will allow us to assess whether costs were economically and efficiently incurred. If we decide they have not, either:

- these costs will be excluded from the future calculation of allowed revenue, resulting in lower Service Charges for Service Users
- DCC could be subject to an undertaking in relation to the future management of its costs⁶.

We may consult on any costs that we are considering disallowing in this way or any undertaking.

Summary of responses

Our February consultation⁷ on the RIGs and templates asked for comments. These focussed in particular on:

⁴ Condition 32 of the Licence.

⁵ A redacted version of the Licence Application Business Plan is available from the DCC website.

http://www.smartdcc.co.uk/media/7417/redacted_licence_application_business_plan_-_30_april_2014_2_.pdf

⁶ These powers are set out in Condition 37 of the Licence.

1. whether they capture the significant cost and expenditure items
2. whether the definitions are correct
3. whether they provide scope for flexibility for the future
4. whether the breakdown of the information is sufficient to enable determination of whether they have been economically and efficiently incurred, while maintaining an appropriate level of regulatory burden on DCC.

We received four responses to the consultation, all of which are on our website⁸. In general, respondents seemed comfortable with the overall approach. Some commented that the RIGs templates should allow DCC costs to be scrutinised. Below we summarise the responses to the specific questions we asked, and comment on the other issues that respondents raised.

1. Significant cost and expenditure items

Three respondents answered the question on whether the templates captured the significant cost and expenditure items. One mentioned that they were unable to comment on the detail without insight into DCC's accounting or reporting systems.

One respondent agrees that the RIGs capture the significant cost and expenditure items, but suggested that the analysis of External Service Provider "new scope"⁹ costs could be reviewed at a more detailed level, for example at a Project/Change Request level. Another respondent suggested external costs should be broken down by the constituent costs.

What we think

We have adjusted the reporting templates to include sub-categories of "new scope" for the External Service Providers. The project costs will be itemised and are now separated into: impact assessments, catalogue services, and projects¹⁰. We also ask for incentive payments and performance-related refunds to be reported separately. We are scrutinising the contract costs of the Service Providers but expect DCC to manage these contracts and ensure value for money. In the qualitative reporting under the RIGs, DCC must report on how it managing its contracts and how it has applied the value-for-money provisions in the contracts.

2. Definitions

One respondent agreed in principle with the definitions used in the RIGs, but suggested changes to the definitions of corporate management and commercial to better reflect their purpose.

What we think

We have decided to change the definitions for corporate management and commercial as suggested¹¹. But we have not included the reference to "shared services" in the definition of corporate management because the RIGs require shared services to be reported separately. To provide a greater understanding of the shared services and how these are

⁷ Available on the Ofgem website: <https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-regulatory-instructions-and-guidance-consultation-0>

⁸ <https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-regulatory-instructions-and-guidance-consultation-0>

⁹ Costs associated with the scope agreed in the business plan, is labelled "baseline" in the template. Costs incurred as a consequence of a new activity or project is labelled "new scope".

¹⁰ Chapter 4 of the RIG, under external costs

¹¹ Chapter 5 of the RIGs, under inputs of internal costs by cost centre.

used by DCC the RIGs have been amended and now include a detailed description of shared services and what is included in the shared services charge. We will discuss with DCC the development of volume metrics for shared services. This section of the RIGs will be developed as required in future regulatory years.

3. Flexibility

A respondent commented that including “New Scope” activities should make the templates sufficiently flexible given the uncertainties. One respondent commented that the RIGs will need to adapt to reflect the changes to services over time. They proposed reviewing the RIGs in stages, using an approach similar to that used in the consultation for smarter markets review of consumer protection measures¹². This means that the project would be divided into phases, and the approach would be reviewed to check it is still relevant and appropriate. Another respondent thought we should look at the RIGs after the first year to ensure the approach is correct.

While commenting that the RIGs provide a reasonable balance between detail and flexibility, one respondent had concerns that they should also capture expected costs, which are charged for, but DCC does not go on to incur.

