



Making a positive difference  
for energy consumers

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Dear company secretary,

**Approval of statement pursuant to paragraph 19.5 of condition 19 (Charging Statement for Service Charges) of Smart DCC Limited's Smart Meter Communication Licence<sup>1</sup>**

This letter sets out the basis for the Authority's<sup>2</sup> decision to approve the form of the Charging Statement for Service Charges (statement) prepared by Smart DCC Limited (DCC).

**Background**

What is DCC?

DCC is a new licensed entity that we regulate. It is a central communications body appointed to organise the communications and data transfer and management required to support smart metering. It is responsible for linking smart meters in homes and small businesses with the systems of energy suppliers, network operators and other companies (service users).<sup>3</sup>

DCC plans to develop and deliver these data and communications services by contracting with external service providers (service providers). We expect DCC to start offering data and communications services to its service users in late 2015. In the interim, DCC is taking steps to ensure that it can provide these services. These will involve testing the systems being built by the service providers to make sure they work together and work with the systems of the service users.

What does DCC's licence require?

The first form of the statement that DCC is required by its licence to have was approved by the Secretary of State.<sup>4</sup> Under its licence, DCC has to maintain the statement in a form that we have approved.<sup>5</sup> The statement must set out<sup>6</sup> the basis on which the charges that DCC will levy on service users for the provision of certain services under the Smart Energy

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<sup>1</sup> The Smart Meter Communication Licences were granted under both the Gas Act 1986 and the Electricity Act 1989. For ease, in this letter we refer to these licences in the singular.

<sup>2</sup> The Office of the Gas and Electricity Markets Authority (Ofgem) supports the Gas and Electricity Markets Authority ('the Authority') in its day-to-day work (in this letter, 'we' and 'us' are used to refer to both 'Ofgem' and 'Authority').

<sup>3</sup> Condition 4 of DCC's licence defines the activity that the licence authorises DCC to carry out in GB.

<sup>4</sup> Under condition 19.6 of the licence.

<sup>5</sup> Licence condition 19.5.

<sup>6</sup> Required by licence condition 19.4.

Code<sup>7</sup> ('service charges') will be payable. The statement must enable service users to make a reasonable estimate of the charges they will face and must be prepared in accordance with the charging methodology in the Smart Energy Code.

DCC's licence<sup>8</sup> requires it to periodically review the information in the statement. Further, at least once in each regulatory year (beginning on 1 April of each year), DCC must make any changes necessary to ensure the statement continues to be accurate and reliable. To provide as much financial certainty as possible for service users, the licence and the Smart Energy Code (Section J.4) further limits the ability of the DCC to amend the service charges more than once in each calendar year (subject to certain caveats).<sup>9</sup>

### What are we approving?

To be clear, we have no role in approving DCC's service charges (which are included in the updated form of the statement) in advance of the regulatory year commencing. Our approval is of the *form* of the statement. Ex post, we will have a role in assessing whether costs were economically and efficiently incurred. We set out more detail on this assessment under the "licence-related issues" heading below.

### **Initial submission and consultation**

On 24 December 2013 DCC submitted an updated statement to us. Compared to the 2013/14 statement, the changes DCC proposed included:

- General
  - paragraph numbering added
- Section 1 (Introduction)
  - explanation of the purpose of the statement added
  - signposting to charging documents on DCC website added
- Section 2 (Assumptions)
  - explanation of how the charging group<sup>10</sup> of export electricity suppliers is dealt with (specifically it is combined with import suppliers) added
- Section 5 (Invoicing and Payment)
  - explanation of what DCC will do if there is an unforeseen delay in invoicing added
- Annex section 1 (Introduction)
  - this section now signposts where further information on the topics covered in the main of the document can be found within the annex
- Annex section 2 (Estimated Fixed Revenue for Regulatory Year 2014/15)
  - explanation of how indexation is applied to various costs added
  - additional detail on what activities/resources contribute to the costs outlined in the table of high-level costs DCC estimates it will face. For example, more detail was provided on internal costs, changes to internal costs, baseline margin, external costs, as well as an explanation of the estimated correction factor
- Annex section 3 (Estimated Explicit Revenue for Regulatory Year 2014/14)
  - explanation of potential services that DCC may need to introduce explicit charges for in 2014/15 and how DCC would go about reflecting such charges into the statement added.

The statement was in the form that DCC expected to use for the regulatory year starting on 1 April 2014. We published the statement on 9 January 2014 and invited views on the form, in particular on whether it:

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<sup>7</sup> The Smart Energy Code is a new industry code. It is a multiparty agreement which defines the rights and obligations between DCC and service users

<sup>8</sup> Condition 19.14.

