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Decision

DCC Review: Phase 1

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This decision[1] document concludes the first, scoping phase of our ongoing review of the regulatory arrangements for the Data Communications Company (DCC). It responds to our autumn 2022 consultation which set out our identified principles of the review, two broad models for a future regulatory model to deliver to those principles, and considerations for a transition period, future role of DCC and price control changes.

Having considered stakeholder representations, we present our conclusions on:

- Five key features to form the basis for the design of the future regulation
- Licence extension

This document also lays out our considerations for a way forward to a detailed design of the new framework and its implementation.

[1] Please note, throughout this document the use of the term 'decision' is in reference to our conclusions in relation to 'DCC review: Phase 1 Consultation'. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

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Executive Summary

The Data Communications Company (DCC) is responsible for providing a centralised, secure communications network for smart metering in Great Britain. It operates under the Smart Meter Communication Licence, awarded by the government in 2013 for an initial period of 12 years. We are reviewing the regulatory arrangements to be put in place for DCC following the expiry of the current Licence, due in 2025.

In autumn 2022 we published a consultation concluding the first, scoping phase of our review. We are now presenting our conclusions on a set of key features to form the basis of the design of the new regulatory model and a Licence extension term. We are also setting out the way forward on two key elements of the new regulatory design: future role of DCC and changes to the price control arrangements.

Future regulatory model

Design on the basis of 5 key features

We consulted on two broad options for the DCC future regulatory framework: Option A embodied a continuation of the current shareholder-controlled, for-profit model with changes to governance, price control and incentives; Option B proposed a more radical shift to operation by an industry-led or owned not-for-profit organisation.

While a plurality of respondents expressed preference for an Option B-type framework, we received a wide range of comments on the trade-offs associated with implementing either of the two models we had consulted on. Overall, we found strong cross-cutting support for certain underlying principles and features. As such, having considered all representations, we have decided to adopt a set of key features to form the basis of the new regulatory model:

1. The company Board should be majority stakeholder or independent controlled and include consumer representation
2. The Core Mandatory Business should be conducted on a not-for-profit basis
3. Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process.

In addition, we have decided to retain the following features of the current model:

4. The operational model will remain primarily outsourced with key contracts procured competitively on the market (decisions made by the Board subject to Licence limitations)
5. DCC's Core Mandatory Business will remain funded by charges on users

Implementation

We have decided not to alter the existing procedure for granting the next Licence to a new licence-holder ('Successor Licensee'); we will therefore follow the existing legislative requirements and implement the new framework via an open, competitive tender process run by Ofgem.[2]

Transition period considerations

Licence extension and transition plan

We consulted on three options for a possible extension to the current Licence to facilitate the design and implementation of the new regulatory model. Upon reviewing responses provided by stakeholders and our assumptions, we now consider a Licence extension of between 12 and 36 months will be necessary, though our ambition is to make this period as short as possible. We therefore intend to extend the current Licence Term under Part 1 Section C of the Licence. We will consult with DCC on the timelines and provide a formal notice by summer 2024 to confirm the exact term of the Licence extension.

Interim changes

We will aim to bring in incremental improvements to the current Licence to realise early benefits where possible. These will include:

- Consultation on interim changes to the price control framework to move towards an *ex-ante* regime with strengthened incentives from April 2025
- Changes to the governance via appointment of customer representatives to DCC's Board and a potential observer role for Ofgem to oversee the Business Handover
- Review of current arrangements for the Centralised Registration Service (Switching)
- Revisit of the rationale for the current levels of Baseline Margin and Shared Service Charge applied to DCC's Internal Costs

Future role of DCC

Future Mandatory Business

DCC's primary role will be to deliver its Core Mandatory Business (CMB), understood as provision of communications and data services to and from smart meters in a secure, economical and coordinated manner. The CMB will continue to be defined through the

[2] In line with the Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012. www.legislation.gov.uk/uksi/2012/2414/contents/made

Licence and relevant industry codes (SEC, REC) using (subject to consultation) modified existing categories of 'Core Communication Services' and 'Enabling Services'. We will consult on whether some currently provided services should be removed from the scope of future Core Mandatory Business. The new framework will also include provisions for Additional Mandatory Business, comprising Mandated Business Services (as instructed by the Authority or the Secretary of State), Ancillary Services (delivering system enhancements and efficiencies) and Additional User Services (bespoke capability provided on demand). We will consult on the final scope, governance, funding and cost control arrangements of the Core and Additional Mandatory Business.

Evolving DCC's role

To ensure DCC's role can evolve in a controlled and transparent manner in a future uncertain environment, we will progress on the basis of our consultation proposals to put in place formal mechanisms to manage uncertainty in response to the following 'triggers': change in customer expectations & consumer needs, new policy or regulatory requirements, and evolving technology.

Enabling re-use

We intend for the Licence to allow the re-use of DCC's infrastructure, subject to agreed conditions and measures. We will consult on these detailed measures, in particular maturity level and funding & governance models.

Price control changes considerations

We found strong support for changes to the price control regime and a shift towards an *ex-ante* regulation. Initial analysis of DCC's financial data over period 2024-2026 also shows that a majority of DCC's costs would be suitable for *ex-ante* funding.

We therefore confirm that we will move towards *ex-ante* regulation for costs of activities deemed to be sufficiently stable. We will introduce changes in two steps:

1. We will make improvements to the existing price control arrangements with the aim for these to take effect from April 2025 for the duration of the Licence extension. This will help realise benefits of *ex-ante* regulation sooner, provide opportunity to strengthen current margin-based incentives, and allow for a smoother transition towards enduring arrangements.
2. We will move to enduring arrangements following business transfer to a Successor Licensee. In the context of our conclusion that Core Mandatory Business will be provided on a not-for-profit basis, we will ensure that sufficient

mechanisms are in place to assure cost efficiency and quality of service under the enduring arrangements.

How will these decisions benefit consumers?

Now that the DCC service has been set up, stabilised and is operating at scale, a shift towards a not-for-profit, purpose-driven organisation with stakeholder-led or independent Board will better align DCC's incentives for the next Licence period with the needs of its customers and, by extension, consumers. Consumers will benefit from an increased focus on cost-efficient service delivery and continuous improvement. The new governance will improve focus on delivering the core service and addressing priority issues important to customers and consumers.

A consumer representative on the DCC Board will help ensure that impacts on consumers and issues of equity are considered in decision-making.

Coming into effect before the expiry of the current Licence, our planned changes to the cost control will help provide earlier certainty of costs, improve cost transparency and drive quality of service by increasing the focus of resources on core business.

Overview of our conclusions and areas for further consultation

Parameter	Decisions and proposals carried forward	Proposals subject to further decision
Parameter 1: Ownership	• Ownership will be determined via competitive retender under existing 2012 tender regulations[3] • Competitive tender will be open to all eligible parties meeting minimum criteria, irrespective of their business model	• Role of the new parent company and the relationship between DCC and its parent • Length of the new Licence Term
Parameter 2: Accountability & Control	• Future DCC Board will be controlled by a majority representing a combination of DCC customers, independent members and at least one consumer representative • The future DCC will be subject to the conditions of its Ofgem-awarded Licence	• Future Board composition, the powers of appointment and removal of directors • Rules for Authority intervention • Detailed governance arrangements, incl. relationship between DCC and relevant code manager(s)
Parameter 3: Cost control & incentives	• Core Mandatory Business will be conducted on a not-for-profit basis • Costs of activities deemed to be sufficiently stable will be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process • Enduring cost control arrangements will include an accompanying incentive mechanism to provide additional assurance for cost-efficiency and service quality	• Detailed design of the new cost control arrangements, including the full process of *ex-ante* forecasting, reporting and assessment, role of stakeholders, dispute resolution and appeals, management of uncertainty, among others • List of activities subject to upfront approval vs profile of residual cost uncertainty • Detailed design of any incentive mechanisms
Parameter 4: Funding	• Core Mandatory Business will continue to be funded by charges on users	• Funding mechanism for any additional services to users or commercial reuse • Review of requirements and objectives for DCC's charging methodology
Parameter 5: Operational model	• Primarily outsourced with key contracts procured competitively on the market • Decisions made by the Board subject to Licence limitations	• Governance in the context of new cost-setting mechanism • Transition of DESNZ's role in overseeing certain procurements and contract changes under Licence Condition 16.6A-C

[3] The Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012. www.legislation.gov.uk/uksi/2012/2414/contents/made

Other areas		
Licence extension & handover	• Extend the current Licence for 12-36 months to facilitate design and implementation of the new framework, appointment of Successor Licensee and Business Handover	• Determine the exact length of the extension term, following consultation with the licensee
Interim changes	• Explore moving elements of DCC's business from *ex-post* to an *ex-ante* price control framework where costs are deemed to be sufficiently certain and stable • Where available, implement changes to SEC and REC governance to reflect the role of new code managers under the code reform changes • Work with DCC to add customer representatives to the current DCC Board	• Detailed design of transitional price control arrangements • Revised incentives under a (partial) *ex-ante* regime, eg risk-sharing mechanism • Revision of overheads and margin on Internal Costs • Review of licence and code arrangements for the provision of Centralised Registration Service (Switching)
Secondary legislation changes		• Licence and code changes required to facilitate interim and enduring changes, and Business Handover
Future role of DCC	• DCC's primarily role will be to deliver a newly defined "Core Mandatory Business" • There will be provisions for "Additional Mandatory Business", comprising Mandated Business Services, Ancillary Services and Additional User Services • To accommodate uncertainty, the framework will include a mechanism for a controlled change in DCC's Mandatory Business in response to one or more of the following triggers: change in customer expectations & consumer needs, new policy or regulatory requirements, or evolving technology • The Licence will include provisions for a commercial re-use of DCC's infrastructure subject to agreed measures in the following areas: maturity level, governance, funding, risk & reward distribution, and competition. Relevant licence conditions and objectives will be amended (subject to consultation) to de-emphasise the pursuit of reuse.	• List of services comprising Core Mandatory Business and their definition through the SEC • Revised DCC's objectives • Details of scope, governance and funding provisions for Additional Mandatory Business • Redesign of existing Elective Communication Services, potential delivery of additional services for the industry under a contract • Formalised enduring process for change in DCC's role • Detailed measures required to unlock the opportunity to explore commercial re-use • Future of 'Minimal Services' • Cost control arrangements for different types of activities within Core Mandatory, Additional Mandatory, and Permitted Business

1. Introduction

1.1 This document is in response to our[4] consultation on the review of the regulatory arrangements to be put in place for the Data Communication Company (**DCC**) following the expiry of its current Licence, due in 2025. The consultation was published on 30 September 2022 and closed on 16 January 2023.[5]

1.2 DCC is the term used to refer to the holder of the Smart Meter Communication Licence ("the Licence"). It operates under the conditions of its Licence and is regulated by Ofgem. At present, Smart DCC Ltd is the legal entity that holds the Licence, following a competitive tender process that took place in 2013. Throughout this decision document, we refer more broadly to "DCC", meaning the holder of the Licence (in its generic sense) and the organisation currently carrying on the Authorised Business, and our references should be interpreted in accordance with the context to which they relate, whether that be the current licensee or the future DCC.

1.3 DCC is responsible for establishing and operating a secure national communications network for smart metering in Great Britain, which connects smart meters in people's homes and small businesses. Its main role is to effectively manage large contracts with communication and data service providers to derive value for money and ensure a stable and secure service.

Context and related publications

1.4 The objective of the DCC review is to:

- Put in place an effective regulatory framework to underpin the future role of DCC following the expiry of the current Licence
- Appoint a Successor Licensee to hold that Licence

1.5 We set out in our 2023-24 Forward Work Programme[6] that we would be considering the new regulatory model for the current DCC, including any legislative changes required for a Business Handover Period. We also noted that we would, as appropriate, commence the necessary planning work for a Licence

[4] The terms 'we', 'us', 'our' refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority

[5] Ofgem (2022), DCC review: Phase 1 Consultation. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

[6] Ofgem (2023), 2023/24 Forward Work Programme. www.ofgem.gov.uk/publications/202324-forward-work-programme

extension period and the subsequent handover period to a new licensee. Finally we said that we would explore changes to the current regulatory model, as informed by industry consultation.

1.6 Our autumn 2022 consultation concluded the first, 'scoping' phase of the DCC review. The consultation sought views on:

- Agreed principles and intended outcomes of the review (see figure 1.1 below)
- Changes to the regulatory framework we think are necessary to deliver these principles
- Considerations for transition to the new regulatory framework
- Our view on the future role of DCC
- Potential changes to the price control arrangements

Figure 1.1: Principles of the DCC review

Principles to which a new regulatory framework should deliver:

1) Drive delivery of a quality, cost-efficient and secure service
2) Be customer-centric and consumer-focused
3) Enable full accountability and decisive governance
4) Allow DCC's role to evolve in an uncertain environment
5) Maximise the value of DCC infrastructure by enabling the exploration of re-use of assets subject to appropriate control mechanisms

1.7 The objective of the consultation was to gather the necessary information to inform two key decisions, both of which we are setting out in this document:

- The type of regulatory framework we will design in the next phase of the review. We presented two broad options in the consultation which we termed Option A and Option B
- Whether an extension to the current Licence period was required and, if so, what the length of that extension should be

1.8 In addition to those decisions, we also sought to gather views in two further areas:

- What the role of DCC should be in future, including (but not limited to) which services should be defined as part of its Mandatory Business, which additional services it may be required to undertake, and details around the possible commercial re-use of the smart metering infrastructure subject to specific conditions

- Whether changes should be made to the future price control arrangements, in particular consideration of whether some or all cost aspects of DCC's Allowed Revenue should be managed under an *ex-ante* approach as opposed to the current *ex-post* model

Our decision-making process

1.9 Work on the DCC review commenced in February 2021 with our Call for Evidence.[7] The document invited stakeholders to share their views to inform the scope of, and our approach towards, the DCC review. In April 2021 we held a series of structured bilateral engagements to help contextualise the evidence we received.

1.10 In June 2021 we hosted a stakeholder workshop designed to gather views on our understanding of the main issues identified through the call for evidence, test and agree our proposed principles, explore the extent of changes needed to deliver to these principles, and confirm whether those changes could be achieved via changing and retendering the Licence.

1.11 This consultation, which followed on from that work, opened on 30 September 2022 and closed on 16 January 2023.[8]

1.12 We ran a further stakeholder meeting in October 2022 shortly after publishing our consultation as an opportunity for stakeholders to explore the proposals and questions presented in the consultation. We also held further bilateral meetings before and after the closure of the consultation to inform our further analysis.

1.13 In total we received 24 non-confidential responses and 2 confidential responses to the consultation. The non-confidential responses have been published on our website.[9]

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[7] Ofgem (2021), Call for evidence: Review of the DCC licence arrangements. www.ofgem.gov.uk/publications/call-evidence-review-dcc-licence-arrangements
[8] Ofgem (2022), DCC review: Phase 1 Consultation. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation
[9] Ibid.

Decision-making stages

1.14 This consultation process has followed the below four key steps:

Date	Stage description
30/09/2022	Stage 1: Consultation open.
16/01/2023	Stage 2: Consultation closed (awaiting decision). Deadline for responses.
06/02/2023	Stage 3: Responses reviewed and published.
25/08/2023	Stage 4: Consultation decision published.

Next steps

1.15 Following the publication of this conclusions document, we intend that an ensuing Phase 2 of the review will focus on the detailed design of the new regulatory framework. This will include at least two public consultations on:

- Future role of DCC, preferred governance and operational model for the new Licence
- Mechanisms for the determination of Allowed Revenue and incentives under a future price control

1.16 As part of this process we plan to hold at minimum one industry workshop in autumn 2023.

1.17 We will give effect to our policy decisions through subsequent drafting of a new Licence and necessary code changes. We will confirm the timeline for these changes, some of which may be brought in early to facilitate interim improvements during a Licence extension.

1.18 As part of Phase 2 we will also continue to work with DCC on a review of its Business Handover Plan, so that a revised version can effectively support Licence retender and business transfer. We will also continue work with DCC on the development of interim changes to the Licence that we are seeking to make within the current Licence Term.

1.19 Following the conclusion of Phase 2, we will proceed to Phase 3 (Tender process for a Successor Licensee) and, subject to its outcome, Phase 4 (Business Handover to the new Licensee). Please see Appendix 1 for further details.

General feedback

1.20 We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We would welcome your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

1.21 Please send any general feedback comments to stakeholders@ofgem.gov.uk.

2. Alternative Regulatory Models

Section summary

We consulted on two broad options for the DCC future regulatory framework: Option A embodied a continuation of the current shareholder-controlled, for-profit model with changes to governance, price control and incentives; Option B proposed a more radical shift to operation by an industry-led or owned not-for-profit organisation.

A plurality of respondents expressed preference for an Option B-type framework. The key favoured aspects included direct accountability to customers, focus on delivery of quality service and more transparent cost control. Some, however, noted that a stakeholder-controlled, not-for-profit DCC might lack sufficient incentives to control costs, innovate and think-long term.

Only a small number of stakeholders preferred a continuation of the current framework under 'Option A'. While enhancements to incentives, price control and governance via customer representation on the Board were seen as desirable improvements that could be made to this model, most felt these changes would not go far enough.

A few also felt they lacked details of specific proposals to endorse either option.

Overall, we found strong cross-cutting support for certain underlying principles and features. As such, having considered all representations, we have concluded to adopt a set of key features to form the basis of the new regulatory model:

1. The company Board should be majority stakeholder or independent controlled and include consumer representation
2. The Core Mandatory Business should be conducted on a not-for-profit basis
3. Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process

In addition, we will retain the following features of the current model:

4. The operational model will remain primarily outsourced with key contracts procured competitively on the market (decisions made by the Board subject to Licence limitations)
5. DCC's Core Mandatory Business will remain funded by charges on users

Finally, we will appoint the new Licensee via a competitive tender process to be held following our detail design of the new Licence.

Consultation questions:

Q1. Which of the two broad models do you think we should adopt as the basis for our design of the future regulatory framework for DCC and why? What are the features of your preferred option that lead you to this choice?

Q2. Do you agree with the way we have applied the principles in our analysis of the options? Please state your reasoning.

Q3. With regard to Option A, to what extent do you think that changes to the DCC Licence alone could provide incentives that result in a third party investor-controlled DCC Board providing the quality and cost of service that DCC customers require, and managing DCC effectively?

Q4. With regard to Option B, how effective do you think a non-profit-making, stakeholder-controlled or independent DCC Board would be in providing the quality and cost of service that DCC customers require, and managing DCC effectively?

Q5. Do you have any views on the details of Options A and B?

Background

2.1 We identified two broad models in the consultation for a future regulatory framework for DCC:

- 'Option A' embodies a similar approach to the current DCC regulatory framework, with an investor-owned DCC, and a Board controlled by the shareholder(s) with a minority of independent industry-appointed representatives. Price controls would include a combination of *ex-ante* controls for established on-going operational costs, and *ex-post* controls for new and uncertain activities. The operational model would comprise in-house and contracting-out, on a case-by-case basis, with the possibility for greater discretion for *ex-ante* price-controlled activities. Funding would continue to be through industry charges, with the potential for separate funding avenues for commercial re-use of DCC systems.
- 'Option B' involves more extensive changes, with ownership by all or a subset of SEC and REC parties, the public, or by one or more specific industry parties. The Board would be stakeholder-controlled[10] or independent, with scope for an Ofgem appointed or approved independent chair and CEO.

