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Modification proposal:	**Retail Energy Code (REC): Service Provider Performance Charges (R0025)**		
Decision:	The Authority[1] has decided to approve[2] this modification[3]		
Target audience:	REC Board, REC Parties and other interested parties		
Date of publication:	30 Jan 2023	Implementation date:	01 April 2023

Background

The Switching Programme was designed to transform gas and electricity switching arrangements, resulting in faster, more reliable switching for consumers. In order to achieve this, a new switching system known as the Central Switching Service (**CSS**) was introduced on 18 July 2022.[4]

The new Switching arrangements are made up of a number of different services and systems delivered by different Service Providers. The Data Communication Company (**DCC**) is responsible for providing three of these services under the umbrella of its role as Centralised Registration Service (**CRS**) Provider, those being the CSS Provider, the CSS Certificate Authority and the Switching Operator. The requirements on DCC in providing each of these services are codified in the Retail Energy Code (**REC**) in the relevant Service Definition document for that particular service.

As a regulated monopoly company, DCC is subject to a Price Control mechanism under terms as set out in the Smart Meter Communication Licence.[5] The Price Control enables DCC to

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[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989 and section 38A of the Gas Act 1986.
[3] 'Change' and 'modification' are used interchangeably in this document.
[4] Link here to our designation of the "CSS Go-Live Date" as 18 July 2022
[5] Link here to the Smart Meter Communication Licence

recover the costs it needs to allow it to perform its various roles in Smart Metering and Switching, as well as earning a pre-determined profit margin. It is important that DCC's costs are economic and efficient, and ultimately provide value for money for consumers.

We recently published our decision following consultation to introduce the "Switching Incentive Regime" (**SIR**), a financial incentive regime for DCC in its roles in Switching under its Price Control.[6,7] The scheme, which is similar to the regime that exists for Smart Metering (the Operational Performance Regime, or **OPR**), is designed to incentivise DCC to retain the margin it earns on its Switching business under its Price Control by placing 100% of its allowed margin at risk against performance incentive measures. Poor performance against one or more incentive measures will result in DCC sacrificing a portion of its margin, up to a total of 100% of its allowed margin value for the entire regulatory year.

The scheme will commence on 01 April 2023, with further details to be provided in a Direction which we intend to consult on shortly. We noted in our consultation that we felt DCC should be incentivised against two key measures in Switching - 1) operational performance, and 2) customer engagement performance. We consider that the operational performance element of the SIR could be administered on a day to day basis within the REC, as DCC is already accountable to the performance assurance function (the Performance Assurance Board, or **PAB**) within the code in its fulfilment of its codified requirements regarding the provision of its services.

We therefore welcome the REC Code Manager raising this Change Proposal, which seeks to introduce an economic incentive scheme into the REC for the DCC in its role as the CRS Provider. In light of the above, we consider that it could represent an efficient and effective way to incentivise DCC to deliver good performance in its Switching roles under the REC as part of its Price Control, in a way that is fair and reasonable to DCC and leads to good outcomes for consumers.

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[6] Link here to the November 2022 DCC SIR consultation on the Ofgem website
[7] Link here to the January 2023 DCC SIR decision on the Ofgem website

The modification proposal

Effective delivery of CRS Provider services is essential to the functioning of the new Switching systems and the retail market more widely.

R0025 was raised by the REC Code Manager (the Proposer) on 4 January 2022, and seeks to incentivise the performance of DCC in its role as CRS Provider by introducing a Performance Charge framework. This framework involves the levying of Performance Charges against the CRS Provider in the event that it does not meet its Service Level Agreements (**SLA**s), as defined in the REC in the various Service Definitions. In the Final Change Report (**FCR**) the Proposer argues that, without such a framework in place, there may be little incentive for the CRS Provider to maintain or improve its levels of service performance.

Whilst Performance Charges are already one of the approved Performance Assurance Techniques (**PAT**s) that the Code Manager is permitted to use as part of its Performance Assurance Framework, changes to the REC are required to enable it to do so.

Key details of the framework proposed in the R0025 solution are as follows:

- The maximum possible value of charges to be applied in any one regulatory year (April to March) will be determined by PAB in advance of the start of the year, informed in part by the provisions of DCC's Price Control.
- PAB will publish details ahead of the start of the year of the levels of charges to be applied in the event of the CRS Provider missing one or more SLAs.
- Charges will be applied based on performance within a quarterly period. Within each period the CRS Provider will be allowed to miss one SLA without charge, whereafter increasing charges will be applied for each missed SLA on a sliding scale. Charges are capped at 100% of the quarterly maximum (ie 25% of the annual maximum) where five SLAs are missed within the period.
- The Code Manager will report to PAB every month with details of the CRS Provider's performance against its SLAs. PAB will then make decisions about whether charges should apply.
- Any charges applied will be recovered through a reduction to future invoices issued by the CRS Provider to RECCo.

- The CRS Provider may appeal a decision to apply a charge to PAB within 20 working days of the end of the month within which the charges applied, whereafter PAB will return a final decision.
- The CRS Provider may then appeal any charges applied to Ofgem following the end of the year at the point at which it is making its Price Control submission for that relevant year.
- Following Ofgem's decision on the CRS Provider's allowed revenue for the year following its Price Control determination, any necessary accounting adjustments between RECCo and the CRS Provider can be handled as part of the following year's budgeting process.

The REC Code Manager considers that all three REC Objectives[8] would be better facilitated through the implementation of this Change Proposal.