<sup>9</sup> Condition 19.11 also sets out conditions that must be met before the service charges can be amended more than once in a regulatory year.

<sup>10</sup> The charging groups are import electricity suppliers, export electricity suppliers, gas suppliers, electricity distributors and gas transporters.

- provides sufficient clarity on the charges that service users will face
- is in a coherent and easy to navigate format
- is accurate in all material respects.

We also asked whether DCC should use the latest registration data that would become available in March 2014.

We received seven responses to our consultation, two of which were from network companies and five of which were from energy suppliers.

## **Summary of responses and subsequent changes to the statement**

### Sufficient clarity on the charges that service users will face?

At least three of the respondents thought the statement broadly provided sufficient clarity. However, there were numerous minor points raised and broader questions around whether DCC has provided enough transparency and breadth of information around high-level costs.

#### *Transparency*

Various respondents generally requested more detail and transparency on what detailed activities (and associated costs) make up the high-level costs identified in the statement, with some detailed requests including:

- more detail on what costs the £7.6 million of prudent estimate is set aside for
- more cost breakdowns on the internal costs and changes to internal costs
- how many service users the DCC envisaged when estimating the testing software licence costs.

In response, DCC has added more detail to Annex A, in particular by adding detail at paragraph 30 to more fully explain the costs identified in table 4. For example, they have included a more detailed explanation of the prudent estimate and internal costs. They have also added a new line to table 4 to make clear that some of the changes to internal costs are due to changes to the baseline (a net reduction) and some are due to new scope (ie activities not envisaged during the licence application process).

When determining whether to approve the statement, we must consider the purpose of the statement, namely to allow service users to make a reasonable estimate of what charges they will be liable to pay DCC in 2014/15 in respect of the relevant services. The issue of transparency is of importance in more than just the statement. In that respect DCC:

- organised and presented at the commercial framework workshop on 20 March 2014
- provides updates on programme milestones at the monthly implementation managers forum and technical business design group
- plans to publish a redacted version of their licence application business plan in April 2014
- plans to start holding quarterly 'investor-style' calls after the publication of their indicative charging statement and indicative budget in July 2014.

#### *Charges regarding non-domestic premises*

One respondent suggested that there is a lack of clarity regarding the charges that non-domestic suppliers will face. DCC has provided additional detail at paragraph 13 to clarify that suppliers and network companies should not be charged in respect of non-domestic meter points in their portfolios. We encourage service users to continue to engage with DCC if they have further questions regarding the detail of their charges.

#### *Group weighting factors*

One respondent said they would like to see how the group weighting factors were calculated. At paragraph 15 DCC has provided an explanation of the approach used.

### *Size of charging groups*

One respondent asked about the impact on fixed charges for each charging group of counting export meters as import meters. We understand that DCC adopted this method because there is currently no accurate data source in terms of the number of export meters, and so they avoided estimating the impact on other charging groups as part of the statement. DECC informally consulted with SEC parties on whether DCC should follow this approach on a longer term basis. We understand from DECC that eight respondents were supportive of this transitional extension and agreed with DECC's view that the additional expenditure required to amend the current aggregate reporting does not appear justified given the very minor improvement it would provide to the precision of cost allocation.

### *Service provider performance incentives*

One respondent requested more detail on how the performance of external service providers could impact on future charges. DCC have provided additional detail at paragraph 30 bullet 6, including pointing towards the redacted contracts which are available on their website.

### *Worked examples*

There were various comments regarding the clarity of the worked examples, including requesting more examples and noting that the sample invoice is unrealistic as it includes both a network company and supplier. DCC have addressed this by adding an annex (Annex B), which contains three worked examples (a supplier, a dual fuel supplier and a network company).

There were also questions regarding the accuracy of the service user codes used by DCC. DCC have investigated this matter and believe that they used the correct codes. They committed to liaise separately with the respondent that raised this issue.

### *Pass-through costs*

One respondent asked various questions regarding the treatment of pass-through costs, including:

- who they should pay (DCC or the party the cost is being passed through to?)
- how indexation is applied to these costs
- what costs DCC may be liable to in terms of licence fees to the Authority.

DCC have provided further clarity on these points at paragraphs 25, 28 and 30 (bullet 7) respectively.

### *Ofgem view*

We consider that the charging statement provides sufficient detail in a clear enough manner to allow service users to make a reasonable estimate of the charges they will be liable to pay DCC for the relevant services.

