

2nd Floor, Ibex House
42-47 Minories
London
EC3N 1DY

Laura Nell, Head of Smart Metering
Smarter Metering Team
9 Millbank
Ofgem
London
SW1P 3GE

27th April 2015

Dear Laura,

Consultation on proposal to modify and issue new Regulatory Instructions and Guidance for the Data Communications Company under Part B of Condition 33 of the Smart Meter Communication Licence – DCC response

Introduction and background

The regulatory instructions and guidance (RIGs) set out the basis on which we must report key price control information to Ofgem.

On 24th March 2015, Ofgem published a consultation on proposals to modify the RIGs to provide further description and clarity. This letter sets out our response to that consultation.

We welcome Ofgem's review of the RIGs, particularly in light of its price control decision for Regulatory Year 2013/14 (RY 2013/14). Overall, we agree with the proposed changes which we consider will improve the level of clarity, subject to the points raised in this letter (see below).

On 27th February 2015, Ofgem issued its final determination in relation to its assessment of our costs in RY 2013/14. This was the final step in the first full round of a DCC price control.

We consider that it would be appropriate to keep the RIGs under regular review until DCC is in steady-state operation. We consider that this would be necessary to reflect the changing activity and environment and to reflect lessons learnt and principles established through the price control process.

We are also keen for guidance to be issued by the Authority which may provide further clarity on the price control process. Under condition 37, Part C of the Smart Meter Communication Licence the Authority may issue guidance setting out how it determines economic and efficient spend and the matters it will take into account in considering whether to give a direction or accept an undertaking. We consider that this guidance will allow us to further and/or better understand

reporting requirements, provide better quality information as part of our price control submission and remove any ambiguity around the process and timeline to propose a potential undertaking.

Corporate overhead charge

Paragraph 5.20 of the proposed RIGs sets out the submission requirements in relation to the corporate overhead charge (referred to in the proposed RIGs as the “shared service charge”). We would like to provide clarity on what this charge represents. The corporate overhead charge reflects an allocation of corporate group overhead of our parent company and is not directly based on our use of central group services. The charge recovers group overhead which is not the same as a ‘shared service’, albeit benefits still accrue either directly or indirectly. There are goods and services that we obtain from our parent company which form part of the ‘shared service infrastructure’, such as employee desktop services. These are separate from the corporate overhead and are charged to DCC directly, based on usage.

We suggest that the term “shared service” is replaced with “corporate overhead” and that paragraph 5.20 is replaced with the following text:

Corporate Overhead charge: means the amount paid by the Licensee in respect of a corporate overhead fee charged by the Licensee’s parent company. Links between the costs not incurring corporate overhead row and Tab 9 will calculate the corporate overhead charge (i.e. the corporate overhead row should not be modified by the Licensee). The central overhead covered by the corporate overhead charge is set out in the embedded DECC Licence Model.

In the proposed explanation for the corporate overhead charge, we suggest removing the reference to Section 3.3.1 of the LABP, as this refers to internal support functions that are a mixture between services provided under the ‘shared service infrastructure’ (described above) and services that are part of the corporate overhead.

Paragraph 5.21 of the proposed RIGs sets out a list of examples of services provided in return for the corporate overhead charge, we would like to highlight that this is not an exhaustive list.

Internal Costs by Operational Service Requirement

Paragraph 5.32 places a requirement on DCC to report Internal Costs by Operational Service Requirement (OSR).

Originally, OSRs were used during the Licence Application Process to bring together the anticipated requirements for prospective Licensees. The OSRs were made up of:

- Elements of draft versions of the Licence, the Smart Energy Code and contracts with providers of Fundamental Service Capability (draft versions of which were provided to bidders);
- Elements of relevant legislation; and

- DECC's view of further potential requirements on the prospective Licensee, including elements of 'best practice' (note that these had not been consulted on and therefore had not been introduced into the regulatory framework).

