

# DCC's role in developing a Central Registration Service and penalty interest proposals

## Consultation

**Publication date:** 28 July 2015

**Response deadline:** 22 September 2015

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### Overview:

Ofgem is leading a programme to deliver fast, reliable switching on a new Central Registration Service (CRS).

We are consulting on new obligations for the Data and Communications Company (DCC) to support the development of these new market arrangements, its funding, and consequential changes to its licence.

We are also taking the opportunity to review the arrangements in DCC's licence that allow it to make a prudent estimate of its allowed revenue when setting charges.

## Context

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Smart DCC Limited is referred to as the Data and Communications Company (DCC). It is a central communications body appointed to manage communications and data transfer for 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. DCC will develop and provide data and communications services for smart meters through its external service providers. The Department of Energy and Climate Change (DECC) granted Smart DCC Ltd the Smart Meter Communication Licence ("DCC's licence")<sup>1</sup> on 23 September 2013.

We want to use the opportunities provided by the rollout of smart metering to make the switching process faster and more reliable for consumers.

## Associated documents

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- *Moving to reliable next-day switching: Decision*. Ofgem, 10 February 2015  
[https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast\\_and\\_reliable\\_switching\\_decision\\_final.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast_and_reliable_switching_decision_final.pdf)
- *Moving to reliable next-day switching: Target Operating Model and Delivery Approach: Consultation*. Ofgem, 10 February 2015  
<https://www.ofgem.gov.uk/publications-and-updates/target-operating-model-reliable-next-day-switching>
- Smart Meter Communication Licence  
<https://epr.ofgem.gov.uk/Document>
- *DCC Price control Decision document*. Ofgem, 27 February 2015  
<https://www.ofgem.gov.uk/ofgem-publications/93650/1502dccdecisionfinal.pdf>

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<sup>1</sup>The Smart Meter Communication Licences granted pursuant to Sections 7AB(2) and (4) of the Electricity Act 1989 and Sections 6(1A) and (1C) of the Gas Act 1986. This consultation is being conducted in respect of both of those licences. Together, those licences are referred to as 'the licence' throughout this document.

## Contents

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|   |           |
|---|-----------|
| <b>Executive Summary</b>                                | <b>4</b>  |
| <b>1. Introduction</b>                                  | <b>6</b>  |
| <b>2. Registration and switching arrangements</b>       | <b>9</b>  |
| <b>3. Recovery of costs</b>                             | <b>13</b> |
| <b>4. Licence and SEC changes</b>                       | <b>18</b> |
| <b>5. Penalty interest proposals</b>                    | <b>24</b> |
| <b>6. Next Steps</b>                                    | <b>31</b> |
| <b>Appendix 1 - Consultation response and questions</b> | <b>32</b> |
| <b>Appendix 2 – SLC 15 proposed drafting</b>            | <b>35</b> |
| <b>Appendix 3 – Switching Programme phases</b>          | <b>39</b> |
| <b>Appendix 4 – Draft guidance on SLC 15</b>            | <b>42</b> |
| <b>Appendix 5 – Cost recovery options</b>               | <b>46</b> |
| <b>Appendix 6 – Consequential changes</b>               | <b>51</b> |
| <b>Appendix 7 – Review of prudent estimate</b>          | <b>54</b> |
| <b>Appendix 7 - Glossary</b>                            | <b>57</b> |
| <b>Appendix 8 - feedback questionnaire</b>              | <b>63</b> |

## Executive Summary

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Ofgem<sup>2</sup> is leading a programme to deliver fast, reliable switching on a new Central Registration Service (CRS). DCC will have a crucial role in developing the new registration and switching arrangements, including the procurement of the CRS.

We propose changes to DCC's licence to establish its role in supporting the development of the new switching arrangements, including how this activity would be funded.

We want to ensure that DCC is appropriately funded and has clear obligations that describe its role in supporting the Switching Programme. This will also ensure that it is not impeded in meeting its smart meter obligations.

The scope of the licence changes in this consultation are limited to those that are required for DCC to support the development of the design for the CRS, including the new switching arrangements, as well as procuring the Relevant Service Capability to deliver the CRS. We may amend the licence further as appropriate to cover the delivery of the CRS and its live operation.

### **Summary of our proposals on switching**

We welcome views on our key proposals, which include:

- New obligations on DCC to procure the CRS and contribute to its design, including the new switching arrangements
- Allowing DCC to recover the economic and efficient costs it incurs for participating in this transitional phase through the existing ex post price control framework.
- Recovery of costs through the existing charging methodology.
- Including the preparation for CRS as a new category of mandatory business service.

### **Penalty interest proposals**

In addition to the proposals on switching we are also taking this opportunity to review the arrangements in DCC's licence that permit it to take a prudent estimate of

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<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 document, 'us/we', 'Ofgem' and 'Authority' are often used interchangeably.



## DCC's role in developing a Central Registration Service and penalty interest proposals

its allowed revenue when setting charges. We are seeking views on introducing a regime for a penalty interest rate regime for over charging, and the form this could take.

### **Next steps**

We welcome your views on the issues raised in this consultation, and will consider them when we take our decision. Please send responses to [smartermarkets@ofgem.gov.uk](mailto:smartermarkets@ofgem.gov.uk) by 22 September 2015. We aim to publish the statutory consultation in winter 2015.

# 1. Introduction

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## Background

### Data Communications Company (DCC)

1.1. DCC is a central communications body licenced to provide the communications, 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.

1.2. DECC granted the DCC's licence on 23 September 2013 following a licence competition. The licence is for 12 years and will remain in place until 22 September 2025, unless it is extended or revoked. DECC also established price control arrangements that restrict DCC's revenues, to counter its monopoly position.

### Registration services

1.3. In February 2015, we set out our decision<sup>3</sup> to radically overhaul and re-engineer the switching arrangements. This included requiring DCC to put in place a new Central Registration Service (CRS) that can deliver fast and reliable switching.<sup>4</sup> We have established a Switching Programme to design and deliver these changes.


1.4. Registration services are currently provided separately by gas and electricity networks, and the switching rules are significantly different in both markets. Registration services provide the definitive record of each gas and electricity supply point in the GB market including: the identity of the supplier, the address and unique reference number as well as site characteristics, such as whether it is domestic or non-domestic. We want to harmonise registration services, simplify the switching arrangements and provide a common platform for reliable and fast switching for all customers.

1.5. In addition to switching, registration services support other essential market functions such as energy balancing and settlement, network charging and smart metering.

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<sup>3</sup> Moving to reliable next-day switching: Decision. Ofgem, 10 February 2015  
[https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast\\_and\\_reliable\\_switching\\_decision\\_final.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast_and_reliable_switching_decision_final.pdf)

<sup>4</sup> In this document, unless specifically stated, references to the CRS are references to its role as a register of relevant information on gas and electricity supply points in the GB market, to the arrangements to facilitate fast and reliable switching and the provision of information to support a wide range of other market functions including the balancing and settlement of gas and electricity, network charging and smart metering.



## DCC's role in developing a Central Registration Service and penalty interest proposals

1.6. We want DCC to be responsible for procuring the CRS in its licence. The detailed rules for how the registration service will operate will be set out in the smart energy code (SEC).

1.7. In this document we consult on proposals to amend DCC's licence to clarify the role that DCC should play in developing the new market arrangements. These new licence obligations will provide certainty to DCC on its role. They will also set the boundaries of the activities that DCC, as a price controlled entity, can recover costs for.

1.8. Our proposals aim to ensure that DCC has clearly defined requirements and funding to support the Switching Programme so that this role does not jeopardise the delivery of its other requirements on smart metering. We note that DCC's smart meter requirements set out in the Interim General Objectives (LC 5) take precedence until 2018.<sup>5</sup>

### Context for the changes

1.9. We have identified five phases for the Switching Programme. These are described in Appendix 3. This consultation covers DCC's activity during the first three phases:

- Blueprint Phase,
- Detailed Level Specification Phase, and
- Enactment Phase.

1.10. We consider that DCC should be appropriately funded so that it can actively participate in industry workgroups to establish the high-level design in the Blueprint Phase. These workgroups will start by the end of the year. We want DCC to continue to contribute to the design during the Detailed Level Specification Phase. In addition, we want DCC to contribute to the development of the modifications to industry codes and licences, and procure the Relevant Service Capability, during the Enactment Phase. DCC's full and active participation in these three phases should help to ensure that relevant issues are considered and explored to help avoid unforeseen consequences that delay implementation.

1.11. The scope of the licence changes in this consultation is limited to that required for DCC to be involved in this preparatory work until the Relevant Service Capability for the CRS has been procured, ie up to the end of the Enactment Phase. The changes proposed in chapters 3 and 4 should ensure that DCC is not impeded in

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<sup>5</sup> In addition, DCC has obligations to ensure it has sufficient resource to fulfil all of its defined mandatory business. We propose to include the CRS alongside DCC's smart meter obligations within the scope of mandatory business.

## DCC's role in developing a Central Registration Service and penalty interest proposals

meeting its smart meter obligations. Our proposals should ensure DCC is appropriately funded for CRS, and that DCC's obligation of contributing to the achievement of a full, timely, efficient, economical, and secure Completion of Implementation<sup>6</sup> in relation to smart metering remains its priority until it occurs.