[10] By 'stakeholder-controlled' Board, we mean a board composed of the representatives of DCC customers (with a potential consumer representation).

Budgets and costs would be controlled by the Board, acting in the interests of DCC customers,[11] with the possibility that Ofgem would have the power of approval or veto. In-house vs contracting-out decisions would be taken on a case-by-case basis, subject to limits specified in the Licence. Funding would continue to be through industry charge, as well as, potentially, other avenues for commercial re-use.

2.2 We received 24 non-confidential responses, all of which are published on our website alongside this decision.

2.3 We asked five specific questions in the consultation. As there was a degree of overlap between the questions and therefore the responses received, particularly regarding Questions 1, 3 and 4, we have decided to present the information we received in response to all the questions together along three key themes - 1) Views on the key features of the broad regulatory frameworks (ie 'Option A' or 'Option B'), 2) Views on the application of the principles, and 3) Other views.

2.4 All views presented are those of the respondents as set out in the responses we received, and not of Ofgem.

Summary of stakeholder responses

Theme 1 - Key features of the broad regulatory frameworks

2.5 16 respondents expressed a preference for one of the two broad models, of which most favoured Option B over Option A by way of an approximately 70/30 split. Other respondents were either indifferent as to the exact choice of overall model, noted that there were ultimately advantages and disadvantages to both, or said that they did not consider either option to be suitable.

2.6 A few respondents asked for more details around the options to form a view on exactly which model they favoured, noting that it was difficult to assess their effectiveness without further analysis, in particular given the potential variants of each model. One stakeholder felt that the two options were too broadly defined, and that finer-level detail around implementation was needed to determine which would best improve DCC's operational performance and cost control. Similarly,

[11] 'DCC customers' mean the users of DCC's system or other services provided by; we may use these terms interchangeably. DCC customers include network companies, small and large energy suppliers, as well as a number of 'other users'. You can find a list of DCC's customers on DCC's website, accessible at : www.smartdcc.co.uk/our-smart-network/dcc-customers/. You can also view the current list of parties to the Smart Energy Code (not all of whom are current DCC's users) on the SEC website, accessible at: www.smartenergycodecompany.co.uk/current-sec-parties/

one stakeholder acknowledged that Option B, as the further-reaching proposal, had been left more open-ended, but suggested that we narrow down the proposal on the basis of a not-for-profit, stakeholder-led Board similar to the Elexon model.

2.7 Finally, one stakeholder recommended that Ofgem propose a wider range of model options for consideration believing that neither of the two models sufficiently addresses the issues experienced by users.

2.8 We have presented below the key arguments put forward in support of each model (or a particular feature of that model) in the responses, irrespective of whether the respondent noted that model as their absolute preference. We have also included key arguments made against the alternative model and presented them as proxy arguments in support of the model in question, *ie* arguments made against Option B are presented in the same section as arguments in support of the counterfactual Option A, and *vice versa*).

Views in favour of Option A (investor-owned) / against Option B (stakeholder-controlled)

2.9 Key arguments received in support of Option A were as follows:

- **Independence**: Private ownership creates a structural independence from industry and government, removing potential conflicts of interest that could occur with industry-owned models.
- **Financial incentives**: A profit-seeking entity can be financially incentivised to drive cost efficiencies and deliver quality improvements. It offers a greater scope both for reward and penalty to ensure DCC acts in the best interests of its customers and delivering the best outcomes in terms of quality and value for money.
- **Investment**: It can deliver cost efficiency and quality standards through its greater ability to attract third party investment.

2.10 Some respondents noted that Option A could work if the following improvements to the current model were made:

- **Changes to the price control**: There was a near-universal support for a move towards *ex-ante* price control under Option. Within that, some stakeholders also acknowledged the option of a hybrid regime combining *ex-ante* price control for core activities and established operational costs, which can be budgeted for, and an *ex-post* regime, which could be retained for new projects and programmes to provide the flexibility needed where cost uncertainty is inherent. Arguments in support of an *ex-ante* price control included: opportunity to drive spending discipline, providing greater transparency and opportunity for stakeholders to engage on the DCC budget, including raising challenges if necessary, allowing for effective risk-sharing, and helping to control cost by mitigating scope-creep. We also found suggestions for the price control framework to include a mechanism for DCC users to be compensated where the service fails to meet certain standards, eg through a similar method to the Guaranteed Standards of Performance (GSoPs) that apply to energy suppliers and network operators.[12]

- **Changes to governance**: The appointment of additional industry and customer-representative Board members within the existing structure would provide a better representation of the overall interests of DCC's customers and consumers, and improve accountability. Similarly, improved accountability under Option A can be achieved through greater Ofgem and customer input into the price control process, and wider policy initiatives as a result of the ongoing Energy Code Reform work. Licence changes to introduce greater separation between shareholder and DCC, or even through creation of a separate DCC organisation to undertake core activities, will ensure DCC's priority is always the delivery of its objectives and core role.
- **Redesign of performance incentives**: The performance incentive framework could be revised to better incentivise improvements in contract management and service quality to the benefit of stakeholders. The current Licence creates a penalty-based mechanism which focuses attention on minimum standards in a narrow range of activities, which may not reflect those of greatest importance to stakeholders. SEC Parties could be given

[12] For suppliers, the GSoPs are set out in: The Electricity and Gas (Standards of Performance) (Suppliers) Regulations 2015. www.legislation.gov.uk/uksi/2015/1544/regulation/2/made. Amended by The Electricity and Gas (Standards of Performance) (Suppliers) (Amendment) Regulations 2019. www.legislation.gov.uk/uksi/2019/218/contents/made; and The Electricity and Gas (Standards of Performance) (Suppliers) (Amendment) Regulations 2020. www.legislation.gov.uk/uksi/2020/116/made.
For DNOs, the standards are set out in: The Electricity (Standards of Performance) Regulations 2015. www.legislation.gov.uk/uksi/2015/699/body/made; and The Gas (Standards of Performance) Regulations 2005. www.legislation.gov.uk/uksi/2005/1135/made. Amended by The Gas (Standards of Performance) (Amendment) Regulations 2021. www.legislation.gov.uk/uksi/2021/257/contents/made. See also: Ofgem (2023), Final Decision and Statutory Instrument on Guaranteed Standards of Performance (GSOPs) for Reliability and Connections. www.ofgem.gov.uk/publications/final-decision-and-statutory-instrument-guaranteed-standards-performance-gsops-reliability-and-connections

more powers through the SEC to hold DCC to account themselves on cost and service quality matters without the need for Ofgem intervention.

- **Improvements to cost transparency:** New projects and programmes should be required to produce a needs case, so that industry can scrutinise costs and benefits; programme costs could be ringfenced from operational costs and managed by the project oversight bodies themselves. Independent auditors or assessors could assure accuracy of costs and ensure competitive tendering is undertaken. Ofgem could have the powers to approve or veto costs to ensure robust budgets. The level of business risk associated with the provision of a monopoly service should be factored in any future allowed margin, with a comparison to the rate of return under RIIO-ED2.

2.11 One respondent also proposed a modified form of Option A where the Licence is structured as a Service Agreement with a shorter 5-7 year term. In their view, this creates the opportunity for greater parent company engagement, making it easier to put in place the incentives on the owner and make better use of its skills and resources to run a more efficient business.

2.12 Respondents identified disadvantages to an Option B-type approach, including:

- **Lack of financial incentives to deliver cost-efficient & quality service:** The company may not be adequately incentivised to control costs and deliver efficiencies, particularly where they apply to all customers equally. There would be no incentives to drive down costs once a fixed budget is agreed, whereas under Option A DCC would be incentivised to continue to seek cost efficiencies to the benefit of all users. Significant contingency may need to be built into fixed budgets to account for cost uncertainty in the absence of a price control mechanism. Ofgem oversight of business plans may not counteract weaker cost control incentives.
- **Lack of independence:** An industry-led model may be less incentivised to support changes that do not primarily benefit customers; it may focus disproportionately on the views of current customers, reducing its ability to evolve and realise value for end-consumers. Under a potential public ownership, it may not be efficient for government to have day-to-day operational control over services, even if indirectly through a public body.
- **Lack of ability or incentive to evolve and innovate:** An industry-led Board without financial incentives may not be able to proceed at the pace required to deliver government's decarbonisation agenda with over-emphasis

on the delivery of a stable service *now* at the expense of future innovation. There is a risk that a lack of profit-making incentive to seek new revenue streams, improve service quality through innovation or explore system re-use may stifle long-term thinking and miss opportunities to innovate. Funding for new investments would need to be agreed among stakeholders which could slow down the process.

- **Complex transition:** The establishment of a public ownership model could be complex and problematic at a time of ongoing industry change, and would run counter to government policy on the creation of new public bodies. The costs and work involved in setting up the new organisation and transferring resource across would also be significant. It would introduce risk and uncertainty around transition to the new arrangements, including time delays. The learning curve for industry to be able to effectively manage DCC could be significant. Further work would be required to understand whether the benefits would justify the additional costs and risk, particularly in the current financial climate.
- **Inefficient governance due to lack of stakeholder cohesion:** It may be difficult for stakeholders to agree an effective Board structure due to differing requirements with potential conflicts of interest and priorities between users. There is also a potential conflict of interest among stakeholders in the prioritisation of issues, for example in resolving network issues. It may also be challenging to protect against one group of stakeholders exercising undue control or influence.

Respondents' views in favour of Option B (stakeholder-controlled) / against Option A (investor-owned)

2.13 A greater number of respondents expressed a preference for an Option B type model. Key arguments in support were as follows:

- **More customer and consumer focus:** An independent Board with better customer representation and a consumer advocate would remove the drivers set by a shareholder and re-focus delivery performance for the benefit of its stakeholders and ultimately consumers. It would incentivise DCC to manage contracts with full stakeholder input and accountability and ultimately for their longer-term benefit, rather than being focused on maximising shareholder revenue. It would vest control in those directly accountable to consumers themselves and ensure that consumer needs are best represented and meet the principles of accountability and transparency in decision-making. It would also provide users and consumers with greater influence in the setting of the overall direction of DCC, with greater control and say over how the organisation would deliver against its objectives.

- **Greater focus on core business and duties:** DCC would be directly incentivised to focus on delivering its Core Mandatory Business rather than pursuing additional commercial ventures. Potential provision of additional services could be assessed on a case by case basis subject to stakeholder views. Equally, customers could set the right of innovation without conflict with a third-party shareholder.
- **Improved quality and cost of service:** It would be more effective than an Option A approach in delivering quality and cost of service given the difficulty of applying a price control framework to an asset light organisation. It would potentially reduce the need for a complex price control and financial incentives subject to a robust user accountability.
- **Improved cost transparency:** It would increase transparency and scrutiny over DCC's activities, costs and budgets. Stakeholder representatives would be expected to be more likely to share information with customers and provide better evidence of cost efficiency.

2.14 Respondents further identified key considerations that would be critical to get right for a successful Option B-type model:

- **Governance:** Developing the detailed governance arrangements will be critical to success; in particular putting in place a mechanism to prevent Board members acting unduly in the interests of their employer companies, and ensuring that no one company or subset of the industry can exercise undue influence. Several stakeholders pointed to the governance of system bodies, with a number of respondents referring specifically to an Elexon-style model of governance as a useful example for a not-for-profit and industry-accountable set-up, though one party cautioned against an Xoserve model on account of limited accountability to Ofgem. One stakeholder identified synergies with the development of governance for new code managers, suggesting that similar structures and reporting lines would help stakeholders to engage.

- **Performance assurance:** An Option B-type model should be supported by a performance assurance regime with well-structured incentives that align Board objectives with user interests to ensure the right behaviours.
- **Current *vs* future investment**: Ofgem should be required to formally approve business plans in order to maintain the balance of interests between current and future consumers, mitigating against the risk that the Board will focus on delivery of current core services at the expense of innovation and other future consumer considerations.

2.15 Furthermore, some respondents noted disadvantages to an Option A type approach as follows:

- **Misalignment of incentives**: Licence changes to the current model alone may not be able to challenge the overriding profit-maximising commercial incentives to which DCC ultimately responds and align them with the interests of its customers, or provide the correct incentives which would lead to the required level of service including cost efficiency and transparency of contracts. A fundamental shift would be required from the owners of DCC to be more customer-centric and consumer-focused, including improvements to responsiveness to customers and general stakeholder engagement. A profit-seeking model would not offer the same level of customer input as an Option B-type approach.
- **Lack of transparency:** An Option A model would fail to resolve a lack of transparency in contract management and in the processes for addressing service failures.
- **Performance assurance challenges**: The activities of a profit-seeking licence-holder are difficult to reflect in a performance incentive framework. Increasing incentives based on user engagement and feedback may lead to unintended consequences – a service provider that sees limited profit potential and potentially significant sanctions might see little interest in investing in improvement and instead seek to surrender its licence and exit, resulting in expensive costs to resolve and a period of service decline.
- **Procurement challenges**: The nature of DCC’s work of simplification and cost reduction is unlikely to appeal to third-party shareholders, who would have little incentive to deliver these objectives. It is likely that another competitive tender would find few organisations able to provide the required specialist service.

- **Lessons learnt from existing model**: There is a lack of evidence of identifiable advantages to the competitive procurement of a third-party parent. Furthermore, some expressed that changes to the current model (consumer and industry representation on the Board, *ex-ante* price control) would not be enough to meet the agreed principles and provide a reliable, secure, scalable and value-for-money smart metering ecosystem.

Theme 2 - Views on the application of the principles

2.16 As a reminder, the principles we set out in the consultation as informed by previous stakeholder engagement were as follows:

We consider that any effective future regulatory framework should:

1. *Drive delivery of a quality, cost-efficient and secure service*
2. *Be customer-centric and consumer-focused*
3. *Enable full accountability and decisive governance*
4. *Allow DCC's role to evolve in an uncertain environment*
5. *Maximise the value of DCC infrastructure by enabling the exploration of re-use of assets subject to appropriate control mechanisms*

2.17 Most respondents agreed with the principles and in the way we applied them in our analysis of the options we presented. A few respondents noted that they either disagreed with certain principles or with our application of them.

2.18 We have set out below the key arguments put forward. Again, all views presented are those of respondents, not Ofgem.

2.19 **Weighting of principles**: A number of respondents considered that the main focus should be on principles 1 and 3, *ie* cost-efficiency and accountability in governance, respectively. Some felt principles 1 to 3 should be weighted greater than 4 and 5. A few stakeholders asked for an outright removal of principles 4 and 5. By contrast, one respondent felt principles 4 and 5 were the most significant on the basis that the need for DCC to evolve and maximise use of the infrastructure underpins good performance against principles 1 to 3 - for example, a DCC that can better commercialise its infrastructure will drive down costs and create value for its customers under its core work, whilst a DCC that does not fully leverage the value of its infrastructure would not be acting in the interests of consumers in that opportunities to support the net zero transition would be missed.

2.20 **Principle 1:** In terms of driving 'quality of service' some felt that focus should be on measurable outcomes, with one respondent highlighting that bidders for the new Licence will need to understand expectations. There was also a suggestion that service reliability should be explicitly called out within the principle with a commitment to geographical equality to minimise differences between the long range radio service employed in the North Communication Region and the mobile network service in the South. One respondent further asked for a commitment to universal service obligation, whereby all premises with mains electricity should have access to a usable signal from their comms hub. Another called for a focus on ensuring any disruption to DCC services are minimised in the context of live and upcoming programmes. In terms of cost efficiency, there was an acknowledgement that challenges could remain in ensuring value for money is derived from existing service provider contracts under either option.

2.21 **Principle 2**: One respondent argued that customer centricity and consumer focus should not tie DCC solely to traditional stakeholders' views or groups but allow it to evolve and reflect the needs of increasingly diverse stakeholders, including newly emerging business models. They also argued that the application of those principles should go beyond board representation and be embodied in the organisational ethos. In terms of stakeholder input, there were views that the framework should allow stakeholders to define how a service is delivered that most effectively meets their needs, and that a future framework should support a consumer complaints framework allowing consumers to contact DCC directly, up to and including escalation to the Ombudsman service.

2.22 **Principle 3**: In terms of accountability, one stakeholder felt there was a lack of focus on accountability to consumers; another stressed the importance of having an appropriate financial accountability regime in place for the licensee to incentivise good performance. Speaking of the aim to ensure appropriate organisation independence, one respondent suggested that a third-party owner, or firms linked to Board members, must not be awarded contracts by DCC; another considered an independent Board to be crucial in achieving the right balance in governance.

2.23 **Principle 4**: A number of respondents expressed concerns over evolving DCC's role in the future, with key risks seen in a potential scope creep, additional complexity and costs, and inappropriate use of resources to gain advantage in a competitive market.

2.24 **Principle 5**: Several stakeholders expressed concerns about expansion of DCC's role by allowing re-use of assets and infrastructure. The key risk was seen in a potential distraction away from the core duties, particularly under a for-profit ownership model. There was a view that DCC's role should not be that of an active innovator on account of its monopoly position; others acknowledged the opportunities of re-use in innovation and to generate revenue to offset costs of core service, albeit noting that any reuse of the infrastructure should be in line with customer needs.

2.25 **Additional general points on the principles**: One stakeholder found it disappointing that the process has not resulted in a clear preference between Options A and B. A couple of respondents asked for clarity on the use of the weighted principles in future consultations and trackability of targets. It was further suggested that feasibility and impact on DCC customers during transition to the new arrangements should be included as part of the analysis.

Theme 3 - Other views

2.26 Finally, this section captures comments received that do not specifically relate to the advantages of either of the two models, or to our application of the principles.

2.27 **Complexity of governance arrangements**: Several stakeholders spoke of the issue of complexity and lack of transparency in DCC's governance and service delivery, with specific comments including an ask for:

- Simplification and streamlining of DCC's role
- Clarity on cost approval and appeal processes, cost and contract transparency, and Board appointments and accountability to stakeholders
- Aligning governance structures and reporting lines to relevant code managers under the new licensing model to make it easier for DCC users to understand and engage with it

2.28 **Roles of Ofgem and government** in the future framework should be clearly defined under a new framework; specifically to ensure clarity in requirements on DCC and to avoid the need for the government's intervention, albeit some asked for assurance of Ofgem's continued involvement to support and challenge the new licensee. Some stakeholders also raised concerns over the process through which Ofgem and the government can introduce new requirements to DCC's remit, noting a risk to transparency on the role of DCC and increasing complexity.

2.29 **External contracts**: Several respondents made comments about DCC's external contracts and their importance in DCC's costs and performance. A couple of respondents identified the limitations of licence changes alone to address the terms of DCC's contracts and the existing design and technical issues. One stakeholder recommended more robust checks and balances on the management of supplier contracts to ensure value for money, observing the magnitude of DCC's costs in comparison to other Central System Delivery Bodies, while another asked what influence an Option B-type Board could have over existing service provider contracts. Some stakeholders noted that external contracts should reflect expected outcomes under the SEC, arguing for their alignment. Others asked Ofgem to consider ways to compensate customers for poor performance or under-delivery of service with a need to ensure sufficient financial accountability is placed on DCC.