We consider that there is minimal value in reporting at an OSR basis since this information is only produced for price control reporting, and is not used internally within the business or by management for either reporting or analysis. Furthermore, we do not consider that OSR reporting provides useful information to our stakeholders. We have found that stakeholders focus their questions (during meetings and quarterly financial updates) on specific cost areas, and so using cost categories and drivers to explain our costs is more useful to them. None of our reports, presentations and/or meetings with stakeholders refers to OSRs and no stakeholder has requested information by OSR.

We understand that it may have been considered important to maintain OSR reporting for the purpose of a future Licence Application Process, to be conducted by the Authority, in the run up to the end of the current Licence. However, it is our understanding that OSRs were not intended to be maintained beyond the comparison of bidders in the original Licence Application Process, and that they would play a reduced role in documenting the requirements of DCC¹. Furthermore, the basis for the formation of the original OSRs has transformed significantly since Licence award, and there are likely to be further changes necessitated by new initiatives². We do not consider that OSR reporting would be relevant for those services since the OSRs makes no reference to the introduction of dual-band Communications Hubs and the approach to Enrolment and Adoption in the OSR no longer aligns with government policy.

We recognise that the Authority, in running the procurement of a future Licence award, may need to create the equivalent of the OSRs at that point in time. Whilst some elements of the old OSRs may aid this process, they are very likely to be fundamentally different. Under our Licence, we are required to co-operate with the Authority and the successor Licensee to in order to secure the continuity of, and an orderly handover of control of, the Authorised Business, the provision of supplies or services in connection with that business, and the effective operation of any asset in connection with it³. At that stage, it may be more appropriate to develop new OSRs.

We consider that the production of this information, for price control reporting only, is an unnecessary reporting burden. Therefore, we suggest that the requirement for reporting Internal Costs by OSR is removed.

Procurement for Relevant Service Capability

In Section 7 of the proposed RIGs, "Specified Information – supporting questions" a number of changes have been proposed to the question on the procurement of Relevant Service Capability. We have broken down the question by sub-section as follows:

¹ This is stated in Section 3.2 of our Licence Application Business Plan

² The Licence, the Smart Energy Code, and the contracts with providers of Fundamental Service Capability; have all developed considerably since the award of the Licence. There are also upcoming new initiatives that are likely to necessitate further e.g. Enrolment and Adoption, dual-band Communications Hubs, alternative HAN proposals, Centralised Registration etc.

³ Licence Condition 43.18(a)

1. If the Licensee has undertaken or intends to provide Relevant Service Capability from its own resources or has undertaken or intends to undertake procurement of Relevant Service Capability from an Affiliate or Related Undertaking, or from elsewhere, in accordance with Licence Condition 16.6: please explain how the Licensee, having regard to the principles set out in Part B of Licence Condition 16 (excluding Principle 2), has satisfied itself that the provision or procurement of capability in that way, would be the most economical and efficient option; or would be immaterial in terms of its value or use of resources within the overall context of the Mandatory Business of the Licensee.
2. Please explain how this is in line with the Licensee's procurement strategy, and how value for money was or will be secured through the provision from the Licensee's own resources and/or through procurement process, as the case may be.
3. If the Licensee has undertaken any procurement of Relevant Service Capability, please provide assessments and key documents supporting the outcomes of those decisions.
4. Please report on any review that has been carried out on the goods and services procured (including shared services) from an Affiliate or a Related Undertaking or elsewhere, or provided from the Licensee's own resources, and how value for money is being secured on an ongoing basis.

We have a number of observations about the proposed changes to the question, these are set out below.

Part 1 of the question requires DCC to "explain how the Licensee, having regard to the principles set out in Part B of Licence Condition 16 (excluding Principle 2), has satisfied itself that the provision or procurement of capability in that way, would be the most economical and efficient option; or would be immaterial in terms of its value or use of resources within the overall context of the Mandatory Business of the Licensee." We are assuming that this question introduces a requirement for us to explain the process we undertake for all procurements, as opposed to providing detail for individual procurement exercises. We would welcome clarification on whether our assumption is consistent with the intent.