1.12. The scope of DCC's enduring role, the detailed design and technical specification and the regulatory framework and the enduring commercial arrangements will all be discussed as part of working groups in the Switching Programme.

1.13. In our February 2015 decision document on fast and reliable switching<sup>7</sup>, and accompanying consultation on the target operating model (TOM)<sup>8</sup>, we set out the expected enduring role of DCC in providing the CRS in live operation.

### Penalty interest proposals

1.14. We are also taking this opportunity to seek views on a range of options in relation to prudent estimate. In our price control decision document for the Regulatory Year 2013/14<sup>9</sup> we committed to monitor the use of the prudent estimate provision<sup>10</sup>, and to consider whether the prudent estimate provision places the right incentives on DCC. We also said we would consider future potential changes to DCC's licence to ensure the incentives to estimate allowed revenue are right.

1.15. We have looked at the penalty interest rate arrangements faced by networks for over-charging. In chapter 5, we consider different approaches to introducing a penalty interest rate regime for DCC.

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<sup>6</sup> Completion of Implementation as defined in licence condition 5, Part C.

<sup>7</sup> Moving to reliable next-day switching: Decision. Ofgem, 10 February 2015

[https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast\\_and\\_reliable\\_switching\\_decision\\_final.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/fast_and_reliable_switching_decision_final.pdf)

<sup>8</sup> <https://www.ofgem.gov.uk/publications-and-updates/moving-reliable-next-day-switching-consultation-target-operating-model-and-delivery-approach>

<sup>9</sup> Price Control Decision 2013/14

[https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/1502\\_dcc\\_decision\\_final\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/1502_dcc_decision_final_0.pdf)

<sup>10</sup> Under the licence DCC can take a prudent estimate of its estimated allowed revenue when it is setting its charges.



## 2. Registration and switching arrangements

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### Chapter summary

In this chapter we propose changes to DCC's licence that will require the DCC to contribute to the design of the CRS that will be the platform for fast and reliable switching and procure Relevant Service Capability to deliver this service.

**Question 1:** Do you agree with our proposals to amend LC 15 of DCC's licence (including the proposed legal changes described in Appendix 2)?

**Question 2:** Should DCC be required to document the design of the CRS (including the new switching arrangements)?

**Question 3:** Should DCC be required to draft the required modifications to the SEC and/or other related industry codes?

**Question 4:** Should the Authority take a broad power to direct DCC on the preparation for the new arrangements, including the ability to stop its activity?

**Question 5:** Do you agree with our proposal to provide guidance to DCC on its licence and the draft content set out in Appendix 4?

### Replacing LC 15

2.1. Licence condition (LC) 15 of DCC's licence currently allows the Secretary of State to issue a direction to DCC to secure the incorporation of energy registration services into the services provided under the SEC.

2.2. The joint responsibilities letter<sup>11</sup> published last year sets out that Ofgem, rather than DECC, is now leading the Switching Programme. We propose to remove the current requirements in LC 15 and replace them with a new set of obligations which reflect this arrangement.

2.3. Retaining the existing Secretary of State powers could cause confusion on roles and responsibilities and what mechanism will be used to require DCC to undertake preparatory activity.

### New objective

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<sup>11</sup> <https://www.ofgem.gov.uk/publications-and-updates/implementation-and-regulation-smart-metering-open-letter-industry>



## DCC's role in developing a Central Registration Service and penalty interest proposals

2.4. As a key stakeholder in the Switching Programme, DCC should have a clearly defined and funded role to support development of the new arrangements. This will also help to ensure that DCC retains sufficient focus on delivering its smart meter obligations. To facilitate this, we will introduce a new Interim Central Registration Service Objective for DCC (referred to in this chapter as the "new objective"). The components of the new objective are described in the section below.

### **Designing the CRS and switching arrangements**

2.5. The proposed new objective would require DCC to contribute to the achievement of a full and timely design for an efficient, economical and secure CRS that will facilitate fast and reliable switching.

2.6. We welcome views on whether DCC should be required to document the design of the new arrangements as they will appear in the SEC. We also welcome views on whether DCC should be required to produce the legal drafting for the changes to the SEC and the other affected industry codes to implement that design.

2.7. A number of parties could perform these roles. Our current view is that the Smart Energy Code Administrator and Secretariat (SECAS), supporting the SEC Panel, is well placed to document the design. It is also well placed to lead the drafting of the legal changes to the SEC with support from other code bodies regarding their respective industry rules. This has the advantage of making best use of existing expertise and would retain the detailed knowledge with those organisations that would administer the codes.

2.8. However, there may be advantages in requiring one party, such as DCC, to retain ownership of relevant design documentation so that there is consistency with the products that it will develop to procure the Relevant Service Capability, including the technical service design. There may also be advantages, in terms of consistency, in DCC drafting the changes to industry codes. In this case, the changes would be subject to consultation to ensure the quality and appropriateness of the documents.

### **Procuring Relevant Service Capability**

2.9. The proposed new objective would also require DCC to undertake all relevant preparatory steps and then to procure the Relevant Service Capability that would build, test and operate the CRS.

2.10. We intend to designate the design specification against which DCC must procure the Relevant Service Capability. This will provide clarity on when the design is considered to be sufficiently mature to establish these service contracts. We expect to designate this design when we approve the modifications to the codes required to implement the design at the end of the Enactment Phase.



## DCC's role in developing a Central Registration Service and penalty interest proposals

2.11. We have not proposed any incentive mechanisms or other requirements at this stage for DCC's procurement. We will consider this further during the Blueprint Phase and welcome any initial views from stakeholders.

### **Duration of the new objective**

2.12. The proposed obligations cover the period from licence condition implementation until the point that the Relevant Service Capability to deliver the CRS has been procured by DCC. In the event that this requires more than one contract to be entered into, we expect this to be when all relevant contracts have been entered into.

2.13. Once the Relevant Service Capability has been procured at the end of the Enactment Phase, subject to the industry working groups we may replace the new objective with an enduring objective. The enduring objective would cover the requirement to build and test the CRS and its operation after go-live. We propose to develop the enduring objective in the Blueprint phase.

2.14. Our planning assumption is that the Relevant Service Capability should be procured by 2018.


### **Directions and guidance**

2.15. The registration service is a fundamental building block of the market. It must be designed to the highest standards with regulatory arrangements that secure reliable, economic and efficient outcomes for consumers and the industry. We therefore propose to take a power to direct DCC to undertake activities that we consider will best meet the requirements of the new objective.

2.16. The power to direct DCC will provide flexibility to respond to the changing requirements of the Switching Programme and give DCC additional clarity on the areas where it should focus its work.

2.17. To help manage uncertainty, this power to direct DCC will allow Ofgem to stop it undertaking all or part of the activities required by LC 15. This may, for example, be necessary if DCC or other industry parties need to prioritise other work areas. We welcome views on whether this is a sensible safeguard.

2.18. The nature of an objective-based licence condition means that DCC will be required to think widely to ensure that it does everything reasonably required to meet its objective. We want DCC to take ownership of its new objective without the need to seek advance approval or guidance from Ofgem as a matter of course. However, where Ofgem provides guidance, we expect DCC to take it into account.



## DCC's role in developing a Central Registration Service and penalty interest proposals

2.19. To assist at this early stage in the Switching Programme we have set out initial views in appendix 4 on the non-exhaustive activities that we would expect DCC to consider in relation to its objective. We welcome views on this guidance.

### 3. Recovery of costs

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#### Chapter summary

We think DCC should be appropriately funded to participate in the transitional phase of CRS. This chapter is an overview of the options considered for how DCC could recover costs for CRS. We also look at the materiality of the costs associated with the transitional phase.

**Question 6:** Do you agree with our preferred option that DCC should recover costs through the existing ex post price control framework?

**Question 7:** What are your views on introducing an ex ante control for the procurement costs?

**Question 8:** Do you agree that DCC should be able to recover costs it incurs for participation in the transitional phase 2015/16?

**Question 9:** What are your views on introducing incentives in relation to the activity DCC takes under LC15, particularly its procurement activities?

#### Our preferred option

3.1 We propose that DCC should be able to recover the economic and efficient costs it incurs for participating in this transitional phase<sup>12</sup> through the existing ex post price control framework. We consider that this is proportionate given there is still uncertainty regarding the role DCC may have in CRS, also the limited time any changes made will be in place for, and given the arrangements will be reviewed as part of the industry working groups.

3.2 We welcome views on introducing an ex ante control on the procurement costs, where there should be less uncertainty regarding DCC's activity and where these costs can be benchmarked.

3.3 As part of the industry working groups we would recommend that all models of cost recovery are considered for the enduring framework.

#### The current framework

3.4 Price control arrangements restrict DCC's revenues, to counter its monopoly position. We have a role in ensuring that costs are incurred economically and efficiently. DCC incurs costs and passes these onto users under its ex post framework. We review these costs after the end of the regulatory year in which the costs were incurred. DCC must submit price control information by 31 July after the end of each regulatory year.

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<sup>12</sup> The transitional phase refers to the first three phases of the Switching Programme, as set out in chapter 1.