2.30 **Security controls**: Adequate security controls must be put in place, including considerations around security assurance and governance. As a minimum, the existing security obligations in the Licence and SEC should be retained.

2.31 **Review of access to smart meter data**: It has been suggested that the governance of smart meter data access should be considered as part of this review. Specifically one stakeholder asked for separating the provision of the smart meter infrastructure from the governance of access, suggesting creation of a separate industry-led data trust to act as a steward of the data on behalf of industry, with DCC left to focus on smart meter security and access control. The expected benefit would be maximising the value of smart meter data by allowing parties to access data collected by DCC without needing to contact the meter itself. The stakeholder referred to the existing Data Transfer Service Agreement as an example of an industry-led model for data management.

Our view

2.32 Having considered all representations, we are making the following decisions for the way forward.

2.33 First, we have concluded to proceed to design the new regulatory model on the basis of a set of "key features" which received cross-cutting stakeholder support and which we believe will best deliver the outcomes set out in our principles. The 5 key features are as follows:

1) **The company Board should be majority stakeholder/independent-controlled with consumer representation**

2) **The Core Mandatory Business should be conducted on a not-for-profit basis**
3) **Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process**
4) **The operational model will remain primarily outsourced with key contracts procured competitively on the market (decisions made by the Board subject to Licence limitations)**
5) **DCC's Core Mandatory Business will remain funded by charges on users**

2.34 Features 1-3 mark a shift away from the current framework, while features 4-5 continue with current arrangements.

2.35 Below we in turn set out our rationale for the decision to proceed on the basis of these features, as opposed progressing solely with "Option A" or "Option B" in isolation, our reasoning for adopting these specific features, considerations for the design with a particular attention to mitigation of design risks highlighted by stakeholders and identified through our analysis, and our assessment of the intended outcomes against our principles.

2.36 We have decided not to alter the existing procedure for granting the next Licence to a Successor Licensee and will follow the existing legislative requirements to implement the new framework via an open, competitive tender process run by Ofgem.[13] As we are proceeding to design the new framework on the basis of the identified key features, we consider a competitive tender remains an appropriate route for award of the new Licence. We believe that this will help strengthen the checks and balances in the new model by preserving the role of the licence-holder, for example in the governance arrangements. To invite bids from a diverse pool of organisations, we will decide on the role of the parent organisation under the new Licence to inform the tender criteria.

Decision to proceed on the basis of key features

2.37 The two options presented in our consultation represented a spectrum of potential solutions, with a third-party owned and controlled, profit-maximising organisation at one end, and a stakeholder-controlled or independent, non-profit

[13] Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012. www.legislation.gov.uk/uksi/2012/2414/contents/made

making organisation at the other. While a majority of stakeholders expressed a preference for one of our presented options, with a plurality in favour of Option B, we acknowledge the breadth of views expressed in favour or against each option, as well as the large number of considerations and trade-offs around the details of each model.

2.38 We found compelling arguments for both models, underlying our consultation view that both options had the potential to deliver to our principles, subject to specific trade-offs. Equally, however, we believe that our identified 'key features' represent a cross-cutting agreement on how to deliver to our principles and how to tackle associated trade-offs, allowing us to proceed to detailed design.

2.39 As set out in our consultation, we consider the issue of control (that is who controls the company Board, irrespective of who owns the company) to be the main consideration and, which, as such, is central to our decision. Regardless of the preferred option, we found strong support to drive accountability and transparency in governance through a degree of stakeholder influence. We agree that even a minority representation of customers and consumers on DCC's Board, while retaining a majority shareholder control, could improve overall transparency and better focus in DCC's decision-making on customer and consumer priorities. However, in a continued majority-shareholder model our ability to ensure cost efficiency and delivery of quality service would continue to rest primarily on cost control and incentives to counter the shareholder's profit-maximising objective. On balance we believe there are inherent barriers in the nature of DCC's business and cost structure that make changes to cost control and incentives in a majority-shareholder model a weaker option to driving desired outcomes through a shift to more direct accountability.

2.40 First, the high proportion of External Costs (costs associated with external service provider contracts) in DCC's Allowed Revenue limits the amount of commercial risk any profit-making licensee can realistically face before the risk is borne by the industry. While this can be partially mitigated by a shift to an *ex-ante* price control model with risk sharing mechanisms and guarantee requirements, the fundamental risk of additional costs would remain underwritten by the funding industry parties of DCC while the shareholder would always expect net profit.

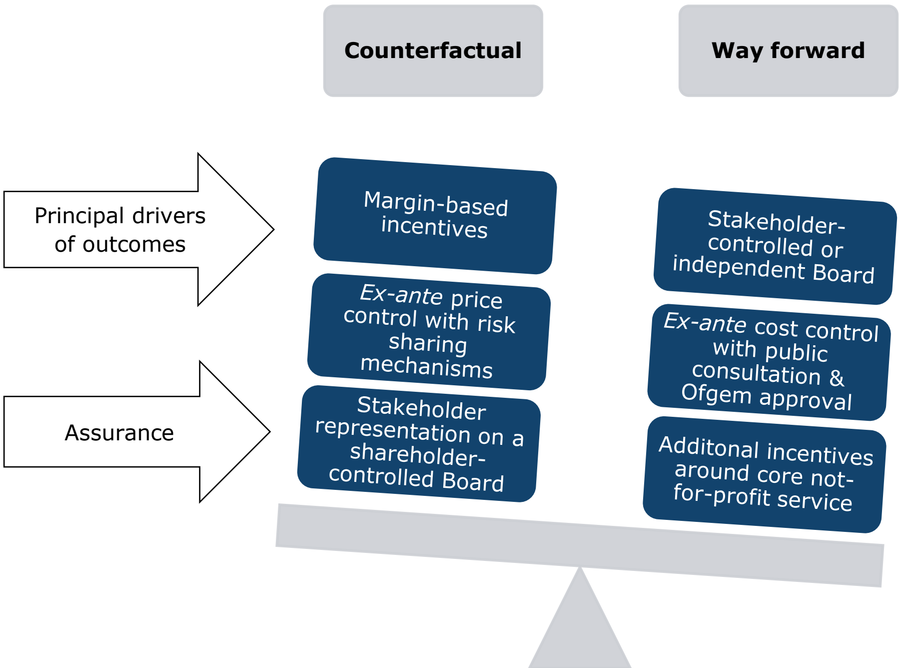
2.41 Secondly, the technical and commercial complexity of DCC's operations, large supply chain, and a broad customer base with diverse needs and expectations, make it inherently challenging to design an effective performance regime that can fairly and accurately reflect all aspects of DCC's performance. This constrains the effectiveness of any performance incentive regime to align the interest of the shareholder and the funding users.

2.42 Thirdly, although additional controls can be imposed on a third-party shareholder via licence conditions and strengthened cost control and incentives, any improvements to governance through increased customer participation are limited so long as the shareholder is able to prevail in decision-making.

2.43 On balance, we therefore see changes to the control of the Board, with assurance provided through modified cost control and complemented by a lighter touch incentive regime, as a stronger option compared to a continued reliance on cost control and margin-based incentives, accompanied by some governance changes.

2.44 A shift to an industry-led or independent, purpose-driven model will follow examples of best practice employed in the governance of other Central System Delivery Bodies. Nonetheless, we recognise that the nature of DCC's role in managing the smart metering system is distinct. Within each 'key feature', we will therefore consider a range of options for implementation to create a model with strong checks and balances.

Figure 2.1: Our way forward vs counterfactual



Key feature 1 – Governance via a majority stakeholder-controlled or independent DCC Board

2.45 To establish strong accountability as the primary vehicle for driving the right future outcomes, we consider that the future DCC Board shall be controlled by a majority representing a combination of DCC customers, independent members and at least one consumer representative.

2.46 We recognise the concerns that a majority stakeholder controlled DCC could bring a number of risks, including:

- Weak incentives to control common costs or, conversely, cost minimisation impacting quality of service
- Conflict between stakeholder representatives resulting in operational constraints, slow decision-making and loss of strategic vision
- One or more stakeholder groups exercising undue control at the expense of the interest of smaller and future users
- Disruption and skills shortages

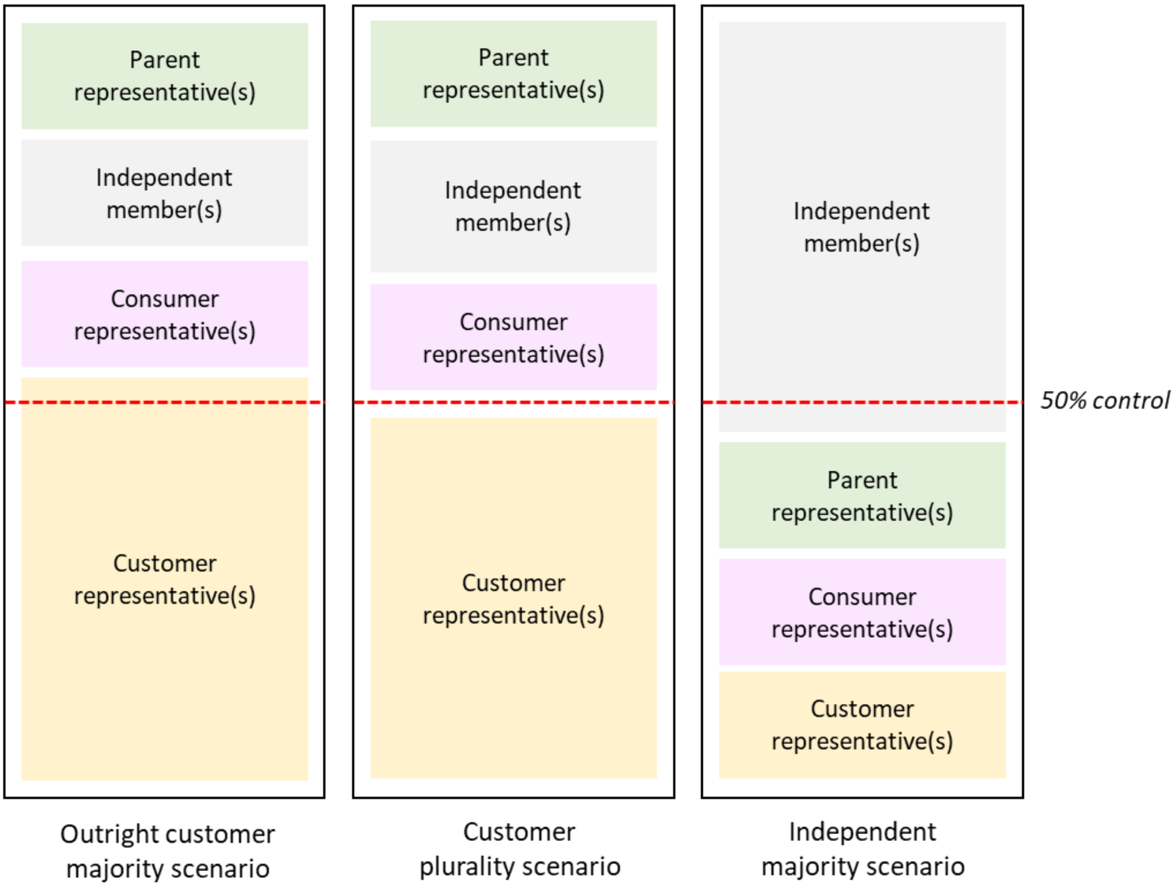
2.47 To ensure that the Board's decisions achieve value for money by striking the right balance between cost and quality service we will design a cost-setting and cost-control process supported by an appropriate incentive regime. We discuss the details of these options in paragraphs 2.55-2.58 below.

2.48 To assure effective and balanced decision-making, we are minded to:

- Protect a minority representation of the new parent organisation to provide a balance of views
- Appoint sufficiently independent directors with a breadth of expertise to prevent potential capture of vested interests; this may extend to the role of the Chief Executive and/or Chair

2.49 For the avoidance of doubt, we are not making a decision on the exact composition of the Board which will be decided through further consultation process. Nonetheless, in figure 2.2 below we have provided examples of three different scenarios for a future Board composition that could be considered – please note that these are non-exhaustive and illustrative only at this stage.[14]

Figure 2.2: Illustrative examples of possible Board composition



2.50 We will refer to the governance models of other Central System Delivery Bodies and comparable organisations in developing the detailed proposals of how Board members will be nominated, ratified and removed. As part of this, we will also consider:

- How best to represent different groups of stakeholders, for example using a constituency-based model for appointment or ratification of a subset of Board members
- Granting Ofgem an enduring observer role

[14] Please also note, under any model, customer representative(s) would not be expected to represent views of a specific company, rather the body of DCC customers as a whole, or its defined subset.

- Retaining the power to approve or veto the appointment of the Board Chair and Chief Executive

2.51 To assure continued alignment to regulatory and wider energy policy and strategy, changes to governance will be implemented in the context of the Energy Code Reform changes. As set out in our consultation,[15] DCC will be accountable to the relevant code managers to the extent as they succeed existing code panels (with details of the mechanisms for this yet to be developed). Once in place, in the long term, the newly licensed code managers will prepare delivery plans setting out how they will ensure their respective codes align with the strategic direction set by Ofgem, and they will have the ability to propose code modifications where necessary.[16] Consequently, this will entail a role, through their management of the code and assessment of proposed changes, in defining the services that DCC would be required to provide. We envisage that the future DCC Board will cooperate with the code managers to ensure efficient delivery of code modifications by determining how best to deliver DCC's services to the expected quality and cost. The Board will also continue to prepare annual business plans which will include medium to long-term view of how the DCC systems may need to evolve to respond to changes in regulation, technology, and customer and consumer needs.

2.52 We recognise that the success of these changes will depend on the appointment of persons of sufficient calibre and are aware of the risk of potential shortages. To that end, we will:

- Work with DCC to start the process of backfilling existing Board-level vacancies in line with our outlined direction of travel towards greater customer representation
- Consult on the remuneration and incentive package for future Board members
- Take advantage of the tender process to ask bidders to demonstrate ability to assume an effective minority role on the Board

2.53 We acknowledge that there may still be some disruption during transition period as the outgoing Board is replaced by a new one. We will work with DCC to ensure

[15] Ofgem (2022), DCC Review: Phase 1 Consultation, paragraph 3.52. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation
[16] For more details, see BEIS, Ofgem (2022), Government response to the consultation on Energy Code Reform, esp. Section 3 (Roles and Responsibilities). Accessible at: www.gov.uk/government/consultations/energy-code-reform-governance-framework

the process is captured in its Business Handover Plan, prepared by DCC and approved by Ofgem under Licence Condition (LC) 43.

2.54 Finally, irrespective of its final composition the Board will be bound by the conditions imposed on DCC through its Licence. Ofgem will continue to oversee the licensee's compliance with its Licence obligations and will consider enforcement action in circumstances where non-compliance has been identified.

Key feature 2 – The principal business should be conducted on a not-for-profit basis

2.55 Our second key feature is that DCC will be not-for-profit in respect of the provision of its Core Mandatory Business. The rationale for this decision follows from a move towards purpose-driven governance. With a duty to act directly in the interests of its customers rather than a shareholder, there is no central rationale for the organisation to seek to maximise profit.

2.56 While we found support for this key feature among stakeholder responses, we recognise concerns that in the total absence of profit that can be put at risk, the organisation may lack strong incentives in respect of cost efficiency and quality of service, and that additional assurance would be needed to complement changes to the governance. We will therefore consider options for additional incentivisation. These may include:

- Allowing DCC to earn a surplus above its allowed costs to be put at risk against performance incentives, with any retained revenue distributed at the discretion of the Board, for example as bonus payment to its staff
- Allowing DCC to retain a portion of some cost savings to be reinvested at the discretion of the Board, for example to attract talent and skills or to create an innovation fund

2.57 The form of any accompanying incentive regime will be developed as part of the upcoming detailed design phase of the project in consultation with stakeholders. However, we would expect a future incentive regime to be less complex than any incentives required to drive outcomes in a profit model as it will primarily serve the purpose of additional check and assurance.

2.58 For the avoidance of doubt, we are not foreclosing the possibility that DCC may be able to earn additional revenue from potential non-core activities, such as commercial re-use of its infrastructure. These revenues could be used to defray the costs of providing core services to its users, and, if appropriate, to develop further non-core services with the view to offset the cost of core service in future. We will also consider the balance of risk and reward associated with the development and funding of any additional, non-core services and whether it may be appropriate to allow a third party, including the parent organisation, to bear some of the risk and reward. We discuss this in more detail in Chapter 4 (Future role of DCC).

Key feature 3 – Sufficiently stable costs to be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process

2.59 Irrespective of respondents' preferred model, we found strong support for the introduction of an *ex-ante* regime for cost control with the expectation that it would improve cost transparency, customers' engagement and scrutiny.

2.60 We note concerns expressed by a number of stakeholders that under not-for-profit arrangements DCC may have a weak incentive to control costs, especially those that impinge on all users equally in the event of industry-led governance. Conversely, that there may also be a risk of too much pressure on cost at the expense of quality service or innovation.

2.61 We therefore consider that a form of cost control will be necessary to underpin the new framework, especially to ensure delivery of our ambition under principle 1 (driving delivery of a quality, cost-efficient and secure service). As such, we will develop a cost control mechanism on the basis that, where possible, costs should be scrutinised and agreed upon upfront and be subject to Ofgem approval. (We discuss details of our consideration in the price control changes in Chapter 5.)

2.62 At minimum, we envisage that DCC will be required to prepare business plans and periodically submit its budgets and costings, both for its ongoing operations and for new projects, to public consultation and to Ofgem for approval. This will help ensure that costs to operate and cost of change are economic and efficient, that resources are allocated to the right areas to control Internal Costs, and that business plans and forecasting reflect long-term strategy and include sufficient investment. Upfront cost allocation with Ofgem approval will also help protect against scope-creep and provide timely scrutiny on the Board's procurement decisions before new contracts or service begin to incur costs. The public consultation process will also give individual stakeholders additional opportunity to challenge DCC's costs above beyond the input of their Board representative(s). As discussed in paragraph 2.56 above, this cost-control process can also allow for introduction of additional incentives on cost efficiency and service quality to mitigate against the risk that, once approved, in absence of margin at risk DCC would not be driven to seek further efficiencies in delivery.

2.63 Though we recognise general desire for full transparency, in some circumstances, the need to avoid undermining commercial negotiations between DCC and service providers could limit the detail that can be put in the public domain; however, customer representation on the Board should provide additional degree of assurance to the industry in such areas.

2.64 We also note that not all of DCC’s costs may be suitable for upfront approval. This may require introduction of an uncertainty mechanism or *ex-post* assessment. We have commenced work with DCC to determine the proportion and magnitude of such costs and will consult on the process for their control.

2.65 Finally, as identified by respondents and noted in our consultation, the shift towards a form of *ex-ante* cost control may not automatically lead to cost reductions due to the high proportion of External Costs and issues beyond DCC’s direct control; nonetheless, with the preservation of cost scrutiny and from available data we would expect to see stabilisation, at minimum in the costs of BAU operations, including live programmes, over time.