### Coherent and easy to navigate format?

Most respondents broadly agreed that the statement was in a coherent and easy to navigate format. One respondent disagreed, but did not explain their view and noted that the format and layout is reasonably logical. Some respondents suggested ways that the statement could be improved.

### *Detail in the annex*

One respondent suggested that most of the useful information is in the annex and could be helpfully brought into the main of the statement. DCC have not taken this comment into account. Our view is that this is a minor presentational issue.

### *Acronyms*

One respondent suggested that future statements should contain definitions and acronyms. DCC has added a glossary as an annex (Annex C).

### *Ofgem view*

We agree with most respondents that the statement is coherent and easy to navigate.

### Is the statement accurate in all material respects?

Of the four responses to this question, two thought the statement was accurate in all material respects. One thought it was not possible to confirm until further detail was included in the statement. The final respondent said it was difficult to comment, and requested assurance from us that DCC is only recovering what is allowed (we deal with this point under the "licence-related issues" heading below).

### *Size of charging groups*

Respondents questioned the sources used to establish the size of the charging groups and why there are differences between the number of meters points associated with suppliers compared to those associated with network companies. One noted that they believe that not all parties have acceded to the SEC and that those suppliers that have are being overcharged. They wanted to know when those suppliers will accede and what process will be followed to reconcile the overpayments.

In terms of the sources used, DCC added this detail to the statement at paragraph 14. DCC also added explanation that the difference in number of meter points is due to some suppliers not having acceded to the SEC (we note that those numbers represent the status in December). There is no term in the charging methodology (section K of the SEC) that provides for reconciliation from those suppliers that did not accede to those that did. In a situation where DCC has incorrectly estimated the service charges such that their total recovery is more than allowed, this would be returned to services users, usually in the next regulatory year.

One respondent thought it unclear how a charging group of zero expected size (ie export electricity suppliers) can be assigned a positive weighting factor. This is how the SEC methodology works based on specifying price ratios; applying charges in this manner would not lead to any over or under recovery.

### *Ofgem view*

We consider that the statement is accurate in all material respects.

We note that some of the matters discussed above are simply reflections of how the charging methodology works. If service users have concerns with the methodology they should consider the routes available to modify the SEC.

### Should the latest registration data be used?

In our 24 December 2013 consultation we noted that DCC has estimated the size of the charging groups based on the registration data provided to it on 15 November 2013. We understood that more up-to-date data would be available in March 2014. We asked whether it would be preferable for the statement to reflect the latest available data.

Of the two respondents to this question, one noted that certainty of costs is helpful but that even if updated data was used, the impact on costs was unlikely to be material. The other noted that this issue is secondary compared with other issues.

### *Ofgem view*

We have no evidence that using the data from November 2013 will negatively affect consumers. We do however recognise that service users think there is benefit to cost certainty. We do not currently have plans to take any action in relation to the use of updated data, given the value service users place on cost certainty.

### Licence-related issues

Some respondents raised questions that relate to whether DCC is acting in accord with its licence, and how we are making sure DCC only recovers what it is allowed when it is bringing forward costs and setting its prudent estimate.

Due to DCC's unique nature and the new regime it will be operating in, an ex post price control regime was agreed as part of the competition to award the licence. DCC will incur costs and pass these onto service users. We will review these after the end of the regulatory year in which the costs were incurred, in our ex post review.

DCC must submit price control information on the previous regulatory year by 31 July in the following regulatory year. The price control reporting allows us to monitor DCC's compliance with its price control licence obligations<sup>11</sup> and assess the costs incurred with running DCC. The information will help us determine whether DCC incurred costs economically and efficiently. We may disallow costs or impose special measures on DCC to make it better manage its costs if we decide this was not the case.<sup>12</sup>

We are currently consulting on a draft set of cost and revenue reporting templates and the draft regulatory instructions and guidance (RIGs).<sup>13</sup> We will use the RIGs to monitor DCC's compliance with its obligations under the licence, in particular condition 36, which obliges it to take all reasonable steps to secure that regulated revenue does not exceed a prudent estimate of allowed revenue for that regulatory year. The prudent estimate should ensure that service charges do not need to be amended in the course of the year except in response to a reasonably unlikely contingency. This is consistent with section J of the SEC, which states DCC should only amend charges once in each year. A within-year change can only be made if the amendments are made in accordance with condition 19 of DCC's licence. Any over recovery and interest, which is a consequence of the prudent estimate, will be returned to users through a correction factor.