## DCC's role in developing a Central Registration Service and penalty interest proposals

3.5 Using this information, we carry out an assessment of the costs reported. If we consider that costs are not economic and efficient these will be Unacceptable Costs<sup>13</sup> under the DCC licence.

3.6 Under the DCC licence, DCC is only entitled to recover costs that are part of its allowed revenue. DCC's allowed revenue is the amount that can be recovered through service charges for the provision of mandatory business services.<sup>14</sup>

3.7 These are defined as Core, Elective and Enabling services.<sup>15</sup> Under its current framework DCC is not able to include the preparatory work for CRS as part of its costs. This would mean DCC is unlikely to be able to appropriately fund its participation in the industry working groups or the preparation and procurement of Relevant Service Capability to deliver the CRS. We want to make sure that DCC is appropriately funded and has clear obligations that describe its role in relation to CRS to ensure DCC is not impeded in meeting its smart meter obligations.

### Overview of options

3.8 We propose that the preparation for CRS is included as a new category of mandatory business service cost, this is set out in chapter 4. Based on this assumption we have looked at a number of different cost recovery models. We considered the benefits and risks of the following models:

- **No change to the licence:** DCC is not able to recover its costs
- **Ex ante controls:** Costs are agreed before they incurred. We have considered variations of this approach with uncertainty mechanisms.
- **Ex post controls:** The current framework where DCC incurs costs and we determine whether they are economic and efficient.
- **Full Co-operative Model:** Industry control the costs of the central registration provider

3.9 Our options analysis supports that an ex post approach should be used for the transitional arrangements. The main reasons are:

- There is still a great deal of uncertainty regarding the scope of DCC's activity during this phase.
- If the scope of activity and the cost of the activity is very uncertain, then there is very little basis on which to establish an ex ante allowance

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<sup>13</sup> Unacceptable Costs are defined in Licence Condition 37.8(a) of DCC's licence.

<sup>14</sup> Mandatory business services means the services comprising the mandatory business of the Licensee, namely (i) the Core Communication Services, (ii) the Elective Communication Services, and (iii) the Enabling Services in each case as operated or provided by the Licensee in accordance with the relevant provisions of Condition 17 (Requirements for provision of Services)

<sup>15</sup> Defined in Licence Condition 1 of the DCC licence

## DCC's role in developing a Central Registration Service and penalty interest proposals

- The uncertainty is beyond the control of DCC it will be dictated by what comes out of the working groups and Significant Code Review (SCR) preparation work
- An ex post framework would provide flexibility
- Industry working groups are looking at the enduring arrangements, which could mean any changes made will be in place for only a short period of time.

3.10 Table 3.1 is an overview of our analysis. A detailed analysis of the options is set out in appendix 4.

**Table 3.1 Overview of cost recovery models**

| Option   | Benefits   | Risk  | Assessment                                   |
|--|--|---|--|
| <b>1. No change</b><br><i>We do not put in place arrangements for DCC to recover costs</i>   | <ul style="list-style-type: none"> <li>• Strategic growth opportunity</li> <li>• Could incentivise efficient use of resources</li> </ul>   | <ul style="list-style-type: none"> <li>• Constrain DCC's input as its use of resources must not be material.</li> <li>• The right level of technical input is not provided</li> </ul> | May constrain quality of work                |
| <b>2. Ex ante controls</b><br><i>2A Predetermined internal cost</i><br><i>2B Registration term</i><br><i>2C Uncertainty mechanisms</i> | <ul style="list-style-type: none"> <li>• It provides certainty on costs</li> <li>• Provides incentive on DCC to control costs</li> <li>• Risks stay with DCC, who is best placed to manage them</li> </ul> | <ul style="list-style-type: none"> <li>• Uncertainty and difficulty defining the role for the period</li> <li>• In place for a few years</li> </ul>                                   | Should be explored for enduring arrangements |
| <b>3. Ex post controls</b><br><i>Included as part of cost under current framework and subject to cost assessment</i>                   | <ul style="list-style-type: none"> <li>• Provides more flexibility on role</li> <li>• Practical given timescales for the project and materiality of cost</li> </ul>  | <ul style="list-style-type: none"> <li>• Less certainty on costs</li> </ul>   | Provide flexibility and control of costs     |
| <b>4. Full Co-operative Model</b><br><i>Industry review the costs related to central registration services</i>                         | <ul style="list-style-type: none"> <li>• Reduces regulatory burden</li> </ul>  | <ul style="list-style-type: none"> <li>• Commercial sensitivities</li> <li>• Concern whether governance framework is in place for transition</li> </ul>                               | Should be explored for enduring arrangements |

3.11 Taking into consideration uncertainty and proportionality we think there is a strong case for the ex post regime to apply to the CRS transitional phase. However, we are interested in stakeholders' views on the options set out in table 3.1 or those not considered within the table.

3.12 In particular, we are interested in views on whether an ex ante control should be considered for the procurement costs, where there is likely to be more certainty about the activity DCC will be undertaking. These costs are likely to be the most material in the transitional phase and an ex ante approach would provide greater certainty. However, this would need to be balanced against more changes to the licence to introduce a predetermined cost term and the time taken to scrutinise and finalise the level of ex ante cost associated with the procurement activity.

3.13 The reasons for our preference to apply the ex post framework may not necessarily apply in the enduring framework. The industry working groups should consider all the various options for cost recovery for the CRS enduring framework.

### **Recovery of costs incurred in 2015/16**

3.14 The industry working groups looking at the high-level design and technical specification in the Blueprint phase should start later this year. This will mean DCC will incur costs in regulatory year 2015/16 prior to these proposed modifications being finalised.

3.15 Subject to consultation, we expect any licence modifications if implemented to be in place in spring 2016. DCC will report its costs for Regulatory Year 2015/16 in July 2016. We will assess DCC's costs against the licence in place at the time we undertake our ex post review. This will mean, if the licence is modified as proposed, DCC will be able to recover costs in 2015/16 and onwards. DCC has not included costs for CRS in its charges, so any costs for CRS will be reflected in a positive correction factor, and charged for in a future year.

3.16 We are planning to publish a response to comments received in respect of this consultation by the end of this year, alongside a statutory consultation. DCC is able to take a prudent approach to its charges and this should mean it can reflect anticipated costs for CRS in its Notice of charges that will take effect from 1 April 2016.

### **Incentives**

3.17 We are also seeking early views on whether incentives should be introduced in relation to the activity DCC takes under LC15. There would need to be clear and tangible outcomes to justify an incentive. An area where it might be beneficial to incentivise DCC could be in its procurement activities. Introducing the incentives should provide additional certainty that DCC will do all it can to support the development of the CRS and procure the CRS minimising delays. DCC's margin is at risk to Implementation Milestones during the implementation phase of smart metering to incentivise them to achieve live operations. A similar regime could be considered for CRS. An ex ante control provides a cost efficiency incentive.

3.18 The commercial working group will look at the introduction of incentives for the enduring arrangements and this will also be considered in the design of the operational incentive regime.

### **Materiality of costs**

3.19 We have considered the materiality of the costs we can reasonably expect DCC to incur during the transitional phase in proposing a cost recovery model.

3.20 In assessing the materiality we considered the governance structure and deliverables outlined in the February decision document on fast and reliable switching and Target Operating Model for the Blueprint, Detailed Level Specification and Enactment phases.





## DCC's role in developing a Central Registration Service and penalty interest proposals

3.21 DCC's role is expected to increase during this transitional period as we move into the more detailed design and then into the procurement activities in the Enactment phase which we aim to complete by 2018.

3.22 We have undertaken our own analysis on the expected *quantity* and *type* of resource that we expect DCC to contribute during these phases. In this analysis, we have benchmarked and scaled the quantity and expertise of staff requirements using data on comparable systems design and procurement resourcing. We have looked at a number of cost and resource scenarios. This analysis is described in appendix 5.

3.23 We expect DCC to use a proportionate mixture of capabilities and seniority in its recruitment. We have used benchmarking data on market costs for similar role profiles to create a range of scenarios for DCC's costs. We do not envisage DCC's efficient costs during the transitional phase of the Switching Programme to exceed 1.5 % of the indicative allowed revenue estimates published by DCC to date<sup>16</sup>.

3.24 This estimation does not serve to prejudice the scope of the industry working group activities or any future DCC price-control decisions. It is also dependent upon the scope of DCC's role during the transitional phase, as discussed in chapter 2. Any costs DCC incurs will still be subject to an ex-post economic and efficient test, if our proposals on the cost-recovery model for the transitional phase are implemented. If DCC's incurred or forecasted costs for supporting the Switching Programme exceeded our estimates and the scope of its role had not changed materially from the role currently envisaged, it would need to provide a strong case for why these costs are economic and efficient.

3.25 As with all new scope projects that DCC undertakes, we expect it to be reasonable in forecasting its costs and to take into consideration its obligation to ensure regulated revenue does not exceed a prudent estimate of its allowed revenue. chapter 5 considers options for introducing a penalty interest rate on DCC for material over-recovery in its charges.

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<sup>16</sup> DCC has published a charging statement for 2015/16, an indicative charging statement for 2016/17 and indicative budgets for 2017/18 - 2018/19.  
<http://www.smartdcc.co.uk/charges/indicative-budgets/> and  
<http://www.smartdcc.co.uk/charges/charging-statements/>

## 4. Licence and SEC changes

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### Chapter summary

In this chapter we set out the analysis we have undertaken of the Licence and the SEC to identify where changes are needed, and identify those obligations that should apply to CRS.