Key feature 4 – Operational model to remain primarily outsourced with key contracts procured competitively on the market

2.66 We consider that the current operational model of competitive procurement for key services should be retained. Contracting out of services is an essential means of benchmarking, ensuring costs are efficiently incurred and, in line with DCC’s objective, driving competition in the market.[17]

2.67 We will review the existing Licence requirements and guiding principles for procurement to strengthen and update the provisions and consult on any proposed changes.[18] Nonetheless, we intend to:

- Retain the existing Licence requirement on DCC to procure Fundamental Service Capability on a competitive basis without exception[19]

[17] LC 5.10, part a) of the Second Enduring General Objective
[18] LC 16 (Procurement of Relevant Service Capability)
[19] LC 16.4-16.5

- Retain the option for DCC to deliver some non-FSC capability in-house where this would result in the most economic and efficient outcome and would be immaterial within the overall context of the Mandatory Business[20]

2.68 Procurements will be decided on a case-by-case basis by the Board and confirmed through the *ex-ante* cost control process where the economy of the resulting costs of each procurement decision would be assessed and agreed.

2.69 We will work with the Secretary of State on the transition of DESNZ’s role under LC 16.6A-C in issuing confirmation of non-objection in respect of certain procurements or contract changes. We will further consider the role these provisions ought to play in the new Licence, if any, or whether changes to governance and cost control would render these requirements functionally redundant.

2.70 We recognise that the operational model will be dominated in the immediate future by existing service provider contracts, which are required to be novated (in accordance with the current Licence provisions) as part of Business Handover to the Successor Licensee. Nevertheless, the DCC Board will be able to have transparency of, and have influence over, the management of these contracts, and will be able to exercise control over the procurement of new and replacement contracts, subject to any requirements or provisions within the Licence.

Key feature 5 – Core mandatory business to remain funded by charges on users

2.71 We will retain the current funding model whereby DCC’s activities are funded by charges on users. This model ensures that the core service, which is critical for the functioning of smart metering in GB, is continually financed and protected from default. It also maintains customers’ stake in the governance of DCC and in cost-control, and prevents conflicts of interest which could arise if the core service was funded by the parent organisation or a limited subset of industry parties.

2.72 The charges on DCC customers will continue to cover DCC’s costs, including covering interest on borrowings. (With suitable indemnities, which may be provided through the parent organisation or the SEC, DCC would be able to borrow as and when necessary, to provide either working capital or capital

[20] LC 16.6

expenditure.) While charges and costs for DCC's activities may not match in a given period, we expect charges to be set with a view to recovering, over the longer term, just DCC's costs; albeit as discussed above, this may include some additional allowance to be used for incentivisation.

2.73 We did not receive any particular comments on the question of future funding for core services. However, we are aware of the ongoing discussion about the allocation of charges among groups of DCC customers.[21] We consider that this issue is best addressed via code governance and are minded not to include this as part of the review. However, we will consider whether the Licence conditions setting out the requirements and objectives for DCC's charging methodology should be updated.[22]

2.74 For the avoidance of doubt, we are not making a decision on the funding of any potential additional, non-core activities. These may include bespoke services to users paid for on demand, as well as options for funding of any commercial re-use of DCC's infrastructure. We will consult on these proposals separately as part of a broader question of the future role of DCC. We discuss stakeholder responses we received on this issue and our view in Chapter 4.[23]

Principles

2.75 We note that most respondents agreed with our application of the principles, even though several respondents disagreed with one or two of the principles themselves or with the weighting of them.

2.76 We have decided to maintain our principles as consulted on as we consider they strike the right balance between different priorities, further reflected in their weighting. In deciding on the key features we focussed in particular on the trade-offs associated with principles 1-3, which together represent weighting of 0.8/1.

2.77 We recognise that the main concerns relate to principles 4 and 5, that is allowing DCC to evolve in an uncertain environment and maximising the value of DCC infrastructure. For clarity, the intention of principle 4 is not necessarily that DCC should lead the evolution of its services, but that the regulatory framework should allow it to adapt to changing circumstances. We note underlying concerns

[21] DP218 Review of the SEC Charging Methodology. Accessible at:www.smartenergycodecompany.co.uk/modifications/review-of-the-sec-charging-methodology/
[22] LC 18 (Charging Methodology for Service Charges), see esp. Part C: Relevant Policy Objectives of the Charging Methodology
[23] See esp. paragraph 4.64

about principle 5 and DCC's priorities and recognise the need for further consultation to determine DCC's future role and governance mechanisms to support delivery of its services.

2.78 We have set out at a high-level our assessment of how the key features will help drive the principles in table 2.1 below. Nonetheless, we note the ask for clarity on the application of principles in our decision-making going forward, as well as feedback in relation to measuring success. We will continue to refer to the principles in our further design and consultation on the regulatory framework.

Table 2.1: Assessment of key features against principles

Parameters with decisions on key features	Principle 1: Drive delivery of a quality, cost-efficient and secure service	Principle 2: Be customer-centric and consumer-focused	Principle 3: Enable full accountability and decisive governance	Principle 4: Allow DCC's role to evolve in an uncertain environment	Principle 5: Maximise the value of DCC infrastructure by enabling the exploration of re-use of assets
Governance, accountability & ownership model: The Board composition should be majority stakeholder/independent-controlled with consumer representation & The Core Mandatory Business should be conducted on a not-for-profit basis	• Allows for improvements to the quality of service with the Board focusing its attention on the core service, priority issues important to customers and development of necessary competencies • Removes profit-maximising objective via increases in Internal Costs • Customer representation will drive coordination in resolving issues and managing change; opportunity to make code change process more efficient through implementation of Energy Code Reform changes	• Creates a purpose-driven organisation acting for the benefit of DCC customers and consumers, rather than for the benefit of a third-party shareholder – aligns incentives on service delivery to customer needs • Embeds customer-centric ethos in the organisational culture • Provides consumers with a voice in DCC's decision-making	• Provides accountability to customers in terms of delivery, while maintaining operational independence for delivery of day-to-day service • Maintains accountability to Ofgem under the Licence • Accommodates DCC's role as a Central System Delivery Body, empowering and making the Board accountable for delivery to the strategic direction • Ofgem's role and oversight, inclusion of independent Board members and parent company representative will help ensure balanced governance	• Empowers Board to adapt *how* DCC discharges its role in response to uncertain future requirements: delivering to changing technology, policy/regulation or customer/consumer needs • Provides transparency to customers on evolution of DCC's services through code governance • Mitigates against the risk of scope-creep motivated by profit-maximisation	• Allows innovation to the extent as is in the interest of customers as opposed to maximising profit of a shareholder • Opportunity for a greater portion of benefits flowing back to stakeholders to offset the cost of core service • Governance arrangements may be required to ensure innovation is not stifled by vested interests
Price control and incentives: Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process	• Improves quality of service by focusing resources on core business • Business planning requirements encourage a proactive approach to investment, planning for change and risk management • Can lead to cost stabilisation, although opportunity for cost reduction may be limited due to continued high proportion of external costs	• Customer role in assessment and potentially approval of budgets and business plans improves cost transparency, reduces information asymmetry and ensure scrutiny over the organisation's priorities • Consumer representation will help ensure that impacts on consumers and issues of equity are considered in cost decisions and planning	• Retains accountability to Ofgem under the cost control and incentive framework • Improves transparency and accountability across the supply chain	• Enables setting of a clear baseline for DCC's activities and spend, reducing inefficiencies and minimising scope-creep • Allows for accommodation of flexibility through uncertainty mechanisms • Ensures sufficient thought and funding is given to long-term strategy, while providing scrutiny over cost of change	• Allows for a transparent decision-making on the allocation of resources for any re-use activity • Opportunity to take advantage of allocated funds and/or generated revenue to strengthen incentives on delivery of core business
Operational model: The operational model will remain primarily outsourced with key contracts procured competitively on the market	• Drives value for money by creating a competitive environment in procurement, allows benchmarking		• Retains accountability of DCC for its own performance and that of third parties	• Protects against market distortion by centralisation of services in-house	
Funding: DCC's core mandatory business will remain funded by charges on users	• Ensures core service is financed and protected • Maintains industry's stake and pressure on costs • Prevents conflicts of interest – funders are also the users of the system				• In combination with other key features, provides opportunity to review funding mechanism for exploring additional services

Our response to other comments

Licence and code changes

2.79 We note the suggestion by one respondent to structure the Licence as a service level agreement with a reduced term focused on outcomes and value for money. We recognise the rationale behind this argument, in particular in terms of the potential to improve agility and efficiency of service delivery. However, we do not believe this change would be appropriate for the full scope of DCC's business as the provision of the smart metering service is a licensable activity under primary legislation and subject to a prohibition order.[24] This is to allow control to be exercised over the way in which DCC's activity is carried out, recognising the strategic importance of smart metering in in ensuring an affordable, secure and sustainable energy supply, and transition to net zero.

2.80 However, we will consider applying this or a similar approach to specific areas of DCC's current or future activities which do not strictly relate to the provision of Core Mandatory Business. This includes:

- Reviewing the existing Licence requirements on DCC to provide the Centralised Registration Service ('Switching')[25]
- Considering whether DCC could be allowed to provide certain services on a contractual basis in addition to its licenced Mandatory Business[26]

2.81 With regards to the length of the next Licence Term, we will consult on this alongside the new draft Licence. We understand the argument that a shorter term can provide more frequent opportunities for the DCC Licence to be contested, therefore putting pressure on the licence-holder to deliver at pace; however, a shorter tenure can discourage long-term vision, particularly in the procurement of key contracts, and lead to instability. It may also favour incumbents who would not have to recover set up costs over a comparatively short period, while the other costs of the reappointment process would be incurred more frequently.

[24] DECC (2012), The prohibition order for smart metering communication activities. Accessible at: www.gov.uk/government/consultations/the-prohibition-order-for-smart-metering-communication-activities. Statutory Instrument: The Electricity and Gas (Smart Meters Licensable Activity) Order 2012. www.legislation.gov.uk/ukdsi/2012/9780111526545
[25] See Chapter 4 (Future role of DCC), paragraphs 4.68-4.78.
[26] Ibid, paragraph 4.57.

2.82 As identified by some respondents, in addition to Licence changes, two suites of accompanying code changes may also be necessary:

- First, code changes needed to complement our policy decisions, for example, and subject to further consultation, to redefine the scope of DCC's Mandatory Business
- Secondly, to enable transition from the current framework to another, for example to allow transitional governance or funding

2.83 We are not, at this stage, taking a decision on any code changes and will work with the SEC and REC Panels on their development and efficient implementation in due course. We expect to consult on code changes alongside the new draft Licence.[27]

Governance & the enduring role of Ofgem and the government

2.84 We recognise stakeholders' comments about the complexity of DCC's governance. We expect that through greater stakeholder representation, open consultation on business plans and cost control, and the implementation of Energy Code Reform changes, the day-to-day governance will become streamlined and easier for both industry and public stakeholders to engage without undue burden, as set out in our principle 2. We will consult on the processes and roles of different parties in:

- Board nomination and ratification
- Business planning and cost control
- Change process in evolving DCC's role

2.85 We will continue to work closely with DESNZ to consider whether and how specific governance provisions in the existing Licence should change. We will present the preferred model when consulting on the detailed governance arrangements. The areas under consideration include, amongst others:

- Governance around the evolution of DCC's role; in particular, the route for adding or amending DCC's Mandated Business via regulatory or policy requirements[28]
- LC 13 (Transitional Objective), which allows the Secretary of State to issue directions to DCC

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[27] We may consult on some licence and code changes early to bring in interim improvements in the transition period. For more information, see Chapter 3, paragraphs 3.39-3.43 in this document.
[28] For further details, see Chapter 4, paragraphs 4.47-4.48 in this document

- LC 16.6A-C, which provides for the Secretary of State's oversight over certain changes or procurements of Relevant Service Capability
- LC 38, which sets out how project incentives are designed under the Baseline Margin Project Performance Adjustment (BMPPA) Scheme[29]

Contract management

2.86 Much of DCC's costs and performance is determined by the contracts with external service providers. Any incoming DCC, under any regulatory framework, will have to operate within the constraints imposed by existing systems and arrangements. Our changes to the governance and cost control will enable the Successor Licensee to maximise the value of existing contracts and to negotiate new contracts to deliver value for money over the long term. We expect that a shift from a profit to a purpose-driven organisation will lead to a step change in the approach to contract management.

Security

2.87 We note stakeholder feedback on the importance of protecting security arrangements under the new framework. As set out in our principle 1, continued security and integrity of the DCC network is a key outcome that any future framework must drive. We will ensure that security arrangements are protected and that the new governance and cost control arrangements include appropriate provisions for it. We welcome views from industry on whether as part of the Licence or accompanying review of the SEC text there are specific amendments to existing provisions that should be considered.

Smart meter data

2.88 We also acknowledge feedback on the importance of smart meter data in innovation and delivering net zero reforms. We are aware of the various initiatives led by the government, Ofgem and industry to improve access to both system and consumption data, subject to appropriate controls and governance around access and sharing. While we are reviewing the role of DCC, our focus is primarily on ensuring that the DCC Licence accurately captures DCC's role and allows it to evolve in future; as such we are focused on putting in place transparent and effective governance arrangements so that relevant parties such as Ofgem or the government can extend the scope of DCC's role in the provision

[29] LC 38, Schedule 1, Appendix 1

of data if required. However, we are open to further engagement with industry and other stakeholders to consider whether data access should be within the scope of changes we may make to the DCC Licence as part of the review.

3. Transition period considerations

Section summary

We consulted on three options for a possible extension to the current Licence to facilitate the design and implementation of the new regulatory model. Upon reviewing responses provided by stakeholders and our assumptions, we now consider a Licence extension of between 12 and 36 months will be necessary, though our ambition is to make this period as short as possible. We therefore intend to extend the current Licence Term under Part 1 of the Licence in accordance with the provisions of paragraph 6 of Section C. We will consult with DCC on the timelines and provide a formal notice by summer 2024 to confirm the exact term of the Licence extension.

We also confirm our intention to bring in incremental improvements to the current Licence to realise early benefits where possible. This will include consultation on interim changes to the price control framework to move towards an *ex-ante* regime, changes to the governance via appointment of customer representatives to DCC's Board, review of current arrangements for the Centralised Registration Service (Switching), and revisit of the rationale for the current levels of Baseline Margin and Shared Service Charge applied to DCC's Internal Costs.

We will continue to work with DCC and government to ensure continued alignment on key dependencies.

Questions posed at the consultation

Q6. What are your views on the options identified and the associated trade-offs for a possible licence extension?

Q7. What are your views on the assumptions we have made for Options A and B transition periods?

Q8. In your view, which of the considerations we have identified for the transition period are the key dependencies and why? Are there any other dependencies that should be considered?

Q9. What is your view on implementing incremental changes to the regulatory framework during a transition period? Which parts of the reg. framework would be most suitable for such changes and why? Do you have suggestions for their implementation?

Background

3.1 The current Licence is set to expire in September 2025. To help facilitate a transition to the new regulatory framework, we consulted the possibility of using a Licence extension to balance the pace of implementation with risks of disruption.[30]

3.2 We presented three extension models to seek stakeholder feedback:

- **No extension** – The new regulatory framework would come into force no later than September 2025. All work including further consultations, tendering, development, and implementation of the new framework will need to be carried out within the next 2 years. This would require faster transition and may significantly increase risks.
- **An extension period of up to 3 years** would provide up to 5 years to develop, test, consult on, tender, and implement the new framework, allowing for a smoother transition and introduction of some incremental improvements.
- **An extension period of up to 6 years** would provide a total of 8 years to develop and transition to the new framework, potentially enabling enhanced coordination and de-risking of implementation, though at the risk of delaying benefits realisation with negative impact on continued effective governance.

3.3 We also provided our estimation on the timeframe for developing and implementing the new framework for models developed based off either Option A or Option B. We found that both options merited an extension of up to 3 years.

3.4 We identified and sought stakeholder views on the following key considerations for the transition period:

- The transition to enduring governance for smart metering
- Energy Code Reform and changes to the Smart Energy Code (SEC) and Retail Energy Code (REC)
- The procurement landscape of DCC's contracts, with some key contracts due to expire
- Sunsetting of 2G and 3G technology in GB over the next 10 years

[30] The Authority may extend the Licence by up to 6 years, subject to conditions imposed by the terms of the Licence. See Part 1, Section C, paragraphs 6-10 of the Licence.

- DCC's ongoing major programmes, in particular 4G Comms Hub & Networks
- Other ongoing industry changes

3.5 Finally, we said that in the event of a Licence extension we would explore bringing in certain changes early to drive benefits where possible. In particular, we identified governance and price control as two areas where incremental improvements would be possible.

Summary of stakeholder responses

Licence extension

3.6 The general consensus amongst respondents was a desire to minimise the length of any extension period to help drive realisation of benefits of the new framework.

3.7 A few respondents expressed their preference for no extension period, suggesting that there should be sufficient time before the expiry of the current Licence in September 2025 to implement the new regulatory framework.

3.8 Others have acknowledged that there may be a need to extend the current Licence by up to 3 years to help support implementation, provided that Ofgem set out clear rationale on the scope of change required for the transition and handover period, whilst minimising disruption in services and cost impacts on customers and consumers.

3.9 A few respondents raised concerns over the assumptions made on the timeline for the handover period, with some calling it optimistic, whilst others requested more details. One respondent mentioned that Ofgem had 'relied heavily on best case scenarios for both options'. Some respondents acknowledged that a longer extension period offered a smoother transition period with one stakeholder noting that any reforms made to the current regulatory model should not be rushed, and sufficient time should be provided to manage and mitigate associated risks.

3.10 One respondent acknowledged that an extension period of 12 months or more was realistic to implement the new framework but felt that this timeframe should be informed by bids from potential future owners.

Specific comments on Option A

3.11 One respondent cautioned that a rushed transition could lead to the tendering process being based on a licence which might require amendments shortly after its implementation.

3.12 Another respondent asked what the transition timeline would look like if the current licensee was successful in the tender process or was the only bidder. Oversight should be provided for any period of time where there is an overlap of costs incurred by both the old and the new licence-holders during transition.

3.13 One respondent observed that the handover period for Option A appeared shorter than for Option B and cautioned that the complexities of moving DCC to a new entity should not be underestimated.

3.14 One respondent agreed that under Option A elements of the future regulatory framework could be phased in during the extension period, however, this extension period should not exceed more than 1 year.

Specific comments on Option B

3.15 One respondent suggested that under Option B there was a possibility to implement the core regulatory framework by 2025, followed by enhancements with detailed requirements post-introduction.

3.16 One stakeholder believed that Option B would require a longer transition, therefore making Option A favourable.

3.17 Another respondent expressed that Ofgem should think more broadly about potential risks that could delay the transitional period, as the transitional period envisaged for Option B may be too short. Transitioning all existing DCC processes to the new framework will be more complex and time consuming.

3.18 On the contrary, a few respondents mentioned that whilst they were in favour of Option B, they did not think an extension period of 3 years would be necessary: The selection process for Option B could be started earlier, allowing for the handover to the new entity prior to 2025.

3.19 One stakeholder suggested completion of due diligence activities of DCC’s operations and risk profile, and an independent review or audit of DCC’s operations.

Dependencies

3.20 Overall, a majority of respondents agreed with the dependencies identified in our consultation, although there were differences of opinions on their relative importance.