One respondent asked specifically about the DCC's ability to incur debt under its licence. Condition 27 of the licence places restrictions on the ways in which DCC can incur debt, create security, or have exposure to financial risks. If DCC were to incur debt it would need to make sure it was doing so in a way that was consistent with its licence obligations.

### *Baseline margin changes*

The value for the baseline margin for each regulatory year is set out in Appendix 1 to condition 36 of the licence. Respondents questioned the changes to the margin referred to in the statement. The licence was awarded on 23 September 2013 and will remain in place until 22 September 2025. However, the margin figure in the awarded licence incorrectly assumed an August 2013 award. As a consequence there is a slight misalignment between the margin set out in the licence and how it will actually be incurred. DCC addressed this phasing issue when they submitted their business plan. DECC will be adjusting the baseline margin in licence condition 36 to align it with the actual term of the licence and the business plan. This amendment will have no material impact on the total baseline margin over the term of the licence.

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<sup>11</sup> Chapter 9: conditions 35 to 41 set out the price control conditions of the licence.

<sup>12</sup> These powers are set out in condition 37 of the Licence.

<sup>13</sup> <https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-regulatory-instructions-and-guidance-consultation-0>

### *Visibility of costs*

Respondents raised issues of how the charges relate back to the impact assessment and the estimated value of the licence over the 12-year duration of £175 million.<sup>14</sup> The impact assessment and expected licence values are not directly comparable. They cover different time periods - the former is discounted to 2011 values whereas the latter is an estimate in nominal 2013 values. They were estimates based on the information available at the time and will not reflect the most recent changes. The estimated value at licence award reflects DCC's internal costs<sup>15</sup> associated with the scope agreed in DCC's licence application business plan<sup>16</sup>. However, the actual costs may be different as a result of new activities (eg set up costs of the smart metering key infrastructure - 'SMKI' - services), justifiable changes to planned activities and prudent budgeting. The statement has been amended to separate internal costs into changes to baseline competition costs and new scope changes.

As part of the ex post review we will scrutinise changes to the baseline competition costs and any costs incurred as a result of new scope. Under the draft RIGs, DCC will be required to provide definitions, justification and also explain how any new scope relates to the scope of baseline activities and existing projects.

Under section J of the SEC, DCC is required to produce indicative budgets and an indicative charging statement<sup>17</sup> within the first five working days of April, July, October and January each year. These forecasts, together with continued engagement with the development of the programme (eg DECC and industry workshops) should help service users with long-term business planning.

In the 2013/14 statement, DCC rephased £1.9 million of costs from 2014/15. A respondent questioned why this rephasing did not lead to lower charges in the 2014/15 statement, given these costs were brought forward. DCC has now provided an explanation for the net increase in the 2014/15 statement at paragraph 30 point 3.

### *Ofgem view*

We do not consider that the issues discussed above impact negatively on (including in light of subsequent changes DCC has made to the statement) whether the statement:

- provides sufficient clarity on the charges that service users will face
- is in a coherent and easy to navigate format
- is accurate in all material respects.

### Issues not relevant to statement

We received various comments that were not directly relevant to the content of the statement for 2014/15, including regarding:

- who is responsible for oversight and management of the external service provider contracts
- the format of, and detail in, indicative budgets and indicative charging statements
- whether DCC would start a charging forum that the industry can attend.

### *Ofgem view*

We recommend that DCC and service users continue to engage on these points.

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<sup>14</sup> DECC press release 8<sup>th</sup> October 2013. The estimated values of the contracts and licence have been rounded <https://www.gov.uk/government/speeches/award-of-smart-meters-dcc-licence>

<sup>15</sup> Under the licence "external costs" are those incurred when procuring Fundamental Service Capability (DSP and CSP costs), "internal costs" are costs incurred for the purposes of providing mandatory businesses services, which in the context of the licence may include services it procures externally (but are but not Fundamental Service Capability).

<sup>16</sup> We understand that DCC intends to publish a version of the licence application business plan on their website in April.

<sup>17</sup> The budgets will be for the second and third regulatory year due to start thereafter, and the indicative charging statement for next regulatory year.

**Authority's decision**

We have considered whether the proposed changes contained in the statement submitted by DCC are consistent with the requirements of condition 19 of DCC's licence and DCC's wider licence and statutory obligations. We have also had regard to our principal objective and general duties in considering the statement. We are satisfied that approval of the form of the statement is consistent with the above.

Pursuant to paragraph 19.5 of condition 19, the Authority hereby approves the form of the statement annexed to this letter.

Yours faithfully,

**Rob Church**  
**Associate Partner, Smarter Metering and Smarter Markets**

**Duly authorised on behalf of the Authority**