As noted above, these proposed changes to the REC have been developed in conjunction with the changes we are seeking to make to the Smart Meter Communication Licence to introduce the SIR. The Code Manager notes in the FCR that, if both sets of changes are implemented, the proposed solution in this Change Proposal will act as the mechanism through which DCC's operational performance is assured as part of its Price Control.

REC Performance Assurance Board[9] recommendation

At the PAB meeting on 20 December 2022 the PAB voted unanimously to recommend that the Authority approve Change Proposal R0025.[10]

[8] As set out in Standard Condition 11B.6 of the Electricity Supply Licence and Standard Condition 11.6 of the Gas Supply Licence.
[9] The PAB is established and constituted pursuant to and in accordance with the REC.
[10] In accordance with clause 9.6 of the REC Change Management Schedule, the PAB acted as the Responsible Committee for R0025.

Our decision

We have considered the issues raised by the modification proposal and the FCR dated 21 December 2022. We have considered and taken into account the responses to the industry consultation(s) which are attached to the FCR[11]. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the applicable Objectives of the REC; and
- approving the modification is consistent with our principal objective and statutory duties.[12]

The Authority has determined to approve the Change Proposal in accordance with the power set out in paragraph 21.2 of Schedule 5 of the REC.

Reasons for our decision

We consider it important that the framework is designed in a manner that acts to incentivise the CRS Provider to deliver a good level of service ultimately to the benefit of consumers, but also allows it a fair and reasonable chance of earning a reasonable profit margin in the services it provides. On balance we broadly agree with the Code Manager's assessment of the advantages and disadvantages to the CRS Provider of the framework design as proposed in the FCR, and consider that it strikes that balance.

We recognise that there are a number of possible variables in the scheme design, for example:

- the length of the reporting period (eg monthly or quarterly)
- the tolerance level of allowed missed SLAs per period before charges commence
- the weighting of service levels relative to one-another, ie whether missing some should carry a greater penalty than others
- the value of charge applicable in the event of a missed SLA

[11] REC change proposals, change reports and representations can be viewed on the REC Portal.
[12] The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 and the Gas Act 1986.

- the details of the provisions for the CRS provider to appeal a decision

Given this, we welcome the level of engagement that the Code Manager has undertaken on the final design of the scheme, both with the CRS Provider directly and with wider stakeholders through the consultation processes. We note that a number of refinements have been made to the scheme design relative to the initial proposal following these engagement processes, as detailed in the FCR.

We also note that the framework will commence on 01 April 2023, approximately 8 ½ months after CSS Go Live. We consider this is a reasonable amount of time for the CRS Provider to respond to any difficulties faced in the early phases of operations and improve service performance before commencement of the framework.

The CRS Provider responded to the consultation with the view that some wording within the REC could be made clearer to address potential ambiguities within the SLAs, in terms of how they are reported and how performance against them is measured. We note the Code Manager and DCC's agreement to consider changes in a separate REC Change Proposal with the view to any solution potentially being capable of being implemented, if approved, in time for the proposed implementation date of this proposal of 01 April 2023. To be clear however, implementation of this REC025 modification is not dependent on the progress of any other modification.

In addition, the DCC have raised concerns around the substantive content of some of the SLAs and their suitability for use in a financial incentive scheme. DCC feel changes are required to the actual requirements placed upon them by these SLAs. We note that DCC are in discussions with RECCo and may in due course raise an additional Change Proposal seeking to amend them. This could require a more substantial Change Proposal than that discussed above. Irrespective of that potential Change Proposal, the framework as proposed within R0025 can operate based on the existing SLAs. We note that DCC were integral to the development of the SLAs and to their subsequent incorporation into the REC, and that they are now required under the code to deliver their services in accordance with them.
We consider that R0025 will better facilitate each of the REC Objectives.

(a) to ensure the REC operates and evolves in a manner that facilitates the achievement of its mission statement

We agree with the Code Manager's assessment in the FCR that R0025 will help to ensure that the REC achieves its mission statement.[13] Specifically, we consider that financially incentivising Switching Service Providers to deliver their required codified service levels will support the efficient and effective running of the Switching arrangements and the wider retail energy market more generally. We expect that the framework for applying Performance Charges in the event that an SLA is not met will help to drive improved performance from Service Providers, ultimately delivering positive consumer outcomes.

(b) to ensure customers interests and data is protected in the operation of the REC

We also agree with the Code Manager's assessment in the FCR that R0025 will contribute to ensuring that customers' interests and data is protected in the operation of the REC. We note that some of the service levels that Service Providers will be financially incentivised against are specifically designed to ensure the customer has a good experience of the Switching journey. More generally, we also expect that the improved performance overall from Service Providers as a result of financial incentivisation will protect customers' interests through the operation of a better functioning Switching service.

(c) to drive continuous improvements and efficiencies in the operation of the REC and the central systems and communication infrastructure it governs

Finally, we also agree with the Code Manager's assessment in the FCR that the ability of RECCo and the Code Manager to operate a comprehensive performance management framework, as would be enabled by R0025, will help to ensure that Service Providers deliver a high value and efficient service in their provision of central systems governed by the REC.

[13] The REC will facilitate the efficient and effective running of the retail energy market, including its systems and process. It will promote innovation, competition and positive customer outcomes.

Decision notice

In accordance with Standard Condition 11B of the Electricity Supply Licence and Standard Condition 11 of the Gas Supply Licence, the Authority hereby approves REC Change Proposal R0025: REC Performance Charges.

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Rachel Clark

Deputy Director, Retail Systems and Processes

Signed on behalf of the Authority and authorised for that purpose