**Question 10:** Do you agree CRS should be a mandatory business service?

**Question 11:** Do you have any views on the proposed changes to the Licence and SEC?

**Question 12:** Do you agree there should be no changes to the charging methodology and this should be considered as part of the industry working group for the enduring framework?

### Proposals

4.1 We propose that the preparation work for CRS is a new category of mandatory business service. We have undertaken analysis of the Licence to identify where changes are needed, and identify those obligations that should apply to CRS. In doing this we have also identified some issues that should be considered as part of the industry working groups.

4.2 We have also looked at consequential changes needed to the SEC. We propose that there are no changes to the current charging methodology in the SEC given the limited time these transitional arrangements will be in place for. The SEC will need to be fully reviewed as part the industry working groups.

### Type of service

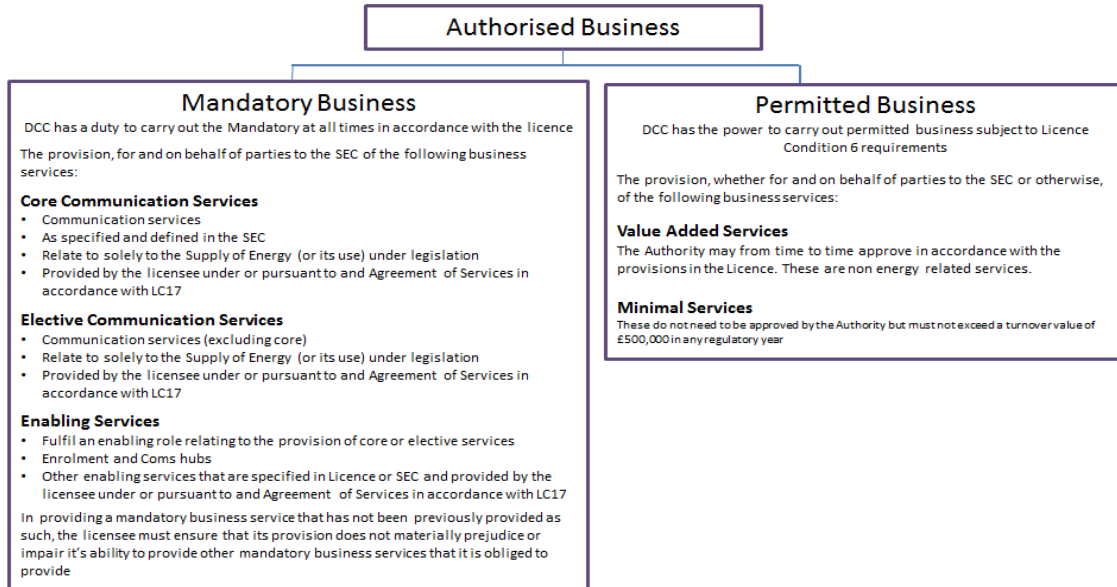
4.3 The authorised business<sup>17</sup> of DCC is defined in the licence. To enable DCC to support the development of CRS and be sufficiently funded the licence needs to be modified to include CRS as part of the authorised business. Figure 4.1 sets out the authorised business of DCC and the different categories of services.

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<sup>17</sup> The authorised business means the whole business carried on by the Licensee, it is set out in Licence Condition 6.

## DCC's role in developing a Central Registration Service and penalty interest proposals

**Figure 4.1: DCC's authorised business**



4.4 We have considered CRS and its preparation being included as part of the mandatory business as part of the existing services, and also as a new separate service. We have also considered CRS being a Permitted Business Service. Our analysis setting out the benefits and risks with each option is set out in Table 4.1.

**Table 4.1: options analysis on service classification of CRS**

| Option  | Benefits  | Risk  | Assessment   |
|---|---|---|--|
| <b>1. Mandatory Business Service</b><br>- <i>Classified under existing services</i> | <ul style="list-style-type: none"> <li>• Inclusion under the existing services would reduce the changes in the licence</li> </ul>   | <ul style="list-style-type: none"> <li>• Separation between smart and CRS may not be clear.</li> </ul>  | Clear separation between smart metering and CRS is needed      |
| <b>2. Mandatory Business Service</b><br>- <i>New service</i>                        | <ul style="list-style-type: none"> <li>• Clear separation from smart metering</li> <li>• More transparent</li> <li>• Likely to be more consistent with enduring solution</li> </ul> | <ul style="list-style-type: none"> <li>• There will be some consequential drafting changes.</li> </ul>  | Provides separation and consistent with the enduring framework |
| <b>3. Permitted Business Service</b>  | <ul style="list-style-type: none"> <li>• Clear separation from smart metering</li> <li>• Clear that establishing the smart metering infrastructure has priority</li> </ul>          | <ul style="list-style-type: none"> <li>• More consequential changes to the licence as service charges should only be levied in respect of the provision of Mandatory Business Services</li> </ul> | Costs should relate to the Mandatory Business Services         |



## DCC's role in developing a Central Registration Service and penalty interest proposals

4.5 Our option analysis strongly favours that CRS should be classified as a new service under the mandatory business. The main reasons are:

- The price control framework allows DCC to recover costs that are associated with the provision of mandatory business services. It is likely there would be wider changes needed to allow different treatment of a new permitted service. It would be essential CRS costs are part of allowed revenue and subject to the assessment of costs under licence condition 37.
- It is important there is a clear separation between smart metering services and CRS, so different obligations can apply in the future. This supports having a new category of service under mandatory business Services. This is also likely to be the most appropriate way to classify CRS in the enduring framework.

4.6 DCC's provision of CRS as a mandatory business service will not affect its current obligations in relation to smart metering. Under licence condition 6 when providing a new mandatory business Service DCC must ensure that the provision does not affect its ability to provide other existing mandatory business services. Also, the Interim General Objective set out in licence condition 5 makes the achievement of a full, timely, efficient, economical, and secure Completion of Implementation<sup>18</sup> in relation to smart metering a priority.

### Summary of consequential licence changes

4.7 We have carried out a detailed analysis of the consequential changes in the licence. Table 4.2 is a summary of the changes we have identified in our licence analysis. The detailed consequential changes by licence condition are set out in appendix 5.

4.8 We publish alongside this consultation document a tracked changed version of the licence illustrating the proposed changes. We plan to publish a statutory consultation in autumn/winter this year. However we welcome any views on these proposed changes at this stage.

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<sup>18</sup> Completion of Implementation is defined in Part D of licence condition 5.

## DCC's role in developing a Central Registration Service and penalty interest proposals

**Table 4.2: Summary of the consequential changes to the licence**

| Type of change   | Licence Condition (LC)           | Brief description   |
|--|----------------------------------|---|
| <b>1. Licence Conditions that require changing</b>                                       | Identified 5 Licence Conditions  | <ul style="list-style-type: none"><li>• Need to include the new definitions for CRS</li><li>• Include reference to CRS so it is clear it is a Mandatory Business Service</li></ul>  |
| <b>2. Licence Conditions where obligations will apply</b>                                | Identified 17 Licence Conditions | <ul style="list-style-type: none"><li>• Appropriate that obligations under these Licence Conditions apply to CRS</li><li>• Some of the annual reporting will need to take into consideration CRS</li></ul>                    |
| <b>3. Licence conditions that need to be reviewed as part of industry working groups</b> | Identified 13 Licence Conditions | <ul style="list-style-type: none"><li>• Obligations that should be reviewed for the enduring framework</li><li>• Interactions with the development of the operational performance regime and reporting requirements</li></ul> |

4.9 We are proposing consequential changes to licence condition 1 and 6 that will define CRS as a mandatory business service. The effect of this would be that the preparation for CRS would be reflected in DCC's price control as mandatory business services, allowing DCC to recover the economic and efficient costs it incurs for participating in this transitional phase. These changes would also ensure that the existing obligations that attach to mandatory business services performed by DCC under the DCC licence would similarly attach to CRS.

4.10 We think it is appropriate existing obligations that attach to mandatory business services apply to CRS. We have identified the licence conditions so it is clear where an obligation would apply if our current proposals were implemented. In some cases this may have implications for documents that DCC must have in place under some of the licence conditions<sup>19</sup>. We are proposing DCC reviews or appropriately updates the documents the next time they are due for review, following the modification coming into place.

4.11 We propose to move the definition of Core Industry Documents from licence condition 22 to licence condition 1, as this definition now applies to licence condition 15 as well.

4.12 We propose to remove the reference to the Direction by the Secretary of State in licence condition 22, to be consistent with the new Licence Condition 15

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<sup>19</sup> This applies to LC7, 8, 9, 10, 11, 12, 16, 18, 19, 24, 27, 28, 32, 34, 37, 42, and 43. More detail is provided in appendix 6.

## DCC's role in developing a Central Registration Service and penalty interest proposals

drafting. We also propose to modify licence condition 22 and 30 to add CRS to the lists of services that are mandatory business services for consistency.

4.13 We have identified licence conditions that the industry working groups may want to further consider in the enduring framework. We think the proposals from the commercial or regulatory working groups could have implications or interactions for these licence conditions.