3.21 Many felt that the key dependencies were in DCC’s programmes and procurements, particularly 4G Comms Hubs & Networks programme and DSP re-procurement, and that it was important to avoid their disruption. There was a concern that any ongoing contract negotiations between 2025 and 2028 might cause delays and disruptions to DCC users and therefore that it was important for DCC to secure the extension of 2G and 3G service prior to any transition window. Another stakeholder felt that CSP contracts, set to expire in 2028, should be settled before the go-live of DCC2.

3.22 A number of stakeholders felt that Market Wide Half Hourly Settlement (MHHS) should be considered a key dependency due to its scale and importance to other reforms. In particular, a group of respondents asked for assurance that the transition will not create a risk to the success of the MHHS programme. In that context, one respondent highlighted the need to ensure continuity of processes and systems, and retention of expertise during transition.

3.23 Several stakeholders spoke of transition to enduring governance, asking for clarity on the roles of DESNZ and Ofgem in order to streamline governance and lines of responsibility.

3.24 A few respondents raised that it is important to ensure the new Licence is in alignment with the changes made through the Energy Code Reform. One stakeholder identified the Code Reform as the main dependency due to its impact on overall governance arrangements. They suggested that these changes should be scheduled ahead of the Licence renewal to inform the policy design and provide clarity to potential bidders on the end-to-end governance. One respondent mentioned that aligning the Licence to the Code Reform proposals could avoid prolonged periods of change in governance models.

3.25 A group of stakeholders expressed a concern about the involvement of the current licensee in negotiating new contracts in the run up to the Licence expiry date and during any transition period with one respondent asking for greater oversight from Ofgem of any (re)procurement activity.

3.26 Finally, one respondent highlighted ongoing innovation projects and the outcomes of the Smart and Secure Electricity System (SSES) consultation as dependencies for the future role of DCC.[31] Similarly, a group of respondents expressed concerns about DCC potentially being instructed by the government to deliver new services before the end of transition to a new licence.

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[31] DESNZ (2022), Delivering a smart and secure electricity system: the interoperability and cyber security of energy smart appliances and remote load control. Accessible at: www.gov.uk/government/consultations/delivering-a-smart-and-secure-electricity-system-the-interoperability-and-cyber-security-of-energy-smart-appliances-and-remote-load-control

3.27 Despite these considerations, we did not find an appetite to delay the implementation of the regulatory changes. One respondent pointed out that delaying necessary reforms while waiting for external dependencies to crystallise was likely to a create more incurred costs as new issues will take precedence over older issues. Nonetheless, one stakeholder was of the view that impacts of changes made to the new DCC through Code Reform and price control changes may not be fully understood by 2028.

Interim changes

3.28 A vast majority of respondents supported our proposal for incremental improvements to the current framework before full implementation of the new model, in particular in the case of a longer Licence extension. One stakeholder mentioned that incremental changes may be necessary to help facilitate transition, especially if it is based on an Option B model.

3.29 Those in favour of introducing incremental changes called especially for an early implementation of an *ex-ante* price control, and industry representation on the current DCC Board. A group of stakeholders also suggested reviewing, strengthening and making more transparent DCC's existing external contracts. Moreover, a number of stakeholders noted the opportunity to implement Code Reform changes into governance; though one party asked for assurance that interest of DCC customers will be protected if the SEC Panel is disbanded under the Code Reform, referring to the REC Issues Forum as an example. One stakeholder asked for changes to consider equal treatment of DCC users.

3.30 We also found support for a review of the Shared Service Charge. One respondent argued that DCC is now largely in operational mode and that the charge could be removed by the end of the current Licence period.

3.31 Finally, there was a suggestion to decouple the provision of the Switching service from DCC's Licence earlier.

3.32 A few respondents raised concerns about incremental changes due to the risk of introducing complexities into the transition. One stakeholder argued that excessive focus on 'quick wins' could distract from implementation of long-term reforms. However, another felt that any interim changes which can benefit consumers, should be introduced without delay.

Our view

Licence extension decision

3.33 In light of our decision on the key features for design of the new regulatory model, and upon review of our assumptions and stakeholder representations, we consider that some form of a Licence extension will be necessary; our current assessment is that this will be 12-36 months. **We therefore intend to extend the current Licence Term[32] under Part 1 of the Licence in accordance with the provisions of paragraph 6 of Section C.** We will confirm the exact duration of a Licence extension no later than **August 2024** in line with Licence requirements.[33]

3.34 We note from stakeholder feedback the general desire to ensure that, regardless of the regulatory model chosen, the duration of any extension is minimised to avoid introducing uncertainty and delaying benefits of the new model, while mitigating against undue risks and disruptions.

3.35 Based on our analysis of existing evidence and in line with relevant Licence requirements, we are satisfied that it will be necessary to continue the current Licence to complete the following subsequent successive stages of the review:

- Design of the new framework in the basis of our selected key features, following due public consultation process
- Facilitating an efficient tender process for determining the grant of a Successor Licensee in line with the 2012 Regulations[34]
- Facilitating an efficient handover of the Authorised Business to a Successor Licensee while minimising risks to the continuity of service
- Closure of the current Licence, including at minimum carrying out the final price control

3.36 Nonetheless, we are conscious of the concerns raised by some stakeholders about uncertainty for DCC customers and the wider industry if the implementation of the new model is delayed. We will consult with DCC on the timelines and provide a formal notice by summer 2024 to confirm the exact term of the extension as

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[32] As per paragraph 3 of Part 1 of the Licence.
[33] Part 1, Section C, paragraphs 7 and 9.
[34] 2012 Competitive Tenders for Smart Meter Communication Licences Regulations. www.legislation.gov.uk/uksi/2012/2414/contents/made

required by the Licence.[35] As noted in the consultation, the last opportunity to extend the current Licence for one year or more will be 12 months prior to the Licence due expiry date.

3.37 We expect that by that time, timelines associated with the Business Handover process in particular will become clearer. However, moving on a significantly faster timeline would introduce risk of disruption, particularly at the point of competitive retender and business handover.

3.38 For transparency we have included a high-level timeline of the remaining phases of the programme in Appendix 1.

Interim changes decision

3.39 As set out in our consultation, since we now consider Licence extension to be necessary, **we confirm our intention to consult on interim changes to the current Licence for the extension period to realise benefits where possible**. We note stakeholder feedback on the main areas where improvements can be made and can confirm that we will:

- Consult on interim changes to the price control to move elements of DCC's Allowed Revenue under an *ex-ante* regime. This may also include revisiting incentives to align to these interim price control arrangements. We discuss more details of our preferred way forward in Chapter 5 (Price control changes considerations).
- Work with DCC towards stakeholder representation on the current DCC Board. This will help to transition to a Board with majority stakeholder/independent representation under the new framework in line with our key feature on future governance. We will also consider an observer role for Ofgem, solely to oversee Business Handover.

3.40 In addition, we will explore what changes to governance would be possible through the implementation of the Code Reform. We will work closely with relevant policy teams to implement the changes in a coordinated way but duly note that the timeline for the Code Reform is not tied to that of the Licence review. We understand stakeholder concerns about potential disruption as well as opportunities to align these changes where possible.

[35] Part 1, Section C, paragraph 9.

3.41 We will also consider whether the current arrangements for the Switching programme (Centralised Registration Service) should be revised.

3.42 Finally, to ensure the Licence continues to provide value for money during an extension period, we intend to revisit the rationale for the current level of margin and Shared Service Charge applied to DCC's Internal Costs.

3.43 We note stakeholder feedback on ensuring that any interim changes are introduced in a time efficient manner and are purpose-driven with end-consumer benefits in mind. We recognise the concerns raised by some stakeholders that implementation of incremental changes could bring complexities to the transition, making it harder to track and manage. Any changes will be done in consultation with industry to realise benefits where practicable, and to afford industry sufficient time to adapt to the changes without undue additional burden.

Our response to other comments

Contractual landscape

3.44 We note the concerns raised around DCC's procurement landscape during any transition period, including the expiry dates of some of DCC's contracts, and the impacts this could have on DCC's core service and programmes. We understand stakeholder concerns around the 4G Comms Hubs & Networks programme in particular, due to the magnitude and complexity of the programme, and risks associated with any disruption. The Licence provides that the contracts under which DCC procures its Relevant Service Capability must include appropriate provisions to secure the transfer or novation of those contracts in the event of a business handover to a Successor Licensee.[36]

3.45 We also recognise concerns about procurements carried out in the remainder of the Licence period, including during transition, and the risk associated with contract novation where the Successor Licensee will be taking on pre-existing contract terms. We will continue to monitor DCC's procurement activity until the award of the new Licence by overseeing DCC's compliance with the Licence requirements, continued incentivisation of contract management under the existing performance regime, assessment of economy and efficiency of costs of any new procurements through the price control, and working closely with DESNZ when performing their role in respect of business cases.[37] Changes to the current

[36] LC 16.12(c)
[37] LC 16.6A-C

Board to increase customer representation will provide further assurance and scrutiny in the remainder of the Licence Term. Furthermore, we expect that during business handover post-Licence award, representatives of the new licensee will be present in key decision-making forums.

3.46 We would note that DCC can already improve transparency of its contracts and encourage DCC and its customers to work together in the remainder of the current Licence Term. Where appropriate and to the extent that it doesn't unreasonably infringe on DCC's commercial position vis-à-vis its service providers, we would expect DCC to be able to offer its customers the opportunity to enter into bilateral arrangements for disclosure of contractual details.

Governance

3.47 As noted above, in the lead-up to the Licence expiry date we intend to make changes to the current DCC Board to add customer representation for additional scrutiny. We will also consider a potential observer role for Ofgem, solely to oversee the Business Handover. Following the Licence award, the Board will also include representatives of the Successor Licensee during the implementation of the Business Handover Plan and the transfer of business.

3.48 Furthermore, we are working with DESNZ to develop a common approach towards transition to enduring governance, including transfer of relevant roles and obligations from the Secretary of State to other parties as appropriate.

Business Handover

3.49 We note stakeholders' call for more details on the transitional timeline, particularly in relation to the business handover. We are actively engaging with DCC in respect of review of the Business Handover Plan required to be in place under LC 43. As part of this, we actively monitor risks associated with the Business Handover period.

3.50 The Business Handover Plan is required to set out DCC's commitments, objectives and all matters relating to novation of contracts, payments, data sharing, and the timeline of the full handover period for the new licence-holder as per the mandatory contents list in LC 43.[38] We also expect the Business Handover Plan to contain other appropriate contents listed under LC 43.18,[39] and further

[38] See LC 43, Part D, section 43.13-17 for the full lists the mandatory contents of the Business Handover Plan

[39] See LC 43, Part E, section 43.18(a)-(f) for the full list of other appropriate contents of the Business Handover Plan

information which may be expedient, such as: the roles and responsibilities of key stakeholders, risks and assumptions, strategy for employee transition, due diligence provisions, or post-transfer support.

3.51 We note the importance of having stakeholder input in the development of the Business Handover Plan. Prior to submitting their updated plan for approval DCC must, under LC 43.10, take all reasonable steps to ensure it has taken into account the views of stakeholders on its proposed plan. We expect DCC to carry out stakeholder engagement on its draft plan and are in discussion with DCC on an appropriate consultation process.

Next steps

3.52 In the upcoming months we will work with DCC to update and further develop the Business Handover Plan in accordance with LC 43.

3.53 We will also explore incremental changes to DCC governance through appointment of customer representatives to the Board; aim to design an *ex-ante* regime for elements of the Price Control; consult on the future arrangements for the Switching Programme; and review the current levels of margin and Shared Service Charges applied to DCC's Internal Costs.

3.54 Following consultation with DCC, we will provide a formal notice to DCC to confirm the exact duration of the licence extension by August 2024.

4. Future role of DCC

Section summary

Based on an overall stakeholder support, we confirm our consultation position that DCC's primary role should be to deliver its Core Mandatory Business (CMB), understood as provision of communications and data services to and from smart meters in a secure, economical and coordinated manner. The CMB will be defined through the Licence and relevant codes through modified (subject to consultation) categories of 'Core Communication Services' and 'Enabling Services'. We will also confirm the scope of CMB through further consultation.

Stakeholders generally agreed with our proposals for Additional Mandatory Business, although many expressed concerns about the impacts on the core service and need for strong governance with stakeholder scrutiny. We confirm our intention for the new Licence to include provisions for Additional Mandatory Business, comprising Mandated Business Services, Ancillary Services, and Additional User Services. We will consult on the final scope, governance, funding and cost control arrangements for these activities.

We likewise found support for our proposed routes to evolve DCC's role in a transparent and controlled manner. We will progress on the basis of our consultation proposals for formalised mechanisms to manage uncertainty in response to the following 'triggers': Change in customer expectations & consumer needs; New policy or regulatory requirements; and Evolving technology.

We received mixed views on the question of the infrastructure re-use. While most recognised the potential benefits of innovation and opportunity to drive down costs, concerns were raised about the risks to system performance and competition, and lack of feasibility. Our conclusion is to proceed with the option to enable re-use, subject to agreed conditions and measures. We will consult on these detailed measures, in particular maturity level and funding models, going forward.

Finally, in response to stakeholder feedback and in line with our previous intention, we will review the position of the Switching service in DCC's Licence.

Questions posed at consultation

Q10 Do you agree with our proposed scope of future DCC's Core Mandatory Business?

Q11 Should the future framework permit DCC to carry out any services additional to its Core Mandatory Business? What are your views on the concepts of 'mandated services', 'ancillary services' and 'additional services to users'?

Q12 Do you agree with our proposed drivers for a controlled change in DCC's role? What are your views on the ways in which evolution of DCC's role can be managed?

Q13 Do you agree that the future framework should enable exploration of re-use of DCC's infrastructure? What are your views on the specific conditions and measures that may need to be in place to enable it?

Background

4.1 In our consultation, we observed that a future DCC should remain focused on the continued delivery of its core business, understood as provision of communications and data services to and from smart meters in a secure, economical and coordinated manner.

4.2 First, we sought views on which services should be part of DCC's future Mandatory Business, proposing two general areas of:

- Core Mandatory Business (CBM), consisting of services and activities which relate directly to ensuring the continued provision of a secure, reliable and efficient smart metering service, and which cannot be contestable
- Additional Mandatory Business (AMB) comprising three categories of other services that DCC could be required to provide, namely Mandated Business Services (as instructed by the Authority or the Secretary of State), Ancillary Services (delivering system enhancements and efficiencies) and Additional User Services (bespoke capability provided on demand)

4.3 Secondly, we proposed to explore mechanisms which would facilitate change in DCC's role and service requirements. We sought views on the types of formal processes that would be followed to enable a controlled change in DCC's role in response to:

- Change in customer expectations & consumer needs
- New policy or regulatory requirements
- Evolving technology

4.4 Thirdly, we proposed that the future framework should allow exploration of commercial re-use of the smart metering infrastructure under specific circumstances, and sought stakeholders' views on necessary preconditions and measures that would be required.

Summary of stakeholder views

Question 10: Core Mandatory Business

4.5 We received near unanimous support for our initial conceptualisation of DCC's Core Mandatory Business. There was a strong support among stakeholders that DCC should focus on delivering its core remit, ensuring secure, reliable and efficient smart metering service.

4.6 Some felt that DCC's remit should not go beyond its Core Mandatory Business – at least until performance standards have been met. We also found some opposition or concern to the extension of scope by further mandated activities.

4.7 We received general support for clear definitions of DCC's role and objectives to ensure organisational focus. A couple of respondents echoed our view that the scope of Mandatory Business should be tightly defined within the Licence. Some expressed concerns about DCC's objectives, particularly in relation to pursuing innovation or re-use, with one respondent suggesting part c) of the Second Enduring General Objective be removed.

4.8 We received the following comments on specific services:

- Switching should not be part of DCC's Core Mandatory Business and should instead migrate to RECCo
- DCC's role in MHHS should be limited only to communication services being used to retrieve consumption for MHHS arrangements
- Testing services should be reviewed due to an existing commercial market for testing of smart metering technology and potentially reclassified as an additional or elective service
- Switching, MHHS and other mandated services should be part of DCC's core remit; however, they could be separated out into multiple licences and retendered for individually

4.9 One respondent commented on our proposed list of services comprising Core Mandatory Business,[40] suggesting improvements to maintenance windows, Decommissioning, Withdrawal and Suspension of Devices, and incident management. Another agreed that SEC Appendix E (DCC User Interface Services Schedule) provided a useful listing of DCC's core services but noted improvements could be made to include the functioning of the commands.

4.10 In the context of net zero, one stakeholder suggested DCC should be allowed reasonable expenditure on innovation, either through a specific innovation expenditure category or as a percentage of turnover. Two stakeholders highlighted the need for flexibility to allow for evolution of the Core Mandatory Business.

4.11 One respondent highlighted that changes to the scope of DCC's role may require a security risk assessment.

Question 11: Additional Mandatory Business

4.12 Stakeholders were generally supportive of licence provisions to allow DCC to provide Additional Mandatory Business across the three categories we consulted on. One stakeholder even suggested DCC may have a role in establishing a market for services to become contestable over time.

4.13 However, there was a widespread view that any additional services should not distract from, or adversely impact, DCC's core business. One respondent asked for explicit justifications and impact assessments for any potential additional service(s).

4.14 We also found strongly held views that stakeholders should be consulted prior to new services being added to DCC's remit, including new activities mandated by Ofgem or the government. A group of respondents suggested a full upfront assessment of any new activities via SEC governance.

4.15 Many stakeholders felt DCC should meet predefined criteria, such as consistently meeting service level agreements, prior to offering any additional services, with one respondent recommending that Ofgem explore a provision to suspend additional activities under certain circumstances.

[40] Ofgem (2022), DCC review: Phase 1 Consultation. Appendix 5. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation

4.16 We also received comments about funding of additional services. One stakeholder suggested Ancillary Services be paid for outside of Fixed charges (via Explicit charges). A group of respondents also pointed to the ongoing review of the SEC Charging Methodology under SEC Mod DP218.[41]

4.17 Several respondents raised the issue of data access, noting the importance of smart meter data to the transition to net zero. One party suggested DCC be allowed to retrieve, store and make available half-hourly consumption data.

4.18 A minority of respondents were opposed to DCC providing any additional Mandatory Business. They mostly argued that DCC should focus on delivery and improvement of the core service and shouldn't provide any contestable services. Instead, one of these stakeholders suggested DCC focused on improving the granularity of data for settlement and HAN latency.

Mandated Business

4.19 We found mixed views on the issue of Mandated Business which DCC has been instructed to provide by either Ofgem or the government. While a plurality of respondents agreed that DCC should be permitted to provide this, there were some who felt Mandated Business has been a distraction away from the core business. One stakeholder disagreed with the concept on the grounds that mandated services are not related to the Core Mandatory Business, referring to Switching as an example.

4.20 On the contrary, one respondent argued strongly in favour, identifying opportunities in public policy delivery (SSES or tackling fuel poverty) and supporting industry (eg theft or anomaly detection).

4.21 A number of stakeholders identified the need for additional checks and balances to enable Mandated Business, including a transparent approval process, funding mechanism and cost control – one respondent noted that early programmes may have uncertain costs and may require reopeners or *ex-post* review.