What we think

This is a new price control regime and given the uncertainties, it is likely that the RIGs will be modified in future. Reviewing the RIGs must be balanced with the need for certainty and regulatory burden on DCC. We will keep the RIGs under review to sure they remain appropriate. If material changes are needed or errors are found, we intend to consult and amend the RIGs as necessary. Any modifications to the RIGs will be in accordance with the process in Licence Condition 33, Part B.

The RIGs will compare forecast cost and revenues against those actually incurred. If DCC includes costs in its charges that it does not incur this would result in a difference between Allowed Revenue and Regulated Revenue in the templates. Any difference in the amount DCC actually charges and what it is entitled to is returned through the K factor¹³ to users.

4. Economically and efficiently incurred

A respondent commented that the format of the templates allows an explanation of events and projects that have taken place. The approach requires DCC to give detailed reasoning for decisions and shows whether costs are incurred economically and efficiently. They also mentioned that aligning with DCC internal systems minimises the regulatory burden of reporting. Another response encouraged us to use external comparators to help assess cost efficiency. While the DCC and the service providers perform some specialist functions, some constituent costs (such as IT) could be benchmarked against other UK sectors.

What we think

We have worked with DCC on developing the RIGs to make them consistent with DCC’s internal reporting systems. The data and qualitative questions should provide a comprehensive evidence base to assess costs. We will compare DCC costs to other

¹² The smarter markets review of consumer protection measures consultation involved identifying project phases, and reviewing the remainder of the work programme at the end of each phase to ensure that it remains relevant and appropriate. <https://www.ofgem.gov.uk/ofgem-publications/85157/consumerempowermentandprotectioninsmartermarkets.pdf>

¹³ The K factor means the correction factor which is defined in Licence Condition 36.

regulated entities and UK sectors. We will make sure these are adjusted so that any comparison is consistent.

5. Other issues

In the responses, two other key issues were also raised. The first was the prudent estimate and related to this, the value of the K factor. The second was the publication of information.

(I) Prudent estimate and K factor

Under Licence Condition 36 when setting charges DCC must take all reasonable steps to ensure their regulate revenue does not exceed a prudent estimate of its allowed revenue. This must be its best estimate to ensure charges do not need amending within the regulatory year, except in response to a reasonably unlikely contingency. Any difference between what DCC is entitled to and what it has charged users will be returned in the K factor. A respondent questioned when users could expect the K factor value to be returned. They have asked us to examine whether using the prudent estimate for cash flow purposes is economic and efficient, whether DCC should have an amount outside the formula instead, and when a K factor will be returned to users with interest.

What we think

Each year we will be requesting DCC to provide us with information on their approach to the prudent estimate, and compare this to what costs were actually incurred. We will look at whether costs have been economically and efficiently incurred, and also how DCC is demonstrating ongoing value for money. There are restrictions on the way DCC can incur debt, but it can do this as long as it meets the requirements set out under Licence Condition 27 that covers indebtedness and transfers of funds. In the indicative charging statement for 2015/16 DCC has committed to publishing a value for the K factor in a future quarterly update. Given the questions about the K factor and the prudent estimate and the purpose of the indicative charging statements to provide visibility to users we think DCC should publish a value for the K factor as soon as it reasonably can. The DCC has a ring-fenced bank account and is not entitled to any interest, which will be returned to users in the K factor as well.

(II) Publication of information

Respondents commented that the RIGs allow industry to understand and scrutinise DCC's and Service Providers' performance, and asked us to publish key data and comparisons. One respondent suggested a "balanced scorecard" approach, which would capture the inputs and outputs.

What we think

We understand industry interest in the information collected under the RIGs and concerns about transparency. A large proportion of the price control information that DCC will report to us is likely to be covered by our legal duties to not disclose information that could seriously and prejudicially affect the affairs of a corporate body. However, where we make any decisions under the price control relating to costs or otherwise, we will share the reasons for our decision. We may justify our decisions using information submitted under

the RIGs, either for transparency or because publishing certain information is in consumers' interests¹⁴.