### Summary of consequential changes to the SEC

4.14 As part of our analysis we have also considered whether there needs to be changes to the SEC. In table 4.3 we identify the changes to the SEC that it might be beneficial to make. These changes are suggested to make sure CRS is referenced and it is clear that DCC can include costs for CRS in its charges. Many sections of the SEC are smart metering specific so at this time we think there are likely to be limited consequential changes.


4.15 For consistency it might be appropriate for the definitions to reflect that the authorised business of DCC includes CRS. There is a licence requirement that services are set out in the SEC. Section H currently has blank holding pages for services that might be offered under the SEC in the future. A similar approach could be taken for CRS, or section H could reference to LC15. Alternatively, a new section on CRS could be added.

**Table 4.3: Summary of the consequential changes to the SEC**

| Type of change   | SEC reference   | Brief description   |
|--|---|---|
| Sections that require changing                                       | Section A1: Definitions<br>Section H: Section on CRS<br>Section K: Charging Methodology | <ul style="list-style-type: none"><li>• Inclusion of definitions</li><li>• Fixed costs in K3.2 should be amended to make clear CRS costs will form part of this</li></ul> |
| Sections that need to be reviewed as part of industry working groups | All   | <ul style="list-style-type: none"><li>• A thorough review required as part of SCR</li></ul>   |

4.16 We propose the existing charging methodology is not changed and CRS costs form part of the fixed cost base. We are only suggesting the wording in section K is amended to reflect that the fixed charges include CRS. We consider this is proportionate given if we make substantial changes to the charging methodology these will only be in place for a limited time as the charging methodology will be fully reviewed as part of the industry working groups.

4.17 We expect there will need to be an extensive review of the SEC for the enduring arrangements. We have not identified all the areas where there might be future changes in the enduring framework. Section H of the SEC currently has blank sections for services yet to be offered but where there is an expectation they will be offered in the future. This approach could be considered for CRS.



## DCC's role in developing a Central Registration Service and penalty interest proposals

4.18 There are two routes to modify the SEC at this time, DECC could make the proposed changes or these changes could be made through an application by a SEC under the urgent code modification process.

4.19 The initial content of the SEC is being prepared within DECC's Smart Metering Implementation Programme, and introduced in a series of instalments to support the development and rollout of the industry programme. Section 88 of the Energy Act 2008 provides the power for the Secretary of State to amend industry codes and licences created under the Electricity and Gas Acts for the purpose of facilitating the installation of smart meters. Section 89 of the Act specifies the procedure to be used.<sup>20</sup>

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<sup>20</sup> DECC has recently published a consultation on amendments to the SEC, and this includes proposed changes to the modification process <https://www.gov.uk/government/consultations/consultation-on-new-smart-energy-code-content-and-related-licence-amendments-july-2015>

## 5. Penalty interest proposals

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### Chapter summary

DCC has a duty to take all reasonable steps to ensure that in setting its charges, its regulated revenue does not exceed a prudent estimate of its allowed revenue for a given regulatory year. We are taking this opportunity to seek views on whether it is appropriate to modify the DCC's licence to introduce a penalty interest rate regime for over-recovery of charges, similar to those used in networks, and the form this could take. Over-recovery of charges refers to regulated revenue which exceeds a reasonable prudent estimate of allowed revenue.

**Question 13:** Do you think it is appropriate to direct some form of penalty interest rate?

**Question 14:** Do you agree with the proposed preferred options? If so, do you think one is preferable to the other? If not, please explain your views.

**Question 15:** What do you think an appropriate penalty interest rate is?

**Question 16:** What do you think an appropriate threshold of tolerance should be for over-recovery of charges?

### Our Proposals

5.1 The prudent estimate is DCC's best estimate of its allowed revenue. It is designed to ensure that DCC's charges do not need to be amended in the course of the year except in response to a reasonably unlikely contingency.

5.2 Some stakeholders raised concerns about this provision due to the level of the charges in regulatory year 2013/14. This was a partial regulatory year and the level of uncertainty DCC faced in setting these charges which was reflected in the high value of the correction factor in 2013/14. The prudent estimate approach to allowed revenue gives users certainty in charging, so we are interested in whether stakeholders still have concerns regarding DCC's application of this mechanism.

5.4 We are taking this opportunity to seek views on making wider modifications to the licence. While reviewing the licence we noticed some inconsistencies within the licence definitions. We propose to clarify in the licence that interest accrued on over-recovered service charges forms part of regulated revenue. This is returned to service users in subsequent regulatory years through the correction factor. Our suggested drafting amendments are set out in appendix 7. We welcome views on this ahead of a statutory consultation that will set out further proposals for any necessary changes to the licence.

5.5 We welcome views on the options we have set out on the penalty interest rate or any alternative approaches. Based on our analysis of the options and given that DCC is still in the implementation phase of the programme, we propose to insert a power within the licence for the Authority to either:



## DCC's role in developing a Central Registration Service and penalty interest proposals

- **Direct any penalty:** Direct an unspecified alternative to the Bank of England base rate as a penalty interest rate on over-recoveries if there are concerns about the accuracy of DCC's judgement of its prudent estimate of allowed revenue and these concerns are supported by evidence; or
- **Report and Direct:** Require DCC to report to the Authority to explain any over-recovery which exceeds a certain percentage of allowed revenue. If DCC does not sufficiently justify the over-recovery we will then consult and direct a penalty interest rate consisting of a certain number of percentage points above the Bank of England base rate.

5.6 We see some additional benefits with the Report and Direct option, as it would provide greater transparency and information in relation to DCC's approach to its prudent estimate.

### Issue

5.7 DCC's licence requires it to take all reasonable steps to secure that regulated revenue does not exceed a prudent estimate of allowed revenue for each regulatory year.<sup>21</sup> The prudent estimate is defined as the best estimate of allowed revenue to ensure that (disregarding any within year adjustments that may be permitted in circumstances by the charging methodology of the DCC) service charges for a given regulatory year will not need to be amended in the course of that year except in response to reasonably unlikely contingency. Any such (within year) adjustments must not result in an expectation that the regulated revenue will significantly diverge from the allowed revenue in the relevant regulatory year.

5.8 The concept of a prudent estimate is unique to DCC. Other companies we regulate have an obligation to take reasonable steps to ensure regulated revenue does not exceed their allowed revenue. The arrangements for DCC reflect their business model, the uncertainties involved in the costs of a novel change programme, and industry demand to have certainty in their service charges.

5.9 However, concerns were raised in response to our price-control consultation<sup>22</sup> regarding DCC's application of the prudent estimate. Some respondents strongly urged us to look to remove the prudent estimate provision and one respondent argued it has a disproportionate impact on smaller suppliers.

5.10 We looked at DCC's charging statements and recognised that the prudent estimate was a large proportion of charges. Based on the six months of cash flow data we had, we also recognised that DCC was in a very liquid position. We

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<sup>21</sup> Licence Condition 36.4

<sup>22</sup> Summarised here: <https://www.ofgem.gov.uk/ofgem-publications/93650/1502dccdecisionfinal.pdf>



## DCC's role in developing a Central Registration Service and penalty interest proposals

committed in our price control decision to consider whether the current licence drafting places the right incentives on DCC to manage the prudent estimate. We indicated then that we may consider introducing a similar regime to the penalty interest rates faced by networks for over-recovery of charges.

### Current treatment of DCC's over-charges

#### Interest incurred

5.11 DCC's licence requires that revenues it accrues and interest earned on these revenues, are held in a ring-fenced account for use of the authorised business and held separately from the bank accounting arrangements of any affiliated company. DCC's regulated revenue is defined differently as the revenue received through service charges or otherwise received from the mandatory business. While reviewing the licence we noticed some inconsistencies within the licence definitions.

5.12 We are considering modifying the licence to remove any ambiguity and make it clear that any interest DCC earns from service charges is part of regulated revenue and will be returned where regulated revenue has exceeded our determination of Allowed Revenue in subsequent service charges through the correction factor.

5.13 The incentives for DCC not to over-recover in its charges (regulated revenue) relative to allowed revenue are reflected in the correction factor formula<sup>23</sup>. The formula currently requires over-recovery to be repaid inclusive of the Bank of England base rate. There are no penalty interest rates applied beyond this base rate in any circumstances in the current licence conditions.

### Approach to our analysis

5.14 We have continued to monitor the size of the prudent estimate within DCC's indicative charging statements to ensure our concern remains relevant. This continues to be a high proportion of DCC's estimated allowed revenue and will have a direct correlation to the correction factor for subsequent regulatory years<sup>24</sup>. We also recognise the potential for this proportion to increase as demand uncertainty becomes more material for DCC's costs.

5.15 We have reviewed the incentives in the licence for DCC to manage the prudent estimate in this context. We recognise that the licence drafting should be clear that DCC cannot benefit from interest accrued on over-charging. All interest from overcharging will be returned to SEC parties through the correction factor. We

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<sup>23</sup> Licence condition 36, Part F

<sup>24</sup> For further detail on the proportions, see Appendix 7.



## DCC's role in developing a Central Registration Service and penalty interest proposals

remain concerned about the incentives created by the requirement for DCC to take a prudent approach when setting its charges, and the Bank of England base rate being applied to any over-recovered revenue. There is potential consumer detriment and risk to smaller suppliers' liquidity from these incentives. Over time we would expect the size of the prudent estimate to reduce and want to ensure the licence provides the ability to recalibrate the incentives, if this is needed.

