

Notice of Price Control Decisions, Determinations and Directions

To: Smart DCC Limited

1. This Notice of Decisions, Determinations and Directions is issued by the Gas and Electricity Markets Authority¹ ("the Authority") under the Licence² granted to Smart DCC Limited³ ("the Licensee").⁴

Purpose of this Notice

2. The Licensee is subject to price control provisions set out in Chapter 9 of the Licence. On 31 July 2014 the Licensee submitted to the Authority the Price Control Information relating to Regulatory Year⁵ 2013-2014⁶ as required by condition 32 of the Licence.
3. Licence Condition 36 Part C provides that the Licensee's Allowed Revenue⁷ in relation to Regulatory Year t⁸ is to be determined in accordance with the Principal Formula⁹. The Principal Formula includes terms reflecting:
 - a) IC_t , meaning the actual amount of the Licensee's Internal Costs¹⁰, as calculated for Regulatory Year t by the Licensee except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Licence Condition 37;
 - b) the BM_t meaning the Baseline Margin that is specified for the Regulatory Year t in Appendix 1 to Licence Condition 36, as multiplied by the price index adjuster for that year (which in Regulatory Year 2013/14 has the value of 1), as described in Licence Condition 36.8;
 - c) the $BMPA_t$, meaning the Baseline Margin Performance Adjustment, calculated for the Regulatory Year t in accordance with Part E of Licence Condition 36.
4. This Notice sets out the Authority's:
 - i. Direction excluding Unacceptable Costs in accordance with Licence Condition 37.8, on the basis that some Internal Costs were not economically and efficiently incurred;

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

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

³ Smart DCC Ltd is registered in England and Wales under Company Number 08641679.

⁴ All terms used in this Notice shall have the meaning given to them under the Licence, unless expressly stated otherwise.

⁵ Defined in Condition 1.4 of the Licence.

⁶ The first Regulatory Year 2013-2014 was a part year, however it was deemed to start on 1 April 2013 in accordance with the definition in Condition 1.4 of the Licence.

⁷ Defined in Condition 35.5 of the Licence.

⁸ The terms 'Regulatory Year t' and 'Regulatory Year t-1' are defined in Condition 35.5 of the Licence.

⁹ Defined in Part C of Condition 36 of the Licence.

¹⁰ Defined in Licence Condition 35, Part B of the Licence

- ii. Determination rejecting the Licensee's proposed Relevant Adjustment to the BM values specified in Licence Condition 36 Appendix 1, in accordance with Licence Condition 36 Appendix 2;
- iii. Determination of the term of the $BMIPA_t$ formula under Licence Condition 38.5.

ICt Internal Costs: Exclusion of Unacceptable Costs from any future calculation of the Licensee's Allowed Revenue

5. Under Licence Condition 37, Part B, the Authority may:

(a) direct that any External Costs or Internal Costs that it considers were not economically and efficiently incurred in the Relevant Regulatory Year (the "Unacceptable Costs") are to be excluded from any future calculation of the Licensee's Allowed Revenue under Condition 36; or

(b) accept an undertaking given by the Licensee with respect to the Unacceptable Costs on terms that relate to either or both of:

- (i) the Licensee's future management of those costs, and
- (ii) the Licensee's future procurement of Relevant Service Capability.

6. The Authority has considered the Licensee's reports¹¹ dated 31 July 2014 and further information submitted by the Licensee between 31 July 2014 and the close of the price control consultation on 21 January 2015. The Authority has consulted¹² the Licensee and other relevant stakeholders on its proposed decisions and has duly considered all responses received. The Authority has considered the matters set out in Part B of Licence Condition 37.

7. Having regard to the provisions set out in Licence Condition 37, the Authority considers that £0.100 million of the Licensee's Internal Costs were not economically and efficiently incurred¹³ and are Unacceptable Costs.¹⁴

8. The Authority has considered the undertaking offered by the Licensee as to its future management of the Unacceptable Costs. The Authority considers that the undertaking is not sufficient to ensure the Licensee will be able to avoid, prevent or mitigate a further occurrence of the same or any similar costs.

Direction as to Internal Costs

9. The Authority hereby directs, pursuant to Licence Condition 37.8 (a) that £0.100 million of the Licensee's Internal Costs are Unacceptable Costs and are to be excluded from any future calculation of the Licensee's Allowed Revenue under Licence Condition 36.

¹¹ The Price Control Information Report submitted under Condition 32 and the annual report on cost performance required under Condition 37.3 of the Licence.

¹² The DCC Price Control Consultation is available at: <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation>

¹³ Details of the Internal Costs that were not economically and efficiently allowed are set out in our Price Control Decision 2013/14 available at: <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-final-decision>.

¹⁴ Defined in Condition 37.8(a) of the Licence.