We will be discussing with DCC the format and information we intend to publish alongside the outcome of the ex post review. A balanced scorecard showing the inputs and outputs once DCC is offering services sounds like a sensible approach, and is something we will consider. The outputs should relate to the operational incentive regime once it is developed¹⁵. The RIGs do not currently include reporting of Quality of Service Information. Quality of Service Information will be added in the future as part of the wider development of DCC's ongoing operational incentives. We will encourage DCC to start engaging users early on the development of the operational incentives. Under Licence Condition 34 DCC must prepare an Annual Service Report that presents, analyses, and evaluates both its performance and that of the External Service Providers.

Changes to the RIGs and templates

We have changed the RIGs and reporting templates in response to the consultation and "trial run"¹⁶ of the template that DCC completed. The main changes are listed in Appendix 1. There were some minor corrections with the spreadsheet which we have now amended.

Next Steps

DCC must report in accordance with the RIGs by 31 July 2014. We will review and analyse the information over the summer. We hope to publish a consultation on the outcome of the ex post review in winter 2014, and a final decision in early spring 2015. This timetable will vary depending on the number and complexity of issues that may arise.

If you have any questions on the DCC price control or any of the issues in this decision letter please contact tricia.wiley@ofgem.gov.uk

Rob Church
Associate Partner Smarter Metering and Smarter Markets

¹⁴ Both the Electricity Act 1989 (s.48) and the Gas Act 1986 (s.35) provide an avenue for the 'publication of advice and information about consumer matters' where it appears to Ofgem that it would promote the interests of consumers.

¹⁵ Under Licence Condition 38, part C, the operational performance regime will be developed and the structure set out in Schedule 4 populated by the Authority in a direction. This can be no earlier than 31 March 2016, but no later than 31 October 2018. This must be undertaken following consultation.

¹⁶ During the consultation period DCC populated the templates with sample data.

Appendix 1: List of main changes to reporting templates and RIGs

Changes to Templates

Reference	Change	Reason
Sheet 3: Revenue Reporting	Incentive payments to Service Providers and performance related refunds shown under external costs have been added. These need to be netted off to compare performance against forecasts.	Provide greater transparency.
	Correction to indexation formula for baseline margin.	Fix a minor error in template.
	Added Lines for Relevant adjustment to Baseline Margin.	To capture any adjustment under Licence Condition 36, appendix 2.
	Added a qualitative question regarding the K factor.	Provide greater transparency.
Sheet 4: Internal cost by DCC cost centre	Lines added for internal costs not incurring shared services.	Provide more detail.
	Removed "shared services" from the General Ledger (GL) codes section of the internal cost sheet.	Consequential change as shared services reported separately.
	Dropdown menus for GL codes under new scope projects.	To make the templates easier to use.
Sheet 7: Cash balances	Removed breakdown of annual cash inflows into actual costs and prudence.	Correction for accounting treatment of charges and prudence.
	Simplified cash-flow metrics (min and max end-of months balance only). Supplementary commentary to be provided on high or low cash balances.	Presentational, and provide greater transparency.
Sheet 8 (a-d): External Costs	Reorganised with baseline and new scope as top-level categories.	To make the information easier to identify.
	New subcategories of new scope: impact assessments, catalogue services, projects.	Provide more detail.
	Added incentive payments and performance related refunds.	Provide greater transparency.
	Simplified Part 2 (Record of changes in regulatory reported costs).	To make the information easier to identify.
Sheet 9: Shared/group/support/external service costs	Added question regarding costs under GL code Internal service and External service.	Provide more detail.

	Added a question on volume information for shared services in the future.	This section we will develop in the future as required.
Sheet 10: Staff and resourcing costs	Split Full Time Equivalents into: permanent employment, temporary employment, contractors provided by Capita, and other contractors.	Provide more detail.
Sheet 11 (a-d): reconciliations	Restructured to match changes in sheet 4 and sheets 8 a-d.	Consistency