5.16 We recognise the benefits of the prudent estimate as a tool for managing uncertainty during the implementation phase of the smart metering programme, and for changes in DCC's activities or scope.<sup>25</sup> This allows DCC to accommodate changes to its responsibilities without creating instability for service users.

5.17 We have looked at penalty interest rates used in network licences as a precedent. However, we recognise DCC's business and regulatory framework is very different from the network companies which have an ex ante price control regime, are in a phase of stable operations, and have asset based businesses. We have taken DCC's unique position relative to other regulated monopolies into consideration in generating our options.

### Options

5.18 We have considered options for introducing a penalty interest rate regime, ranging from maintaining the status quo (of the Bank of England base rate) to introducing a stronger penalty interest rate with immediate effect.

5.19 Table 5.1 summarises these options and our overall assessment of them.<sup>26</sup> All over recoveries and interest will be returned to SEC parties through the correction factor.

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<sup>25</sup> This could include for example adoption and enrolment, and CRS

<sup>26</sup> For more detailed analysis on all of the options considered, see appendix 7.

## DCC's role in developing a Central Registration Service and penalty interest proposals

**Table 5.1. Penalty Interest Rate Analysis**

| Option   | Overall assessment  |
|--|---|
| <b>A) Do nothing</b><br><i>(The base rate will apply to any over recoveries as a penalty interest rate, and returned to users in the correction factor)</i>  | The level of concerns regarding the magnitude of the prudent estimate and the time lag in future to introduce a mechanism supports considering taking the power to direct |
| <b>B) Power to direct any penalty</b><br><i>(No detail of when the penalty interest rate might be introduced or its form)</i>  | Signals to DCC it must forecast accurately. However, it is less transparent   |
| <b>C) Report and Direct</b><br><i>(Reporting requirement above a threshold, with power for us to consult on and direct a penalty interest rate)</i>  | Good balance between the strength of incentive and flexibility  |
| <b>D) Power to direct the penalty interest if exceed a threshold</b><br><i>(Once a threshold is exceeded we would consult and direct the penalty interest rate)</i>  | If the materiality threshold is set too low the penalty will apply. Risks with option E might materialise   |
| <b>E) Immediate effect – interest rate set</b><br><i>(A penalty interest rate above the base rate for over-recovery over a certain threshold would apply. The level of the penalty interest rate and/or threshold could be reviewed by direction.)</i> | Risks to implementation if the materiality threshold is set too low   |

### Preferred Options

5.20 We propose to clarify by modification to the licence that interest accrued on over-recovered service charges forms part of regulated revenue. This should therefore be returned to service users in subsequent Regulatory Years through the correction factor. Appendix 7 includes sections of the licence that we propose to modify.

## DCC's role in developing a Central Registration Service and penalty interest proposals

5.21 Our preferred options introduce a power for the Authority to direct a potential future penalty interest rate on over-recoveries above the base rate if there are material concerns over DCC's judgement of its prudent estimate.

5.22 We think these options will provide flexibility to assess DCC's judgement of the prudent estimate on an ongoing basis and thereby minimise risk of penalising DCC for uncontrollable volatility in its incurred costs. At the same time, through allowing for future directions, we would be able to introduce a penalty, if justified, expediently. However, we remain open to views on the most appropriate options for the penalty interest rate. Specifically, our preferred options are to insert a power for the Authority to either:

**B) Direct any penalty:** Direct an unspecified alternative to the Bank of England base rate as a penalty interest rate on over-recoveries if there are concerns about the accuracy of DCC's judgement of its prudent estimate of Allowed Revenue and these concerns are supported by evidence.

In this option, we would consult on the form of the proposed penalty interest rate and the materiality threshold of over-recovery that the penalty rate would apply to prior to issuing any direction; or

**C) Report and Direct:** Require DCC to report to the Authority to explain any over-recovery which exceeds a certain percentage of allowed revenue. If DCC does not sufficiently justify the over-recovery we will then consult on and direct a penalty interest consisting of a certain number of percentage points above the Bank of England base.

In this option, our decision on whether to apply the penalty interest rate would form part of our annual price-control decisions and directions. We could review the level of penalty rate (either by amending a previous direction or issuing a new direction each year.) This option has precedents in aspects of the RIIO (Revenue = Incentives + Innovation + Outputs) networks regulation model<sup>27</sup>.

5.23 We welcome views on an appropriate threshold of over-recovery that would apply under the Report and Direct option. We propose a threshold of between 110% and 115% of allowed revenue. This is based on the magnitude of the historic and forecast correction factor and the prudent estimate. We have also considered the precedent over-recovery threshold for penalty interest rates in the networks' licence of 110%. We recognise that there is uncertainty in the scope and timing of DCC's

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<sup>27</sup> <https://www.ofgem.gov.uk/ofgem-publications/46671/crcs-master-merged.pdf> CRC 14; <https://www.ofgem.gov.uk/ofgem-publications/86861/schedule2awpdcrs.pdf> CRC 2A



## DCC's role in developing a Central Registration Service and penalty interest proposals

implementation activities, and we have suggested a reporting requirement rather than an automatic penalty interest rate to reflect this uncertainty.

5.24 We welcome views on whether we should consult and direct at the time the threshold is met on the appropriate penalty interest rate to apply, or whether a penalty interest rate should be included in the licence at this stage. There is precedent in networks for a 3 per cent penalty above the Bank of England base rate.

5.25 Our analysis of DCC's explanation for over-recovery above the threshold in the Report and Direct option would follow similar principles to the principles published in our Guidance document for assessing the efficiency of cost-variations in DCC's price-control submissions.<sup>28</sup> The Report and Direct option should provide greater transparency on DCC's approach to its prudent estimate.

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<sup>28</sup> <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures>

## 6. Next Steps

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This chapter briefly outlines the next steps in the Switching Programme, which will be the launch of the significant code review (SCR) and industry working groups. We also set out how to respond to our consultation and our proposed timetable.

### **Next steps on the Switching Programme**

6.1 Later this year we will publish an updated target operating model (TOM) setting out, at a high level, how we expect the new CRS and switching arrangements will work. At the same time we will also publish our SCR Launch statement clarifying the framework that we intend to use to implement the required changes to the regulatory framework.

6.2 Jointly with government, we then propose to hold the first of our regular six-monthly meetings with senior industry stakeholders to keep the programme on track, maintain industry commitment, support and resource for our work.

6.3 We will start the Blueprint phase workgroups and meetings with an external design advisory group (EDAG) – an industry group responsible for overseeing the outputs of the switching workgroups - by the end of the year. We want DCC to actively and constructively participate in these groups. The proposed changes in this consultation should facilitate their ability to do this.

6.4 We will write to the industry later this year asking for expressions of interest in sitting on the Blueprint workgroups and EDAG. We will also provide further information on how parties can keep updated on progress.

### **Views on our proposals and proposed timetable**

6.5. We welcome views on the proposals in this document. Please get in touch with us early if you'd like to:

- discuss or provide feedback on our proposals, or
- provide any additional information.

6.6. We will consider any views provided when we take our decision. Please send responses to [smartermarkets@ofgem.gov.uk](mailto:smartermarkets@ofgem.gov.uk) by 18 September 2015

6.7 We intend to publish a statutory consultation in winter 2015. Our current view is that this will be a 4 week consultation.

6.8 We plan to publish our decision document and Notice of the Licence Modifications in winter 2015/16. If not challenged during the sitting period, after 56 days our proposals will be effective.

## Appendix 1 - Consultation response and questions

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1.1. We'd like to hear your views on any of the issues in this document. We would particularly like to hear from SEC users.

1.2. We would especially welcome responses to the questions at the beginning of each chapter. These are replicated below.

1.3. Please make sure we have your response by 22 September 2015. It would be helpful if you could submit your comments both electronically and in writing. Send them to:

Laura Nell  
Smarter Metering  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
020 7901  
[smartermarkets@ofgem.gov.uk](mailto:smartermarkets@ofgem.gov.uk)

1.4. Unless you mark your response as confidential, we'll publish it in our library and on our website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)). If you ask us to keep your response confidential we'll respect this request unless a legal duty means we can't, for example under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. If you'd like your response to be confidential, mark it clearly to that effect and include your reasons. Please restrict any confidential material to an appendix.

1.6. Once we've considered the responses to this consultation, we plan to publish our final decision in 2015. If you have any questions, please send them to:

Laura Nell  
Smarter Metering  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
020 7901  
[smartermarkets@ofgem.gov.uk](mailto:smartermarkets@ofgem.gov.uk)



## DCC's role in developing a Central Registration Service and penalty interest proposals

### **CHAPTER: Two**

**Question 1:** Do you agree with our proposals to amend SLC 15 of DCC's licence (including the proposed legal changes described in appendix 2)?

**Question 2:** Should DCC be required to document the design of the CRS (including the new switching arrangements)?

**Question 3:** Should DCC be required to draft the required modifications to the SEC and/or other related industry codes?

**Question 4:** Should the Authority take a broad power to direct DCC on the preparation for the new arrangements, including the ability to stop its activity?