BM_t Baseline Margin Adjustment

10. Licence Condition 36 Appendix 1 ("Appendix 1") sets out the values for the BM term for each Regulatory Year. Licence Condition 36 Appendix 2 ("Appendix 2"), Part A, provides that the Licensee may propose a Relevant Adjustment to any one or more of the BM values specified for any one or more of the Regulatory Years. By Notice dated 31 July 2014, the Licensee proposed a Relevant Adjustment to the BM values specified in Appendix 1 for each Regulatory Year of the Licence. The Authority directed the Licensee to provide further information, which was received on 8 October 2014.
11. The Licence provides that the Authority will, at any time before the end of the Determination Period¹⁵, by direction given to the Licensee, determine any adjustment that is to be made to any BM value specified in Appendix 1 for the Regulatory Year to which that BM value relates. The Determination Period ends on 28 February 2015. The Authority must determine any adjustment that is to be made in accordance with Appendix 2 Part B.
12. In accordance with Appendix 2 Part B, the Authority has considered the proposal for a BM adjustment and the further information submitted by the Licensee and has consulted with the Licensee and SEC parties. The Authority has had particular regard to the purposes that the BM term is intended to serve within the Price Control Conditions of the Licence and the basis on which the BM values were agreed during the Licence Application Process with respect to the Licensee's expected rate of return on its activities over time. The Authority has taken no account of the Licensee's general financial performance under the provisions, taken as a whole, of the Price Control Conditions.

Determination as to BM_t Baseline Margin Adjustment

13. Having regard to the provisions of Appendix 2, the Authority hereby determines that the proposed Relevant Adjustment is rejected and that no adjustment should be made to the Baseline Margin values set out in Appendix 1.

BMPA_t Baseline Margin Performance Adjustment

14. Licence Condition 36.11 contains a formula for the calculation of the BMPA_t term for the Relevant Regulatory Year and provides that it is the BMIPA_t the value of which is determined in accordance with the provisions of Part B of Licence Condition 38. Licence Condition 38.5 provides a formula for the calculation of the BMIPA_t that contains terms relating to the Licensee's performance against certain Implementation Milestones.

¹⁵ Defined in Licence Condition 36 Appendix 2 Part E as being the period running from the close of the Application Window (ie 31 July 2014 for the Regulatory Year 2013/14) until the end of the first month of November after that closure, or such later date as may be directed by the Authority in a Counter-Notice served under Appendix 2 Paragraph A8. The Authority served such a Counter-Notice on 16 October 2014, which stated that the Determination Period would end on 28 February 2015.

15. The $BMIPA_t$ formula provides for each of its terms to be zero unless determined otherwise in accordance with such calculations as may apply to the term under the Implementation Performance Regime set out in Schedule 3 to the Licence.
16. Under Licence Condition 38.4 the effect of the BMIPA term is to provide for an adjustment to the Allowed Revenue of the Licensee, where appropriate, to reflect the Licensee's performance against certain Implementation Milestones and, subsequently, against other measures.
17. The Licensee did not meet Implementation Milestone 5 (IM5) of the Implementation Performance Regime.

Determination of the value of the term IM5_{t-1} for purposes of calculation of the value of the BMIPAt term

18. The failure to meet IM5 should be reflected in the Licensee's 2014/15 Allowed Revenue as part of the calculation of $BMPA_t$, which refers to IM values from the previous Regulatory Year ($IM5_{t-1}$). There is no previous Regulatory Year $t-1$ for the Licensee's first year of operation 2013/14. The Authority is therefore determining the value of IM5_t for Regulatory Year 2013/14. This will be the value of $IM5_{t-1}$ in the calculation of $BMIPA_t$ and, consequently, will be the value of $BMPA_t$ in the Principal Formula used to calculate the Allowed Revenue for Regulatory Year 2014/15.
19. Having regard to the conditions and calculations set out in Licence Condition 38 and Schedule 3 to the Licence, the Authority hereby determines that the term $IM5_t$ has the value negative £0.315 million.

Further Direction

20. Pursuant to its powers under Licence Condition 2 Part C, the Authority hereby directs the Licensee to provide to the Authority a calculation of its Allowed Revenue in accordance with the Principal Formula for Regulatory Year 2013/14 taking into account the determinations and direction above no later than 31 July 2015;
21. The Directions in this Notice have immediate effect and remain in effect until such time as the Authority may revoke or amend them in writing.
22. This Notice of Decisions, Determinations and Directions and the Data Communications Company (DCC): Price control decision 2013/14 dated 27 February 2015 together constitute notice of the Authority's reasons for the above decisions pursuant to section 38A of the Gas Act 1986 and section 49 of the Electricity Act 1989.

Rachel Fletcher

Senior Partner, Retail Markets

Duly authorised on behalf of the Gas and Electricity Markets Authority

27 February 2015