Part 2 of the question requires DCC to "explain how this is in line with the Licensee's procurement strategy and how value for money was or will be secured through the provision from the Licensee's own resources and/or through procurement process, as the case may be". The current Procurement Strategy for Relevant Service Capability was put in place in September 2014⁴. We would like to highlight that our price control submission in relation to this question for RY 2014/15 will reflect the fact that for the first 6 months, of RY 2014/15, the Procurement Strategy for Relevant Service Capability was not yet in place. In terms of the question around 'value for money' it is unclear as to how this question differs from the previous question relating to how we have satisfied ourselves that procurements are economic and efficient.

Part 3 of the question states: "If the Licensee has undertaken any procurement of Relevant Service Capability, please provide assessments and key documents supporting the outcomes of those decisions." We suggest that this is amended so that it refers to "material" procurements of Relevant Service Capability rather than "any". The volume of documentation relating to

⁴ Licence Condition 16.19 states that DCC must put in place its Procurement Strategy for Relevant Service Capability within 12 months after the Licence Commencement Date.

procurement can be vast and we consider that it would be proportionate to provide documentation relating to material procurements only.

Part 4 of the question also asks us to “report on any review that has been carried out on the goods and services procured”. We are assuming that this could be in the form of an internal or external review, and we consider that potential examples of such reviews may include service reports,, compliance officer reports and internal organisation and governance reports. We would welcome confirmation that this interpretation is consistent with the intention.

Part 1 of the question requires DCC to provide information in circumstances where “the Licensee has undertaken or intends to provide Relevant Service Capability from its own resources or has undertaken or intends to undertake procurement of Relevant Service Capability from an Affiliate or Related Undertaking, or from elsewhere, in accordance with Licence Condition 16.6”. Given the understanding that Relevant Service Capability represents all activities, in all circumstances we would have undertaken or provided it using one of the three methods described in the question. We are, therefore, unsure as to why the questions starts “If the Licensee has...” unless it applies only to new Relevant Service Capability we have provided or procured (or we intend to provide or procure) in a given Regulatory Year. We note that this wording is also used in part 3 of the question. We would welcome clarification on this requirement.

Implementation Performance Regime

Paragraph 4.19, of the proposed RIGs, explains the inputs to be populated in the revenue reporting worksheet which calculates $BMIPAt$.

In accordance with condition 3.9 of Part F of Schedule 3 of the Licence, we are currently undergoing a general review of the Implementation Milestones. The results of this review may change the structure of the Implementation Milestones in Schedule 3 of the Licence which may not come into effect until after July 2015. We anticipate that you will make your determination based on the Licence conditions at that time. However, we would like to notify you that we plan to report for RY 2014/15 on the basis of what we expect to be in force in the Licence at the time of your determination. We will fully explain this in our price control submission.

DECC is currently consulting on changes to the definition of BMIT (Baseline Margin Implementation Total) which is used to calculate $BMIPAt$ (Baseline Margin Implementation Performance Adjustment), to remove potential ambiguity. The existing BMIT is based on the total of DCC’s Baseline Margin for the period running from licence award until the end of the Regulatory Year in which implementation is defined as being completed, subject to amendments for inflation. DECC is proposing to amend the definition to remove reference to the “completion of implementation” and replace with “RY 2015/16”.

We note that bullets 1 and 2 in paragraph 4.18 of the proposed RIGs sets out an explanation of BMTA (Baseline Margin Performance Adjustment) which includes a reference to the “completion of implementation”. We suggest that the RIGs refers to the relevant section of the Licence for the definition for BMTA, instead of restating parts of the definition itself in the RIGs - this may avoid any potential inconsistency between the Licence and the RIGs following any Licence amendment during the Regulatory Year.

DECC is also proposing to include provisions in the Licence for potential further reviews of the Implementation Milestones. We would suggest that the templates support this potential flexibility.

Next steps

We are content for this response to be published on your website. We look forward to the conclusions of this consultation.

If you would like to discuss any of the issues discussed in this letter please contact fatimah.arif@smartdcc.co.uk.

Yours sincerely,



Paul Hawkins
Regulation Director