**Question 5:** Do you agree with our proposal to provide guidance to DCC on its licence and the draft content set out in appendix 4?

### **CHAPTER: Three**

**Question 6:** Do you agree with our preferred option that DCC should recover costs through the existing ex post price control framework?

**Question 7:** What are your views on introducing an ex ante control for the procurement costs?

**Question 8:** Do you agree that DCC should be able to recover costs it incurs for participation in the transitional phase 2015/16?

**Question 9:** What are your views on introducing incentives in relation to the activity DCC takes under LC15, particularly its procurement activities?

### **CHAPTER: Four**

**Question 10:** Do you agree CRS should be a mandatory business service?

**Question 11:** Do you have any views on the proposed changes to the Licence and SEC?

**Question 12:** Do you agree there should be no changes to the charging methodology and this should be considered as part of the industry working group for the enduring framework?

**CHAPTER: Five**

**Question 13:** Do you think it is appropriate to direct some form of penalty interest rate?

**Question 14:** Do you agree with the proposed preferred options? If so, do you think one is preferable to the other? If not, please explain your views.

**Question 15:** What do you think appropriate penalty interest rate is?

**Question 16:** What do you think appropriate thresholds of tolerance should be for over-recovery?

## Appendix 2 – SLC 15 proposed drafting

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1.1. This appendix sets out the proposed drafting for SLC 15 of DCC's licence. If implemented, it would replace the existing SLC 15.

### **Condition 15. Incorporation of the Central Registration Service**

#### **Introduction**

*15.1 The purpose of this condition is to specify the Interim Central Registration Service Objective of the Licensee and the Licensee's duties with respect to it.*

*15.2 It sets out the requirements of the Licensee under the Authority's Switching Programme up to and including the point at which the Licensee procures Relevant Service Capability to deliver and operate a Central Registration Service.*

#### **Part A: Interim Central Registration Service Objective of the Licensee**

*15.3 Subject to paragraphs 15.5 and 15.6, the Licensee must comply with the Interim Central Registration Service Objective by:*

*(a) contributing to the achievement of a full and timely design for an efficient, economical and secure Central Registration Service that would, if implemented, provide a platform for fast and reliable switching for all Supply Points in the GB market;*

*(b) making all relevant preparations for the procurement of Relevant Service Capability to deliver and operate a Central Registration Service; and*

*(c) procuring Relevant Service Capability to deliver and operate a Central Registration Service that:*

*(i) reflects the design of a Central Registration Service which has been designated by the Authority for this purpose (including any amendments to that designated design); and*

*(ii) would, if executed, in all likelihood, give effect to an efficient, economical and secure Central Registration Service that would provide a platform for fast and reliable switching for all supply points in the GB market.*

*15.4 For the purposes of paragraph 15.3(a), the Interim Central Registration Service Objective includes, but is not limited to, a duty to:*



## DCC's role in developing a Central Registration Service and penalty interest proposals

- (a) document the design of the Central Registration Service; and*
- (b) draft, in each case, in a timely manner and in a manner that is consistent with the design designated by the Authority for that purpose (including any amendments to that designation):*
  - (i) the modifications required to the Smart Energy Code that would define the detail of the Central Registration Service; and*
  - (ii) the modifications required to the Core Industry Codes.*

### **Part B: Requirement in respect of Authority direction**

*15.5 The Licensee must comply with any direction issued to it by the Authority for the purposes of meeting the Interim Central Registration Service Objective in respect of the Licensee's obligations in this condition.*

*15.6 The Authority's power under paragraph 15.5 includes a power to direct that any or all of paragraphs 15.3 to 15.4 shall cease to have effect in this licence on such date and for such period as the Authority may specify.*

### **Part C: Interpretation**

*15.7 For the purposes of this condition:*

**Central Registration Service** means a service provided by DCC pursuant to the Smart Energy Code which:

- (1) includes (but is not limited to) the provision of services equivalent to those which are currently included within:*
  - (a) such services relating to the supply of gas under the 1986 Act that fall within:*
    - (i) the supply point information service provided under standard condition 31 of the Gas Transporter Licence as relate directly to (i) the provision of supply point information and (ii) the maintenance of a register of technical and other data required by Gas Shippers and Gas Suppliers for change of supplier purposes; and*
    - (b) the supply point administration service provided under or pursuant to the Supply Point Administration Agreement.*
  - (b) such services relating to the supply of electricity under the 1989 Act that fall within:*
    - (i) the metering point administration services as defined in standard condition 18 of the Electricity Distribution Licence and*

## DCC's role in developing a Central Registration Service and penalty interest proposals

*that are provided under or pursuant to the Master Registration Agreement; and*

*(ii) such other services provided under or pursuant to the Master Registration Agreement (including any relevant Data Transfer Services provided by the Data Transfer Service under standard condition 37 of the Electricity Distribution Licence) as relate directly to the maintenance of the Data Transfer Catalogue that forms part of that agreement, and*

*(2) supports any further or alternative arrangements as may be identified as being required of the Central Registration Service by the Authority for the purposes of the Switching Programme.*

**Data Transfer Catalogue, Data Transfer Service and Data Transfer Services** have the meaning given to those terms respectively in standard condition 1 of the Electricity Distribution Licence

**Domestic Gas Supplier** means a Gas Supplier in whose supply licence section B of the standard conditions incorporated into such a licence has effect

**Electricity Distribution Licence** means a licence granted, or treated as granted, under section 6(1)(c) of the 1989 Act

**Gas Shipper and Gas Supplier** mean, respectively, a person who holds a licence under section 7A(2) of the 1986 Act and a person who holds a licence under section 7A(1) of that Act


**Gas Transporter Licence** means a licence granted, or treated as granted, under section 7(1) of the 1986 Act

**Interim Central Registration Service Objective** has the meaning given to that term in Part A of this condition

**Master Registration Agreement** means the document that is required to be maintained in a form that is approved by the Authority in accordance with standard condition 23 of the Electricity Distribution Licence

**Switching Programme** means the Authority's programme to amend the services listed in part 1(a) and (b) of the definition of a Central Registration Services, for the purpose of providing fast and reliable switching

**Supply Point** means, for the purpose of this licence condition, Meter Points as defined in the Master Registration Agreement, Supply Meter Points as defined in the Uniform Network Code and any points where a supply of gas or electricity is taken as defined within the scope of the Switching Programme



## DCC's role in developing a Central Registration Service and penalty interest proposals

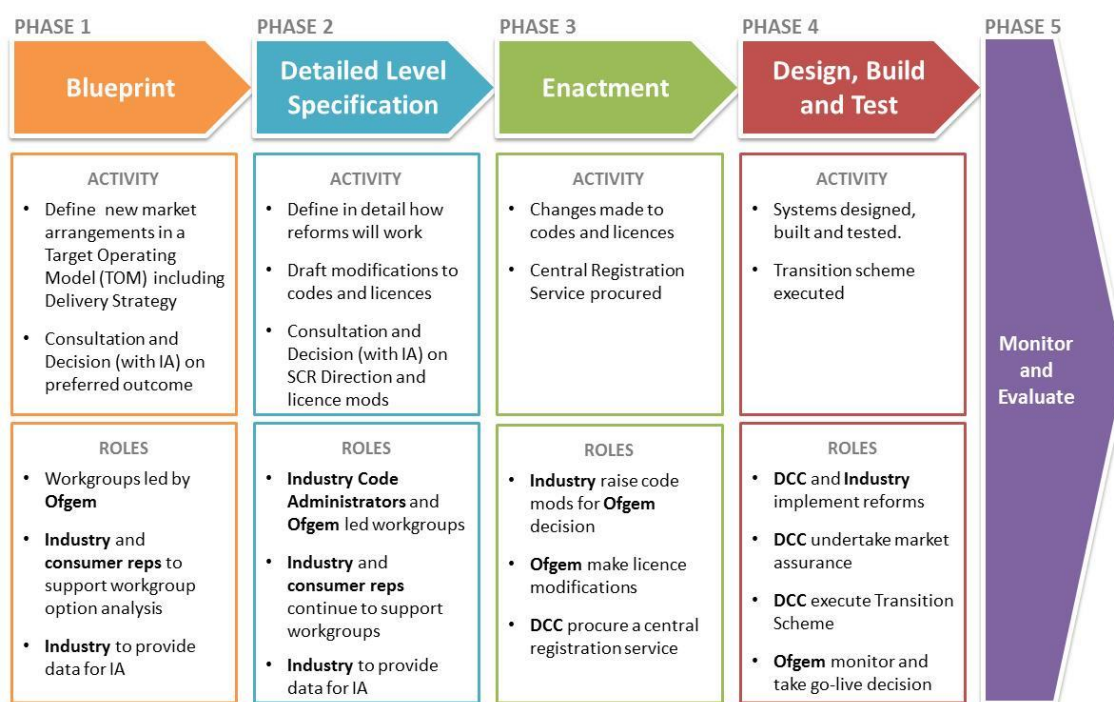
***Supply Point Administration Agreement*** means the document that is required to be maintained in a form that is approved by the Authority in accordance with standard condition 30 of the supply licence held by a Domestic Gas Supplier

***Uniform Network Code*** means the document of that name that is maintained in accordance with special condition A11 of the Gas Transporter Licence

## Appendix 3 – Switching Programme phases

1.1. This appendix sets out the five phases of the Switching Programme. It is an extract from the February 2015 decision document on Moving to Reliable Next-Day Switching. The five phases are summarised in figure A3.1 below and then described in more detail.