Ancillary Services

4.22 A few respondents saw Ancillary Services as beneficial to driving improvements to the Core Mandatory Business. Potential opportunities included: dynamic

[41] DP218 Review of the SEC Charging Methodology. Accessible at: www.smartenergycodecompany.co.uk/modifications/review-of-the-sec-charging-methodology/

optimisation of the network to reduce inefficient data flows, adapter services, meter firmware centralisation, or current 'DCC boxed' services.

4.23 Some were concerned about the impact of Ancillary Services on competition, and the risk of competing incentives.

4.24 One respondent referred to the Xoserve-Correla model where core and contestable services are separated. Another pointed to Elexon-EMRS arrangement for delivery of CfD settlements and CM contracts, where EMRS bears a share of Elexon's overheads.

Additional services to users

4.25 One respondent saw the benefit of Additional services to users in removing the need for lengthy SEC modification processes.

4.26 A couple of stakeholders questioned the feasibility or appetite for these services, noting lack of uptake of elective communication services (ECS). Among those who mentioned them, there was an agreement that the present arrangements for ECS were not fit for purpose, though not all agreed there was value in their redesign. One respondent noted the funding issue to secure additional capacity following exclusivity period, while another mentioned the technical complexities of implementing ECS, such as the need for meter upgrades.

Question 12: Evolving DCC's Mandatory Business

4.27 In general, most respondents agreed that there should be a mechanism for evolving DCC's role in a transparent and controlled manner, although some reiterated that no new activities should be pursued until the core service has reached acceptable performance levels.

4.28 We also found support for the specific drivers of change presented in the consultation, although a number of respondents required further details on the implementation of the identified triggers for change.

4.29 A couple of stakeholders disagreed on the basis of their general objection to altering the scope of DCC's role due to its current performance issues.

Comments on triggers of change

4.30 A few respondents expressed concerns over the 'evolving technology' trigger, with one noting a risk of resources being wasted on projects without appropriate approval or oversight, and others pointing out that technology solutions should be delivered competitively by external service providers.

4.31 A group of stakeholders were concerned about 'new policy or regulatory requirements' in the context of new mandated activities by the Authority or Secretary of State, their costs and impacts on CMB and DCC customers. One stakeholder observed that "external involvement in the DCC's business activities should be kept to a minimum".

4.32 We also found suggestions for the following additional triggers:

- To address service failures, up to requiring a change of licence-holder
- To enable net zero

Other comments

4.33 Referring to stakeholders with a role in modifying DCC's business, one respondent suggested future DCC customers should be included as initiators of change, whilst another urged careful consideration around introducing the code manager role to the DCC arrangements.

4.34 A couple of stakeholders questioned why the 'uncertainty' mechanism would be needed to deliver change in DCC's role.

4.35 One stakeholder suggested the introduction of a fast-track route for some changes which could avoid lengthy procedures of code governance.

Question 13: Exploring re-use of the DCC infrastructure

4.36 We found mixed views on the question of re-use.

4.37 Many stakeholders recognised the opportunity of re-use to offset future costs and maximise investment to date. One respondent specifically noted that re-use revenue should filter through to consumers. A couple of others argued that the objective of re-use should be wider than generating benefits for DCC customers and should include broader public benefits, eg decarbonisation, policy delivery or lower consumer bills, among others.

4.38 Those who were supportive of the re-use option also tended to agree with our high-level criteria, though one respondent found the criteria too restrictive. Specific comments included:

- Two stakeholders referred to the criteria considered for Elexon's diversification under the BSC as a useful example[42]
- There was an agreement on the need for a maturity level threshold, eg evidence of sustained of good performance under SEC Key Performance Indicators (KPIs); however, several respondents disagreed with our observation that DCC is 'unlikely to reach a fully stable state'
- Regarding funding, there was a view that a party should not receive any benefits of re-use without funding it in some way, with suggested options for funding including: discreet innovation budget or cost-plus model, third-party charge with margin costs for additional capacity, upfront cost approval by customers on a case-by-case basis, or a RIIO-style pot of innovation funding that DCC could apply for
- Several respondents asked for governance via existing SEC forums
- A couple of stakeholders noted network security as an important consideration

4.39 Nonetheless, some stakeholders were opposed to re-use under any circumstances. The key concerns were in relation to:

- Impact on core service: re-use would distract DCC from delivery of Mandatory Business
- DCC's monopoly position and the impact on competition: DCC should *enable* innovation through the provision of a secure and reliable communications network, but it should *not* be the innovator itself
- Viability: DCC's ability as a regulated monopoly to be a competitive market player; inherent customer exposure to risk; technical limitations of the infrastructure (in particular in the North communication region)

Our view

4.40 Table 4.1 provides an overview of the proposals for which we have received sufficient support to take forward, alongside proposals which will be subject to further consultations. Below, this section then sets out in more detail the rationale for our way forward and the considerations we have made.

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[42] BSC Parties should benefit from any diversification; The arrangements should not place disproportionate risk on BSC Parties; Standards of service under the BSC should be maintained; Elexon's BSC role should not give it any undue competitive advantage in a contestable activity.

Table 4.1: Overview of our proposals

Proposals to be taken forward	Subject to further consultation
• DCC's primarily role will be to deliver a newly defined "Core Mandatory Business" • There will be provisions for "Additional Mandatory Business", comprising Mandated Business Services, Ancillary Services and Additional User Services • To accommodate uncertainty, the framework will include a mechanism for a controlled change in DCC's Mandatory Business in response to one or more of the following triggers: change in customer expectations & consumer needs, new policy or regulatory requirements, or evolving technology • The Licence will include provisions for a commercial re-use of DCC's infrastructure subject to agreed measures in the following areas: maturity level, governance, funding, risk & reward distribution, and competition. Relevant licence conditions and objectives will be amended (subject to consultation) to de-emphasise the pursuit of reuse.	• List of services comprising Core Mandatory Business and their definition through the SEC • Revised DCC's objectives • Details of scope, governance and funding provisions for Additional Mandatory Business • Redesign of existing Elective Communication Services, potential delivery of additional services for the industry under a contract • Formalised enduring process for change in DCC's role • Detailed measures required to unlock the opportunity to explore commercial re-use • Future of 'Minimal Services' • Cost control arrangements for different types of activities within Core Mandatory, Additional Mandatory, and Permitted Business • Review of Licence arrangements for the provision of the Centralised Registration Service (Switching)

Core Mandatory Business

4.41 We welcome support from stakeholders for our approach. We confirm that DCC's principal role will continue to be the provision of Core Mandatory Business, understood as services and activities which satisfy all three of the following conditions:

- They relate directly to ensuring the continued provision of a secure, reliable and efficient smart metering service
- They cannot be contestable
- Their scope is defined in the Licence or the SEC

4.42 We intend to define the scope of CMB through the Licence and the SEC using the categories of:

- 'Core Communication Services': we are minded to retain the current approach to defining the scope of these in SEC Appendix E (DCC User Interface). This means that the scope and technical requirements can be kept up to date via code governance in line with changing customer needs and network capacity.

We welcome views on whether amendments to the code text would be required as part of the review.

- 'Enabling Services': we are minded to make changes to the current Licence definition to more clearly capture the scope of these services. We will consider consolidating the scope of Enabling Services in Schedule H of the SEC.

4.43 We will confirm the full scope of DCC's CMB through a dedicated consultation, however, we have provided our updated view in Appendix 2. Noting stakeholder feedback, we will at a minimum review the position of *testing services* within CMB. Our expectation is that testing in relation to SEC modifications, internal system testing and production proving would remain in scope of CMB; however, other testing services such as User Integration Testing, Device Model Combination Testing, DCC Boxed, or additional testing support could instead be better provided on demand and funded via Explicit charges, falling within a separate category of 'Additional User Services'. Furthermore, we will also consider whether the *comms hub service* should remain within DCC's remit or whether it would be beneficial to transfer the obligation to procure comms hubs to energy suppliers who are already responsible for meter procurement and installation, with DCC potentially offering one sourcing option. We are mindful of DCC's 4G Comms Hubs & Networks programme and would need to assess the commercial and technical implications of such changes. We will seek stakeholder input on these questions before consulting.

4.44 We note the comments in relation to possible improvements to the core service requirements and description in the SEC, especially Section H and Appendix E, and will consider this as part of any code text amendments. However, in general, we are of the view that code governance is a better route for setting and changing technical requirements and encourage stakeholders to utilise existing code modification channels where they see a case for improvement.

4.45 The expectation on DCC to focus on the delivery of CMB will be reflected in its revised objectives. While these will be confirmed via further consultation, at minimum, in line with stakeholder feedback, we are minded to amend part c) of the Second Enduring General Objective; we are also minded to remove the Interim General Objective from the Licence and will consider whether a new net zero objective linked to the provision of Mandatory Business, or delivery to a strategic direction would be appropriate in its place.[43]

Additional Mandatory Business

4.46 We confirm that the future framework will include provisions for Additional Mandatory Business, comprising three categories of: 'Mandated Business Services', 'Ancillary Services', and 'Additional User Services'. Below we set out our decisions and reasoning for each of these three categories.

Mandated Business Services

4.47 **Scope**: Mandated Business Services will include activities which DCC may from time to time be asked to carry out by the Authority or the Secretary of State in addition to its CMB; for example on the basis of a strategic direction. Both the Authority and the Secretary of State have the powers to 'mandate' new business by modifying DCC's Licence or the relevant codes.[44] A separate licence provision for Mandated Business will transparently accommodate potential future requirements, allow the instructing party to specify requirements on delivery (which may differ from general requirements on CMB), and enable bespoke arrangements and reporting for cost-setting and cost control.

4.48 **Governance**: We note stakeholder concerns in relation to the governance for adding new Mandated Business Services to DCC's remit. In particular, we acknowledge that new requirements should not have an adverse impact on CMB or DCC's customers. Whilst the Licence would contain a general provision for Mandated Business Services, we would expect that the governance process would require a licence or code modification in consultation with industry and DCC. As part of this, the instructing party may also utilise industry forums to seek views on its proposals prior to statutory consultation. The industry-led or independent Board would then determine the most efficient way to deliver the new obligations, while customers would have transparency over associated costs and would be able to question spend during consultation stage of cost control.

4.49 **Funding**: We would expect these activities to generally be funded by Fixed charges apportioned among Charging Groups, reflecting that the Authority or the

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[43] LC 5 Part A. The Interim General Objective will be defunct as of Completion of Implementation, which is expected to occur before the end of the current Licence Term.
[44] The Authority has the power to modify the SMCL under Gas Act 1986, Section 23, and Electricity Act 1989, Section 11A (2). The Secretary of State currently has the power to amend the SMCL under Energy Act 2008, Part 5, Section 88. www.legislation.gov.uk/ukpga/2008/32/section/88

Secretary of State would only seek to mandate new business that would deliver net benefits to consumers and the industry as a whole. In terms of cost control, costs of some activities in their early stages may be more challenging to forecast under an *ex-ante* regime. As explained in Chapter 5 (Price control change considerations), we will account for such costs when designing the new cost control mechanism, depending on their share and magnitude.[45]

Ancillary Services

4.50 **Scope:** Through this provision DCC could be asked, pursuant to an agreement with customers, to carry out additional activities that may be expedient, for example to enhance system efficiency, but not strictly necessary for the provision of CMB. As set out in our consultation and noted in stakeholder responses, DCC may already provide some of these services (eg 'DCC boxed'), and there could be scope for other Ancillary Services in future. On balance, we believe that with appropriate governance arrangements the potential benefits of these additional services merit not foreclosing this option. However, recognising stakeholder feedback about the need to prioritise stabilisation of CMB in the short-to-medium run, we will consult on whether any Ancillary Services should be included and provided from 'day one' of the new Licence.

4.51 **Governance:** We acknowledge stakeholder concerns about the risks of negative impact on competition and potential scope-creep. For the avoidance of doubt, we do not intend for DCC to independently develop and grow Ancillary Services. Instead, a governance process for new Ancillary Services shall be in place, which we anticipate will include:

- Stakeholder engagement, for example via industry forums
- Code or licence changes necessary to enshrine new requirements
- Upfront costing through an *ex-ante* regime

4.52 We will confirm this process through further consultation, including whether code or licence amendments would be required in all instances.

4.53 **Funding:** The intended rationale for Ancillary Services is to deliver system-wide benefits. As such, their funding can generally be assumed to be best sourced from Fixed charges. Nonetheless, there may be some services, in particular existing services as the aforementioned 'DCC Boxed', with volume-sensitive

[45] See Chapter 5, paragraph 5.35 in this document.

operational costs which customers could opt in or out of using. These could instead be covered by targeted (Explicit) charges. For any new services, this should be considered on a case-by-case basis during the development of the business case.

Additional User Services

4.54 **Scope**: We maintain our consultation position that, despite no Elective Communication Services (ECS) having been taken up to date, the opportunity should not be foreclosed for future users.[46] We acknowledge the mixed views we received about the feasibility of ECS due to limited use-cases, unclear funding and technical barriers. We will work with DCC and consult with industry on:

- Identifying barriers to ECS and exploring their potential overhaul
- Expanding the scope of Additional User Services beyond ECS to include other bespoke capability

4.55 **Governance**: Once a process has been agreed for successor ECS, we would anticipate a fully customer-driven model. While also demand-dependent, it will be for further consideration if DCC should take a more active role in offering any non-communication Additional User Services.

4.56 **Funding**: On account of these services being bespoke and demand-driven, we consider that they should continue to be funded by Elective charges. However, we are conscious of the broader issue of ECS funding following the end of the exclusivity period to take into account during any redesign.

Other considerations

4.57 Additionally, we are minded to permit DCC to deliver additional services to industry on the basis of contractual agreements with industry parties, eg code managers. For example, this would allow DCC to compete for the provision of aspects of Switching, if current requirements are removed from the Licence.[47] We will develop details of this mechanism going forward.

[46] Elective Communication Services allow DCC customers to request bespoke functionality in the form of a new service request with a six-month exclusivity period. LC 6.5(b) and LC 17, Part C (Terms in respect of Elective Communication Services).
[47] For more details, please see paragraphs 4.68-4.78 in this chapter.

Table 4.2: Proposed structure of future Mandatory Business

Category	Types of services	Scope	Examples
Core Mandatory Business	Core Communication Services	Services provided on the DCC User Interface Embedded in the Licence and defined in the SEC (esp. Appendix E)	Messages sent/received to and from smart meters
	Enabling services and other requirements	Services and requirements strictly necessary for the provision of Core Communication Services Defined in the Licence with detailed requirements enshrined in the SEC (esp. Section H)	Updating and maintaining security of the network, Enrolment service, Incident management, Processing service requests, onboarding of new customers etc.
Additional Mandatory Business	Mandated Business Services	As instructed by the Authority or the Secretary of State and included in the Licence (with relevant provisions in the SEC/REC for the relevant code manager to require delivery)	Centralised Registration Service (Switching)
	Ancillary Services	As agreed with users and defined in the SEC/REC through a code-change process	Potentially contestable services improving system efficiency or coordination to leverage economies of scale, eg 'DCC boxed'
	Additional User Services	Bespoke capability offered to users on request	Elective communication or other services

Evolving DCC's Mandatory Business

4.58 In line with our consultation proposal, we confirm that the new regulatory framework will include mechanisms to allow for a controlled evolution in DCC's role.

4.59 Firstly, we confirm that changes in DCC's role ('what DCC does') should be allowed to happen in response to one of the following three triggers: Change in customer expectations & consumer needs; New policy or regulatory requirements; Evolving technology. We note stakeholder suggestions to include triggers to address service failures and enabling net zero:

- With respect to rectifying service failures, in addition to general powers of enforcement up to a licence revocation, Ofgem will also have the power to direct DCC to meet code requirements;[48] a trigger to amend the scope of DCC's business is therefore not required in this instance

- We believe delivery of net zero is captured by 'policy and regulatory requirements', particularly in implementation of the strategic direction; however, we will consider whether a net zero licence objective would be appropriate

4.60 We also acknowledge concerns about the triggers relating to technology and new policy or regulatory requirements. It is worth noting that our intention is for these agreed triggers to function as gateways for a governance process to respond to future uncertainty, rather than pursuing a growth in DCC's business.

4.61 Secondly, we confirm that we will proceed on the basis of our proposed formal routes for managing 'what DCC does' built around the roles of four main parties in the governance (code managers, the Authority or Secretary of State, DCC Board and DCC customers) and two key processes (code and licence modifications).[49] We note one respondent's suggestion for a formal inclusion of future users. We consider that insofar as changes to DCC's business as concerned, their interests can be sufficiently served via the code change process: As part of Energy Code Reform, we have proposed that any interested person would be able to raise a code modification and that code managers would be required to establish stakeholder advisory forums and to consult with the relevant forum(s) ahead of making certain decisions, including changes to codes. Additionally, as described in Chapter 2 (Alternative Regulatory Models), the interests of small and future users will be recognised in the composition of the future Board.[50]

Re-use considerations

4.62 We intend for the new framework to include provisions allowing the exploration of re-use of the DCC infrastructure. We consider that, on balance, the overall potential benefits of reusing the infrastructure to offset costs to customers and consumers, and to drive innovation, outweigh the risks associated with implementation.

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[48] BEIS (2022), Government response to the consultation on Energy Code Reform, p.16. www.gov.uk/government/consultations/energy-code-reform-governance-framework
[49] See Ofgem (2022), DCC review: Phase 1 Consultation, table 5.2, p.72. www.ofgem.gov.uk/publications/dcc-review-phase-1-consultation
[50] Chapter 2, paragraph 2.48-50 in this document.

4.63 Nonetheless, acknowledging the concerns raised by some stakeholders, we will develop proposals for detailed measures to enable re-use across the following areas: maturity level; governance; funding; risk & benefits distribution; and competition.

4.64 The measures for determining maturity level and funding have emerged as the two main prerequisites:

- **Maturity level** will determine when DCC will be permitted to undertake a re-use activity. To ensure objectivity in its assessment, we intend to consult on an agreed set of metrics that must be met for DCC to be considered having reached adequate 'maturity level'. One option under consideration is the use of a subset of SEC performance measures over a period of time ('observation window'). We will seek views in developing the detailed proposals.
- **Funding** determines the risk & benefits distribution and has implications for governance by shifting the power to decide what type of re-use activity is pursued. We welcome the range of suggestions that emerged from consultation responses. At present, we see three possible models that could be considered, possibly in combination with one another:

  (1) Funding through an allowance under price control. This model would be suitable for innovation and re-use for the benefit of the energy sector and enable benefits beyond simple offsetting of charges to users. It would allow for a more stakeholder-led governance in developing re-use cases and a higher proportion of benefits flowing back to customers. However, equally, it would place more risk on customers who would fund the allowance through their charges, could restrict the range of available re-use options to the energy sector only and therefore the potential total benefits.

  (2) Funding by a third-party shareholder (parent) could help lift some of the risk off customers but also create legitimate claim to a substantive portion of resulting benefits as revenue. Customers may also forfeit some of their decision-making power in this scenario.

  (3) Funding by a third-party investor would de-risk re-use for customers, potentially open up the most possibilities, including for non-energy use, but also likely lead to the least favourable benefits distribution for customers, although customers could be compensated through a capacity charge.

4.65 Additionally, we agree with respondents that the question of *feasibility* is important. Whilst a lack of existing propositions does not imply an absence of potential business cases in future, we will work to establish the likely scope of potential realisations, which may indicate which of the three models above could deliver best outcomes.

4.66 In line with our consultation proposal, the implementation of this framework will be through specific licence conditions underpinned by a suitable set of objectives:

- We agree that it may be appropriate to disapply the re-use provisions until such time as all necessary measures are met. We will also consider retention of power to suspend the provisions for new re-use if performance falls beyond acceptable levels.
- We also agree that a new objective in place of the existing part c) of the Second Enduring General Objective will be needed.

Other considerations

4.67 DCC's current Permitted Business includes provisions for Minimal Services.[51] We have begun to review the rationale for, and practical utility of, these services and will consult on either their retention with modifications, or discontinuance.

Switching

Background

4.68 DCC has been instructed by Ofgem to take on responsibilities for the delivery of the new arrangements to support faster, more reliable switching.[52] These responsibilities, which were set out through consultation with industry and are additional to the scope of DCC's role at the time of the original licence award in 2013, were added to the remit of DCC's Mandatory Business in the Licence in two phases.

4.69 Firstly, DCC was given obligations in July 2016 to support the establishment of the Centralised Registration Service, including contributing to the design of the new registration and switching arrangements and for procuring the Relevant Service Capability to deliver the service.[53]

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[51] LC 6.8(b)
[52] LC 6.5(d) and LC 15
[53] Ofgem (2016), Decision: DCC's role in developing a Centralised Registration Service. www.ofgem.gov.uk/publications/decision-dccs-role-developing-centralised-registration-service

4.70 Secondly, we decided in October 2018 to further extend DCC's role into the Design, Build and Test (DBT) phase of the programme and on into the early years of the enduring phase after service go-live.[54] DCC was tasked with entering into contracts with service providers to oversee the development of the service, followed by an ongoing responsibility for the provision of the new service in the early years of steady state operations. The rationale at the time for DCC to perform this role was to de-risk the implementation of the new switching arrangements by having the party responsible for procurement also responsible and accountable for then managing those contracted service providers. This was seen as preferable to those contracts being inherited by another party to manage. These new licence obligations came into effect in February 2019.[55]

4.71 Under the enduring switching arrangements following service go-live on 18 July 2022 DCC is required to provide three core switching services – the Switching Operator (SO), the Central Switching Service (CSS) and the Certificate Authority (CA). DCC delivers these services through contracts with three separate service providers – Landmark, NetCompany and CapGemini.

4.72 In our October 2018 consultation, we stated our intention to keep under review whether the Smart Meter Communications Licence holder, *ie* DCC, should remain the responsible party for provision of these switching services. We said that the end of the current Licence Term in September 2025 would provide an opportunity for such a review to take place.[56] We also said that consideration of any changes would be made well in advance of 2025 to allow enough time for a transition if necessary.

Consultation responses

4.73 In response to this consultation, a number of stakeholders suggested that provision of these switching services should be removed from DCC's future Mandatory Business and either enshrined in a new separate licence, or instead that RECCo should assume responsibility for contracting with the service

[54] Ofgem (2018), Switching Programme: Regulation and Governance - way forward and statutory consultation on licence modifications. www.ofgem.gov.uk/publications/switching-programme-regulation-and-governance-way-forward-and-statutory-consultation-licence-modifications
[55] Ofgem (2018), Decision and Notice of Licence Modifications [to include further Switching obligations]. www.ofgem.gov.uk/publications/decision-and-notice-licence-modifications
[56] Ofgem (2018), Switching Programme: Regulation and Governance - way forward and statutory consultation on licence modifications, p.63, paragraph 7.11. www.ofgem.gov.uk/publications/switching-programme-regulation-and-governance-way-forward-and-statutory-consultation-licence-modifications

providers to deliver these services directly. These respondents argued that the synergies between switching and DCC's core smart meter communication roles are not strong enough to justify switching being included within the Licence going forward.

Our view

4.74 We do not consider the creation of a separate licence for the switching service to be efficient or necessary. However, we can see the potential benefits of shifting existing switching obligations from the DCC Licence to RECCo. Whilst we took the decision at the time to support the delivery of the new switching arrangements through the DCC Licence, we recognise that delivery of these services is materially different to the scope of DCC's other obligations. We also note that RECCo has matured as an organisation since its inception in 2019, particularly in its service management capability, and is now likely to be better equipped to provide these switching services directly. We therefore intend to consult on whether the responsibility for delivery of the switching service(s) should remain within DCC's Licence or be transferred to RECCo.

4.75 The main potential advantages we see arising from this potential shift of responsibility to RECCo are:

- RECCo would hold more scrutiny over the service providers and would be able to hold them to account for their performance directly through contract management processes, which may be more efficient than Ofgem assuring DCC's performance in switching through its price control under the Switching Incentive Regime
- There may be synergies between these switching contracts and other RECCo contracts, for example provision of the enquiry services, which could result in efficiencies being realised
- Smart metering arguably requires more robust governance than switching – decoupling switching from DCC's Licence should enable more streamlined governance and decision-making processes when it comes to Switching

4.76 Nonetheless, we recognise there are potential challenges in decoupling Switching from DCC's Mandatory Business that would need to be considered, including:

- Managing re-procurement of two existing contracts due to expire within the current Licence period[57]
- Designing the new governance arrangements, for example considering how another party such as RECCo could be obligated to provide these services through the code or licence framework, and the impact of Energy Code Reform changes
- How to technically and cost effectively replace or replicate the additional 'wraparound' services provided by DCC that are associated with the three main switching contracts set out above, some of which may currently benefit from economies of scale arising from DCC's role in providing smart services

4.77 We will work with RECCo and DCC to understand how these challenges could be overcome ahead of consulting further on these proposals.

4.78 We welcome continued stakeholder engagement on this issue. We will consult on concrete proposals for the future of Switching within the DCC Licence in the next phase of the review.

[57] Landmark (May 2024), Net Company (September 2024).

5. Price control changes considerations

Section summary

We found strong support for changes to the price control regime and a shift towards an *ex-ante* regulation for at least the core, stable aspects of DCC's Allowed Revenue. In general, respondents agreed that an *ex-ante* or a hybrid model would strengthen control over spend, improve cost transparency, provide opportunity for stronger incentivisation of cost efficiency, drive forecasting accuracy and potentially reduce regulatory burden.

Initial analysis of DCC's financial data over period 2024-2026 also shows that a majority of DCC's costs are, indeed, suitable for *ex-ante* funding.

We therefore confirm that we will move towards *ex-ante* regulation for costs of activities deemed to be sufficiently stable. A minority of costs, which may remain unsuitable for *ex-ante* regulation, would be accommodated via either uncertainty mechanisms within full *ex-ante* regime or continued discreet *ex-post* arrangements.

We also confirm that we will introduce changes in two steps:

1. We will make improvements to the existing price control arrangements with the aim for these to take effect from April 2025 for the duration of the licence extension. This will help realise benefits of *ex-ante* regulation sooner, provide opportunity to strengthen current margin-based incentives, and allow for a smoother transition towards enduring arrangements.
2. We will move to enduring arrangements following business handover to the Successor Licensee. In the context of our conclusion that Core Mandatory Business will be provided on a not-for-profit basis, we will ensure that sufficient mechanisms are in place to assure cost efficiency and quality of service under enduring arrangements.

We will design the new cost control framework, including any interim changes, drawing on existing models and in further consultation with stakeholders.

Questions posed at consultation:

Question 14: Do you consider that a hybrid model, where some costs are regulated under an *ex-ante* regime and some under an *ex-post* regime based on the level of cost uncertainty, would be appropriate for DCC?

Question 15: What elements of DCC's Allowed Revenue are stable (with low risk of forecasts being either under- or over-estimated) and would benefit most from an *ex-ante* approach by 2025?

Question 16: What are your views on the different ways in which risk (ie the benefit of underspending and the cost of overspending) can be shared between the DCC and its customers under an *ex-ante* regime?

Question 17: What are your views on whether DCC can be effectively incentivised to reduce costs at scale under an *ex-ante* regime?

Question 18: Do you think that moving to an *ex-ante* regime could adversely affect the quality of service? What mechanisms could be used to reduce the risk of underperformance under an *ex-ante* regime (eg provisions to allow clawback in case of delivery failing to meet specifications)?

Question 19: What are your views on how best to assess costs under an *ex-ante* approach? For example: What level of detail on costs and benefits would be appropriate? How early should DCC share details of costs with customers? How should this information be shared and evaluated?

Question 20: Do you agree with our initial view that an *ex-ante* model has the potential to reduce the resource burden both for Ofgem and DCC? Please state why.

Background

5.1 As a monopoly company, it is important that DCC's costs are subject to appropriate controls. We have been receiving stakeholder feedback on the continuing *ex-post* arrangements for DCC. In general, stakeholders tended to suggest that a move to an *ex-ante* approach could deliver benefits such as: greater control over budgets; more transparency and value for money; greater predictability and more accurate forecasts; and aligning DCC to other regulated monopolies.

5.2 In our consultation, we provided an assessment of the effectiveness of an *ex-ante* approach, including risks and benefits, using the following criteria:

1) Dealing with cost uncertainty

2) Incentives to control or reduce costs

3) Incentives to deliver the right level of performance/quality of service

4) Transparency and stakeholder engagement

5) Regulatory and resource burden

5.3 We sought stakeholder views of this initial assessment under the above criteria, as well as a potential hybrid regime combining both *ex-post* and *ex-ante* approaches. We also sought views on broader considerations for price control changes, including potential interim changes during transition to a new regulatory regime.

Overview of stakeholder responses

Question 14: Views on a hybrid price control regime

5.4 Responses generally considered a hybrid regime a viable option for the future DCC regulatory regime, with some highlighting that *ex-ante* models are already in place elsewhere in the energy system.

5.5 Some responses then described the cost categories that they considered appropriate for *ex-ante* regulation within a hybrid model. Of these responses, all stated that DCC's 'core mandated services' should be regulated *ex-ante*.

5.6 The most common argument made by stakeholders against adopting a hybrid model was that DCC's future regulatory regime should be *wholly ex-ante*, with no *ex-post* aspects.

5.7 Of the responses supportive of a wholly *ex-ante* model, the following arguments were made:

- *Ex-ante* regulation would bring DCC's regulatory model in line with those elsewhere in the energy networks, such as for the Distribution Network Operators (DNOs), bringing greater consistency across the energy system
- A wholly *ex-ante* regime would allow setting cost disallowances in advance and hold DCC to a stricter operational model, reducing the risk of overspend
- Issues that make a given cost category difficult to estimate (and thus difficult to regulate *ex-ante*) should be addressed; the present difficulty of estimating certain costs is not itself a reason to implement a hybrid model over a wholly *ex-ante* model

5.8 Conversely, one response stated that certain costs related to security, such as those associated with sudden or unscheduled incident management, would require *ex-post* regulation, as such costs by their nature could not be accurately predicted.

5.9 Of all responses, only one argued in support of continuing the current *ex-post* regulatory model, stating that, of the costs directly under DCC's control, most are influenced by new service requests that are difficult to accurately determine the cost of in advance.

Question 15: Views on cost stability

5.10 Related to responses to Question 14, responses in favour of *ex-ante* regulation (be it through a hybrid model or pure *ex-ante* model) reiterated their support for *ex-ante* regulation of DCC's 'core mandated services', such as smart metering, Switching, and Market-wide Half-Hourly Settlement.

5.11 Some responses stated that the success of *ex-ante* regulation for DCC would depend on a strict definition of its core business which does not expand over time.

5.12 A few responses noted historic issues with DCC's forecasting. Some stated this would limit the effectiveness and scope of any potential *ex-ante* model, while others argued that a move to *ex-ante* regulation would help mitigate future forecasting issues.

Question 16: Risk-sharing potential in an *ex-ante* regime

5.13 Respondents generally agreed that an *ex-ante* regime would allow for better risk-sharing between DCC and its customers. Similarly, many highlighted the lack of risk placed on DCC under the current *ex-post* regime. However, some stated that the degree to which risk would be shared more equitably also depended on changes to the DCC Licence model, such as whether core services were run for- or not-for-profit.

5.14 A key benefit of *ex-ante* regulation identified by stakeholders was the increased involvement of DCC customers and wider industry in DCC's budget-setting process up front, to help reduce future risk.

5.15 Some stakeholders reiterated that a transparent and fair allocation of risks, such as those associated with underperformance, between DCC and its customers under an *ex-ante* regime, would depend on strict definitions of DCC's core services.

Question 17: Incentivisation of cost stabilisation/reduction in an *ex-ante* regime

5.16 Most respondents believed DCC could be effectively incentivised to reduce costs at scale under an *ex-ante* regime. However, many emphasised that any reductions must not come at the expense of service quality. One stakeholder explicitly advised against new cost reduction incentives to avoid unintended consequences.

5.17 Some responses highlighted the differing potential for cost reductions based on the future ownership model chosen for DCC, stating that Option B (a not-for-profit model) could drive greater cost reductions than Option A. A key reason given for this view was that shareholder returns may reduce interest to drive cost reductions, while under Option B, customer benefit (through reduced costs) would be expected to be a primary concern of the Board.

5.18 One stakeholder doubted the extent to which costs could be driven down under Option B, highlighting DCC's asset-light nature with few internally run services. They argued that bringing services in-house would be a greater cost reduction driver over externally procuring contracts and services. Similarly, another stakeholder was of the view that external costs may be unlikely to decrease overall, though cost stabilisation and predictability through a transparent *ex-ante* regime would still be beneficial for customers.

Question 18: Risks to service quality in an *ex-ante* regime

5.19 Typically, respondents were of the view that a move to an *ex-ante* regime should not adversely affect the quality of service provided by DCC, highlighting other monopolised areas of the energy system that currently operate under an *ex-ante* regime without service quality issues. Similar to responses to Question 17, stakeholders stated that any such service quality reductions that could arise should not be deemed acceptable.

5.20 Multiple responses acknowledged that a decline in service quality would still be a risk, however, that could be mitigated through controls such as clawback mechanisms or penalties for avoidable or foreseeable service failures by DCC. In terms of the design of such penalties, some responses from DCC customers stated that penalties against DCC's margin were preferable to direct customer compensation, for two reasons: first, margin reductions would better incentivise DCC to improve the quality of its services; second, the effects of poor service quality are not adequately compensated through money alone, instead preferring long-term service stability.

Question 19: Approach to cost assessment under an *ex-ante* regime

5.21 Stakeholders gave a variety of responses as to how best to assess costs under an *ex-ante* approach, including:

- Use of a Totex incentive mechanism
- Adopting the same approach used in the RIIO regulatory system for energy networks
- Employing independent, third-party cost benchmarking every two to three years against similar monopoly services within the energy industry

5.22 Regarding the appropriate level of detail to provide on costs and benefits, and how early DCC should provide these to its customers, stakeholders near-unanimously said that as much detail should be provided to customers as early as possible. Responses from DCC customers generally expressed dissatisfaction with DCC's current degree of responsiveness and stakeholder engagement, and argued for greater transparency going forward. Specifically, customers wanted more notice for greater spend, and for costs under an *ex-ante* regime to be released in time to allow them to factor such costs into their plans for the next financial year (eg releasing in December of the previous financial year).

5.23 Regarding the methods through which cost information should be shared and evaluated, a few responses promoted the establishment of a new SEC sub-committee to which DCC would submit costs for scrutiny.

Question 20: Reduction of regulatory burden in an *ex-ante* regime

5.24 Overall, stakeholders were in agreement that an *ex-ante* model had the potential to reduce the resource burden on both Ofgem and DCC. One stakeholder stated that the growth in DCC's cost profile in recent years will have made retrospective assessment more complex and placed a greater burden on Ofgem to understand whether costs were efficient, or why they were incurred in the first place. Another stakeholder stated that *ex-ante* regulation could remove the need for annual price control negotiations, highlighting that RIIO programmes cover a five-year period at once.

5.25 Multiple stakeholders reiterated their point made in response to Questions 14 and 15 that clear definitions of DCC's services whose cost would be regulated *ex-ante* would be key in reducing the regulatory burden.

5.26 Conversely, one stakeholder disagreed, stating that an *ex-ante* regime would be equally burdensome and only shift this burden from the end of the price control cycle to the beginning. Similarly, another response highlighted the risk of increased lead times, and greater liaison between DCC, its customers, and Ofgem. Some stakeholders highlighted that Ofgem must consider the time and work involved in any true-up/reconciliation processes for an *ex-ante* regime.

5.27 Two stakeholders stated that resource burden on DCC users should also be considered. Furthermore, one respondent stated that the burden placed upon Ofgem and DCC should not be a primary concern in the design of future price control arrangements, arguing that whichever regime that delivers the best outcome should be pursued.

Our view

5.28 As set out in Chapter 2, we consider that the future regulatory model should be designed on the basis of 'key features', which include the following with relevance to cost control:

- Costs of activities deemed to be sufficiently stable should be subject to an upfront approval by Ofgem via an *ex-ante* price control or a budget-setting process
- The Core Mandatory Business should be conducted on a not-for-profit basis

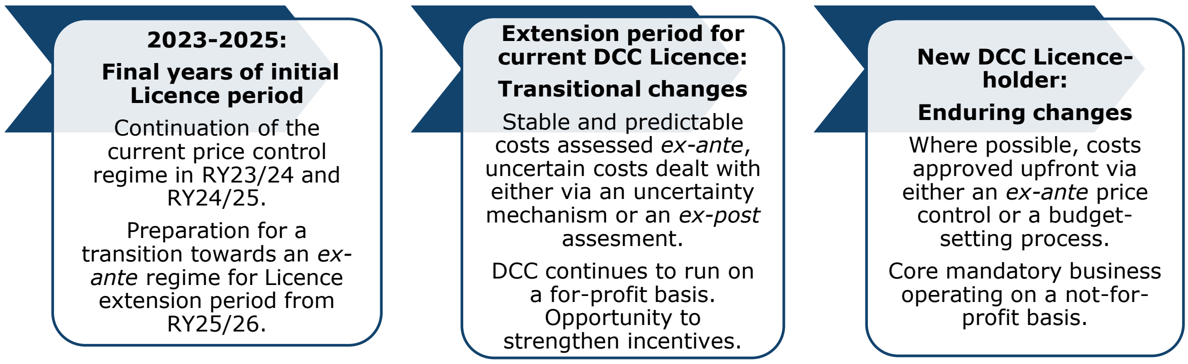
5.29 As discussed in Chapter 3, we also consider that an extension to the current Licence of 12-36 months would be required.

5.30 We said that in the event of a Licence extension greater than 12 months, we would explore bringing in interim changes to drive certain benefits early. As such, we will aim to introduce changes to DCC's price control in two steps:

1. We will aim to make *interim* changes to the existing Price Control arrangements for the current DCC Licence-holder, to take effect in the Licence extension period. Our ambition is for these changes to take effect from April 2025. This will help realise benefits of *ex-ante* regulation sooner and allow for a smoother transition towards enduring changes.
2. We will introduce *enduring* changes in accordance with the two relevant 'key features' to take effect following the implementation of the new Licence.

5.31 The diagram below provides a visualisation of these stages.

Figure 5.1: Introduction of new cost control arrangements



Decision to move towards *ex-ante* regulation

5.32 Based on an assessment of the costs of DCC's current Mandatory Business, our view is that **the majority of DCC's costs are, and will continue to be, sufficiently stable and predictable to be subject to an *ex-ante* cost control mechanism**.

5.33 Table 5.1 below provides a high-level assessment of DCC's costs and their potential suitability for *ex-ante* regulation. The costs are broken down into three broad categories based on their relative expected stability, using DCC's forecast data for years 2024-2026 under a model three-year scenario. For more details on the components included in each category, please see Appendix 3.

5.34 Please note, other additional costs associated with DCC such as financing, device costs and other pass-through costs have not been included for the purpose of this exercise. This breakdown is an estimate and is intended for illustration only at this stage and the percentage breakdown is likely to change dependent on planned activities and as cost estimates and forecasts mature.

Table 5.1: Suitability of different costs for ex-ante regulation

Cost area	[%] of DCC's total costs, estimate over 2024-2026	Suitability for *ex-ante*
Corporate Overheads • Internal costs associated with the running of the business	10-15%	Suitable for *ex-ante* funding - comparable to business support costs under RIIO-2.
Costs to Operate • Costs of life BAU programmes and associated functional support • Costs of maintenance and expected technology refresh	60-70%	Suitable for *ex-ante* funding – based on long-term contracts with external service providers.
Costs to Change • Change programmes in early stages of lifecycle • SEC Release management • Functional support for programmes	20-30%	A portion of these costs may require accommodation through an uncertainty mechanism or an *ex-post* review. This proportion will be dependent on the length of the cost control cycle (predictability).

5.35 We can distinguish two attributes of these costs – *stability* and *predictability*.

- 'Corporate Overheads' and 'Costs to Operate' comprise the majority of DCC's costs, have relatively low variability ('instability') and are generally predictable enough to allow for accurate forecasting.
- 'Costs to Change' are inherently variable ('unstable') year-on-year and can therefore be difficult to predict in multiannual price controls. Shorter price control cycles can significantly increase the share of predictable costs within this category allowing for more accurate forecasting. For example, SEC Releases can be predicted with a 12-month view but are hard to forecast 24 or 36 months in advance. However, the option to reduce the frequency of cost control cycles to mitigate against cost uncertainty will have to be weighed against potential greater resource burden, as noted by some stakeholders.

5.36 We will work with DCC to identify how costs in the category 'Costs to Change' can shift to *ex-ante* regulation over time; for example, as programmes currently in their early stages go live and become part of BAU operations. However, it is likely that some costs will remain unstable and unpredictable as 'residual uncertainty' under any scenario for which arrangements would have to be made to appropriately assess. Depending on their share and magnitude, this may be either via uncertainty mechanisms within an *ex-ante* regime (such as reopeners), or *ex-post* mechanisms within a hybrid regime. Further data analysis will be required to support these detailed considerations; nonetheless, we are confident that there is sufficient evidence to start moving towards an *ex-ante* regime for a majority of DCC's costs.

5.37 As outlined in our consultation, and noting strong stakeholder support, we consider that the move towards *ex-ante* regulation would bring a range of benefits, including:

- Greater overall control over spend
- Better cost transparency for both Ofgem and DCC customers
- Opportunity for stronger incentivisation of cost efficiency
- Greater forecasting accuracy
- Depending on the length of a cost control cycle, potentially reduced regulatory burden

Future cost control mechanism

5.38 There are two basic 'upfront' cost-setting models in the energy sector:

- *Ex-ante price controls* – the best example is the RIIO price control which gas and electricity network companies are subject to
- *Forecast-based budgets* – employed by not-for-profit Central System Delivery Bodies with industry-led or independent Boards such as Elexon or RECCo

5.39 *Ex-ante* price controls are most effective when applied to organisations with a large asset base and profits which can be put at risk. We acknowledge that the not-for-profit nature of the future DCC's business would render some of the benefits of a traditional *ex-ante* price control less effective. Similarly, however, we recognise that a simple forecast-based budget-setting approach may not in itself be sufficient to assure cost efficiency and maintenance of service quality.

5.40 To mitigate these risks, we envisage that a new framework could include measures such as:

- Role of industry in scrutinising DCC's business plans and budgets through a consultation process
- Regulatory reporting to Ofgem and Ofgem's approval of costs
- Appeals route for customers

- Possible additional incentive mechanisms, such as allowing DCC to earn a cost surplus to be put at risk, integration and improvement of existing incentive mechanisms (OPR, ECGS, BMA), or design of a new incentive reflecting the central role of the Board in delivering cost efficient and quality service

5.41 We will, in the coming months, develop more detailed proposals for the design of a future cost control framework, drawing on best practice from existing models. We plan to explore the effectiveness of different options in further discussion with stakeholders via workshops and consultations. In developing these options, we will continue to apply the five criteria outlined in our initial consultation:

1. Dealing with cost uncertainty
2. Incentives to control or reduce costs
3. Incentives to deliver the right level of performance/quality of service
4. Transparency and stakeholder engagement
5. Regulatory and resource burden

Interim Price Control changes

5.42 As set out in our reasoning,[58] we have confidence that certain areas of DCC's costs would be suitable for *ex-ante* regulation prior to implementation of the new Licence. We therefore aim to shift to an *ex-ante* regulatory regime for at least some costs from April 2025.

5.43 The key benefits of this approach are as follows:

- Phasing in *ex-ante* regulatory elements prior to the new Licence will provide a smoother transition by reducing the number of regulatory differences between the current and future Licence.
- An interim *ex-ante* price control will drive some of the expected benefits earlier than otherwise possible. It will give us opportunity to strengthen existing margin-based incentives (improvement of current OPR, ECGS and BMA mechanisms), or introduce new ones, eg Totex Incentive Mechanism to drive cost efficiencies.
- Ofgem, DCC and industry will gain experience of the processes involved in assessing DCC's costs upfront prior to the introduction of enduring

[58] Paragraphs 5.32-5.36 of this document

arrangements under the new framework. It will also give visibility of the cost control process to potential bidders.

Addressing stakeholder comments

5.44 While we note a general support for our proposals, we note two common themes which arose in stakeholders' consultation responses:

- Concerns around DCC's growing number of activities and responsibilities, the impact this has had on DCC's forecasting accuracy in recent years, and a resulting risk to an *ex-ante* model's ability to deal with cost uncertainty
- Concerns around service quality and the need to ensure its continued incentivisation

5.45 We agree with the general stakeholder view that the success of a future *ex-ante* regime would depend on accurate forecasting, which in turn will require establishing clear definitions and boundaries around DCC's Mandatory Business and transparent governance for its change. As set out in Chapter 4 (Future role of DCC), we have commenced this work and will progress it in parallel with developing new cost control. With clearer definitions around DCC's mandatory services, the accuracy of DCC's forecasting should improve as the scope of its responsibilities and services provided stabilises over time. Upfront scrutiny of business plans *ex-ante* cost approval should also help mitigate against scope creep.

5.46 We also agree with stakeholders that any transition towards an *ex-ante* regulatory framework must not come at the cost of the quality of services provided by DCC; nor should a decline in service quality be deemed an acceptable trade-off for an *ex-ante* framework. In line with our decision on governance changes, we expect accountability of the Board to be the primary route in driving service quality and cost efficiency directly on behalf of DCC's customers. However, we accept that further assurance may be required and that under not-for-profit arrangements, performance would have to be incentivised through different means compared to the current for-profit structure.[59]

[59] See paragraph 2.56 in Chapter 2 of this document for further information on the options being considered.

Next steps

5.47 We will hold a workshop in autumn 2023 to test our emerging positions and for stakeholders to provide input to our considerations.

5.48 In spring 2024, we anticipate publishing a consultation focusing specifically on future price control considerations – both proposed interim price control changes and enduring cost assessment mechanisms.

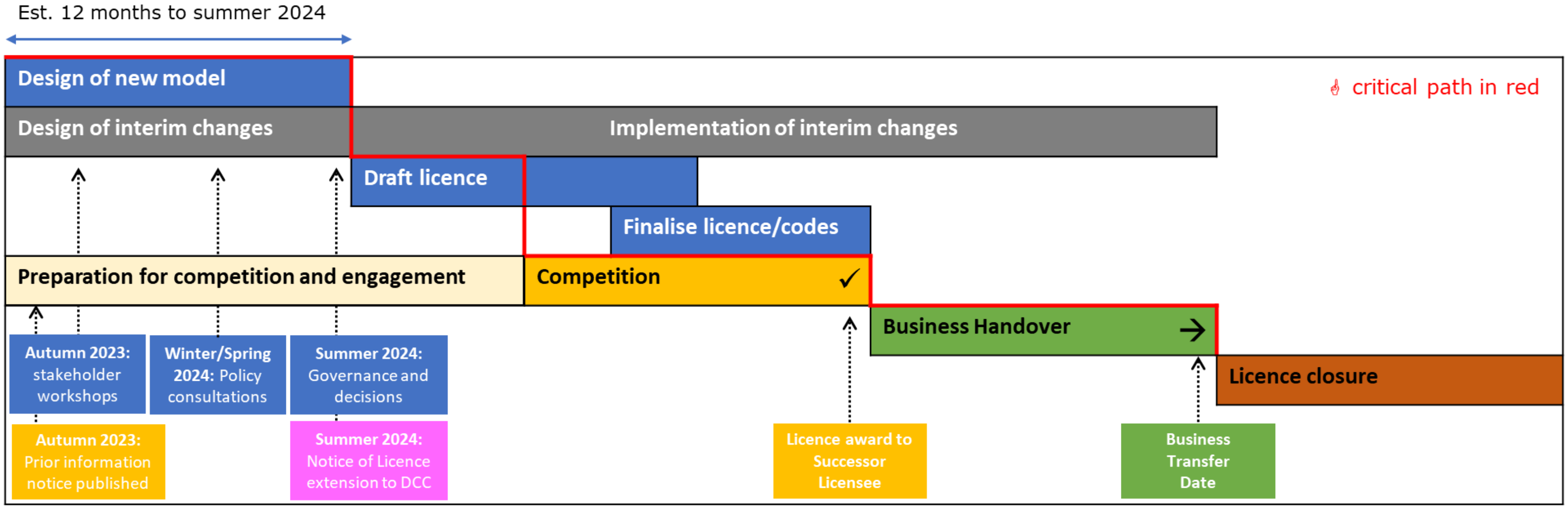
Appendices

Index

Appendix 1 – Illustrative timeline

A1.1 Figure A1.1 below shows a high-level timeline of the design and transition to the new regulatory framework. Please note the timelines, including the extension period, will be confirmed by summer 2024. The timeline is for illustrative purposes only.

Figure A1.1: Illustrative timeline of Phases 2-4 of the DCC review



Phase 2 – Detailed design

A1.2 We intend for the second, detailed design phase of the review to focus of policy development of detailed options in consultation with industry, followed by drafting of the new Licence.

A1.3 We will test our emerging position at stakeholder workshop in autumn 2023, followed by at minimum two consultations covering:

i) Future role of DCC, governance and operational framework

ii) Mechanism for determining DCC's Allowed Revenue (cost control) and incentives

A1.4 Subject to the consultation outcomes and internal governance, we expect to publish our decisions on the detailed design in summer 2024.

A1.5 We will give effect to these changes through drafting of a new Licence and necessary code changes. We envisage issuing a consultation on the draft new Licence and code amendments prior to progressing to the statutory consultation on the final legal text.

A1.6 In parallel, we also aim to design and consult on any interim improvements, including necessary licence and code changes, to bring in changes during the transition period.

Phase 3 - Competition

A1.7 To implement the new Licence, we will run a competitive tendering process in line with the 2012 tenders regulations.[60] We expect the competition to coincide with our publishing of the draft Licence text to inform bids.

A1.8 In preparation for full competition, we expect to carry out pre-competition market engagement, which would commence with our publication of the Prior Information Notice (PIN) in autumn 2023.

[60] 2012 Competitive Tenders for Smart Meter Communication Licences Regulations. www.legislation.gov.uk/uksi/2012/2414/contents/made

Phase 4 – Business Handover

A1.9 The competitive tender process will conclude with the appointment of the new licensee, which will be followed by transfer of business under the Business Handover Plan as per LC 43.

A1.10 We anticipate a period of time when the outgoing licensee continues to provide the Authorised Business under the current Licence before a full transfer to the Successor Licensee takes place, triggering the commencement of the new Licence.

A1.11 Following completion of the transfer of the smart metering business to the new licensee and the expiry of the current Licence, we would at a minimum, expect to conclude the final Price Control with the outgoing licensee.

Appendix 2 – Updated view of DCC's Core Mandatory Business (to be confirmed through further consultation)

What is provided? (The service that DCC delivers – based on the current scope of Authorised Business)		Regulatory Basis (non-exhaustive)	In scope of future Core Mandatory Business (current view)
Core communication services to and from smart meters		LC 6.5(a) *DCC User Interface Service Schedule* (Appendix E) NB, not all service request processing services are in Appendix E, eg enrolment service – are there any other?	YES
Services and other requirement enabling core communication services. This means provision of:		LC 6.5(c)	
	Communications Hubs service (including order management and delivery of CH to users)	LC 6.6(b), SEC Section F5-10, *CH Handover Support Materials* (Appendix H), *CH Installation and Maintenance Support Materials* (Appendix I)	To be reviewed
	Testing services	**SEC Section H14**,[61] **SEC Section F10** (Test Comms Hub), *Common Test Scenarios Document* (Appendix R) *SEC Variation Testing Approach Documents*[62] Production Proving (to the extent as defined in) SEC Section P	In part – to be reviewed
	DCC Boxed	-	NO but it may be an 'Additional Mandatory Business' service
	Updating and maintaining security of the network	SEC Section G	YES

[61] Under *SEC Section H14*, testing services include**:** (a) User Entry Process Tests; (b) SMKI and Repository Entry Process Tests; (c) Device and User System Tests; (d) Modification Proposal implementation testing (as described in Section H14.34); (e) DCC Internal Systems change testing (as described in Section H14.36); and (g) SMETS1 Pending Product Combinations Tests

[62] As developed by DCC directed by Secretary of State, pursuant to SEC Section X11 and incorporated pursuant to SEC Section X5; including *SEC Variation Testing Approach Document* (Appendix AJ), *SEC Variation Testing Approach Document for SMETS1 Services* (Appendix AK), *SEC Variation Testing Approach Document for BEIS Changes included in the November 2020 SEC Release* (Appendix AN), *SEC Variation Testing Approach Document for the CH&N Arrangements* (Appendix AQ), and *SEC Variation Testing Approach Document for the Enduring Change of Supplier Arrangements* (Appendix AR)

What is provided? **(The service that DCC delivers – based on the current scope of Authorised Business)**	**Regulatory Basis** **(non-exhaustive)**	**In scope of future Core Mandatory Business** **(current view)**
PKI (public key infrastructure) related services: SMKI, DCCKI, IKI, incl. SMETS1 PKI	SEC Section L, Appendices A, B, C, D, K, L, M, N, O, P, Q, S, T, U, V, W, W, AO and AP	YES
Enrolment services and smart metering inventory	LC 6.6(a), SEC Section H5, *Inventory Enrolment and Decommissioning Procedures* (Appendix AC)	YES
Ongoing maintenance (eg firmware updates)	*[Cross-cutting obligations]* LC13B (Network Evolution Arrangements)	YES
DCC User Interface and managing demand	SEC Section H3 *DCC User Interface Code of Connection* (Appendix AE), *DCC User Interface Specification* (Appendix AD)	YES
Processing Service Requests	SEC Section H4, *Service Request Processing Document* (Appendix AB)	YES
Decommissioning, Withdrawal and Suspension of Devices	SEC Section H6, *Inventory Enrolment and Decommissioning Procedures* (Appendix AC)	YES
Onboarding service for new customers – administrative	SEC Section H1	YES
Service Management, Self-Service Interface and Service Desk	SEC Section H8, *Self Service Interface Access Control Specification* (Appendix AH); *Self-Service Interface Code of Connection* (Appendix AI)	YES
Incident Management	SEC Section H9, *Incident Management Policy* (Appendix AG)	YES
Business Continuity and Disaster Recovery Testing	SEC Section H10.11-12B	YES
Parse and Correlate Software	SEC Section H11	YES
Intimate Comms Hubs Interface specifications	SEC Section H12	YES
DCC Gateway Connections	SEC Section H15, *DCC Gateway Connection Code Connection* (Appendix G)	YES
Interoperability Checker Service	SEC Section H16.8-14	NO but it may be an 'Additional Mandatory Business' service

What is provided? (The service that DCC delivers – based on the current scope of Authorised Business)	Regulatory Basis (non-exhaustive)	In scope of future Core Mandatory Business (current view)
Provision of registration data and Registration Data Interface maintenance	SEC Section E *Registration Data Interface Specification* (Appendix X); *Registration Data Interface Code of Connection* (Appendix Y)	YES
Enduring Change of Supplier (ECoS)	LC 13A *ECoS Transition and Migration Approach Document* (Appendix AS)	YES
Modifying the services that are provided in response to SEC or REC changes		YES
Other mandatory business: Providing other central services to the extent that BEIS or Ofgem modifies the DCC Licence (or other document, eg SEC/REC) to require provision of *additional mandatory services*	SMCL Part 1 Section F: *Modification of Conditions*	-
MHHS	LC 21 Part H	YES
Providing the Centralised Registration Service (Switching) under the Retail Energy Code in a secure and coordinated manner	LC 6.5(d) detailed arrangements in LC 15	NO but it may be an 'Additional Mandatory Business' service
Providing services ancillary to the Central Registration Service under the REC	LC 15	NO but it may be an 'Additional Mandatory Business' service
Bespoke capability delivered on a bilateral basis (Elective Communication Services)	LC 6.5(b)	NO but it may be 'Additional Mandatory Business'
Permitted Business		NO
Minimal Services	LC 6.8(b)	
Value Added Services	LC 6.8(a) Subject to authorisation under LC 6 Part D	
Other		
Reporting Activity	LC 29 or any reporting under the SEC, as agreed by DCC in SEC Panel or subgroups	YES
Supporting the smart meter rollout planning		YES

Appendix 3 - Further details from analysis of DCC's Allowed Revenue

A3.1 In Table A3.1 below we have provided further details on the components of each of the three cost areas considered in Chapter 5 (Price control change considerations), paragraphs 5.32-5.36 and Table 5.1.

Table A3.1 – Further detail of components of each cost area

Corporate Overheads	Costs to Operate	Costs to Change
• These are predominantly internal costs associated with the running of the business and include the following: ○ Finance ○ Commercial ○ People ○ Customer Experience ○ Regulation & Corporate Affairs ○ Other – including security, property etc.	• Operational costs for running the Network including Operational Management, Service Assurance, Customer Relationship Management, In life supplier management, Data and Analytics, Security Operations etc. • Costs of life BAU programmes and associated functional support. • Costs of maintenance and expected technology refresh.	• Change programmes in early stages of lifecycle, e.g. 4G Comms Hubs & Networks, DSP Data Systems or PKI enduring service • SEC Release management • Other change programmes ○ Functional support for programmes including costs for Business case development, Programme management, Technical design and Testing.