**Figure A3.1: Switching Programme implementation phases**



1.2. In the **Blueprint phase** we will define the new switching and CRS arrangements. To guide this process and provide direction for the rest of the programme, we have consulted on a TOM. This TOM will set out the high level requirements for the new switching arrangements.

1.3. We intend to form four workgroups, which we will chair and lead, to develop a design baseline<sup>29</sup>. These workgroups will be made up of industry and consumer

<sup>29</sup> We will define a series of design baselines through the lifetime of the programme to deliver a



## DCC's role in developing a Central Registration Service and penalty interest proposals

representatives, who will provide the expertise needed to develop the new arrangements.

- *Business Process Design Workgroup*: This group will design a fast, simple and reliable switching service. It will focus on a next-day solution but also examine two-day switching. It will set out the requirements of a CRS, what data (including new data items) should be held in this service to support the market, and who should maintain and access each data item. It will also describe how the arrangements can support existing requirements (eg settlement and network charges) and new market requirements.
- *Regulatory Design Workgroup*: This group will define how the governance for the new arrangements will operate, including what industry codes and licences will need to be amended and, broadly, what changes need to be made.
- *Commercial Workgroup*: This workgroup will define the overarching commercial framework for DCC when procuring the CRS, including licence obligations, incentives and price control arrangements. It will define what changes will be made to existing network obligations and price controls for provision of registration services. It will also define the procurement framework that DCC is expected to use.
- *Delivery Strategy Workgroup*: This workgroup will develop a strategy for how the CRS will be designed, built and tested, how market readiness will be tested and assured and the transition process for current arrangements into the new arrangements (including transitional governance, data migration and implementation technique). This is a complex programme and it is important to make an early start to planning these delivery arrangements.

1.4. At the end of this phase we will consult on our preferred market design with a supporting impact assessment.

1.5. In the **Detailed Level Specification (DLS) phase** we will continue to develop the detailed technical design based on the Blueprint design through the workgroups formed as part of the Blueprint phase. We will define the outputs to be delivered by industry code changes (eg requirements and interface specifications, process maps and service levels) as well as the key documents needed to procure the CRS (e.g. procurement plan). We will also further develop the delivery strategy.

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consolidation of all of the design products at a particular time as a point of reference (e.g. for stakeholder consultation; collecting data for our impact assessment; or to procure a CRS provider against).





## DCC's role in developing a Central Registration Service and penalty interest proposals

1.6. Once the workgroups have concluded we expect to consult on our proposed decision. At the end of the DLS phase we would then issue SCR Direction(s) to licensee(s) requiring them to raise the modifications that give effect to our proposals across a range of industry codes.

1.7. In the **Enactment Phase** we will look to the industry and code administrators to undertake the detailed drafting of business rules and code modifications needed to deliver the changes for their respective codes. Their involvement and responsibility will therefore increase in this phase. We expect to oversee this development to ensure the tight deadlines are met and the overall integrity of the model for the new arrangements is maintained.

1.8. In this phase we expect to make licence modifications and approve changes to industry codes. We recognise the risk of delays as the changes to industry codes progress through the modification process. We therefore intend to take a hands-on role in helping to progress these changes quickly. The CRS will be procured and a contract signed. At this end of the phase, parties will have clear regulatory requirements that establish what needs to be implemented and by when.

1.9. In the **Design, Build and Test Phase** the CRS will be built, tested and populated with data. Other industry parties will make the required changes to their systems and processes. A testing process will provide assurance that the new arrangements can be implemented and the systems will go live. A transition scheme will be executed to ensure that all data migration and market readiness activities are complete.

1.10. We expect specific industry parties (eg DCC and the SEC Panel) to take a leading role in determining market readiness. We expect to monitor overall progress against an agreed delivery plan and transition scheme. We will take the overall decision to go-live.

1.11. We will monitor and report on progress toward implementation during this phase. We will also continue to own and maintain the design baseline as it develops through this phase, and assess and implement any changes to it. At an appropriate point, governance and control of deliverables can be passed to the industry and code administrators.

1.12. During the **Monitoring and Evaluation phase** we will monitor the effects of our reforms on the market and consider any further changes required to ensure that the benefits for consumers are fully realised and any operational problems are resolved.

## Appendix 4 – Draft guidance on SLC 15

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1.1. In February 2015, we consulted on a TOM for the CRS and new switching arrangements.<sup>30</sup> We expect to publish version 2 of the TOM later this year.

1.2. The TOM describes, at a high level, how the new CRS and switching arrangements will operate. DCC should refer to version 2 of the TOM (and any further iterations of it) for guidance on what it should consider when considering how best to meet its Interim Central Registration Service Objective (the new objective).

1.3. The TOM is divided into the following sections that cover the key design and delivery areas:

- The Central Registration Service (CRS)
- New switching arrangements
- Governance arrangements for the CRS and switching
- Charging arrangements for the CRS
- Price control arrangements for the CRS
- Delivery approach for the CRS and switching arrangements

1.4. For each of these sections, this appendix describes where we expect DCC to provide support for the Switching Programme. This list is not exhaustive. We are at an early stage in the Switching Programme and new requirements may emerge as we progress and stated requirements may no longer be required.

1.5. We do not propose to review the TOM again until the second half of 2016/17, once the first design baseline has been established. We expect to consult with the industry if we propose to materially change the TOM at this point, or in advance. If we amend the TOM we will also consider if we should update any guidance provided to DCC.

1.6. We will develop design principles and discuss these with the industry later this year. Our initial thoughts are that we will model these design principles on those used for the Change of Supplier Expert Group.<sup>31</sup> We expect DCC to take the agreed design principles into account when considering how best to meet its new objective.

1.7. We expect DCC to be an active member of the Switching Programme. This includes being contributory members of the four Blueprint workstreams (see

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<sup>30</sup> <https://www.ofgem.gov.uk/publications-and-updates/target-operating-model-reliable-next-day-switching>

<sup>31</sup> <https://www.ofgem.gov.uk/ofgem-publications/75263/20130610cosevaluationcriteria.pdf>



## DCC's role in developing a Central Registration Service and penalty interest proposals

Appendix 3) as well as the External Design and Advisory Group (EDAG), a group formed of industry representatives who will advise on the design for faster switching as it develops.

1.8. We expect DCC to provide timely and accurate data to support the impact assessment of proposals.

1.9. We expect DCC to respond in a timely and accurate way to any interim consultations as well as the consultations expected at the end of the Blueprint Phase and the Detailed Level Specification Phase.

1.10. We are consulting on DCC's role in documenting the design of the new arrangements. This includes capturing all of the relevant elements of the design in electronic form so that it can be shared with stakeholders in a readily accessible and understandable manner. The format should be suitable for incremental design development as well as consultation with industry stakeholders at the end of the Blueprint and Detailed Level Specification phases. We are also consulting on the DCC's role in preparing the draft modifications to industry codes. This would include drafting the proposed legal text that would be incorporated within the modifications. This obligation would not require DCC to raise code modifications. We will review requirements to raise modifications as part of the Significant Code Review Process. We will consider if any amendments are required to this guidance if those proposals are retained.

### **The Central Registration Service (CRS)**

1.11. DCC should play a strong role in defining the CRS functional and non-functional requirements, the data the CRS will hold, the data access requirements and the communication interfaces.

1.12. We expect DCC to contribute to the design of these detailed requirements. We expect it to undertake specific work packages/develop proposals, as requested by the Chair of the relevant Blueprint workstream, on how the new arrangements should operate.

1.13. We expect DCC, as the party responsible for the delivery of the CRS, to provide appropriate technical support to ensure the robustness of design and that the opportunities and efficiencies afforded by different technologies and technical approaches are fully explored. It should ensure that the design of the CRS is robust, economic, efficient and secure. The design of the CRS should be flexible so that it can efficiently meet all reasonably foreseeable future market requirements.

1.14. We expect DCC to take all reasonable steps to prepare for the procurement of relevant service capability to deliver the CRS and to procure this service. This should be undertaken in accordance with DCC's other licence obligations, notably SLC 16 (Procurement of Relevant Service Capability) and its published procurement strategy. We expect this activity to be undertaken in a way calculated to meet the



## DCC's role in developing a Central Registration Service and penalty interest proposals

target implementation date of the Switching Programme and in accordance with the design principles (once these are in place).

1.15. DCC's new objective does not include requirements relating to the build and testing of the CRS after this service has been procured. Subject to consultation, we expect to amend the licence at a later date to cover this and the enduring DCC obligations that cover operation after go-live.

1.16. At an operational level these discussions are expected to take place in the Business Process Design workgroup.

### **The new switching arrangements**

1.17. DCC should contribute to the design of the new switching arrangements to ensure that it best meets the requirements of the TOM and the agreed design principles. DCC should also seek to ensure that the design can be delivered by the CRS.

1.18. We expect DCC, as the party responsible for the delivery of the CRS, to ensure that appropriate technical support is provided to inform discussions on how the CRS will robustly, economically and efficiently support the new switching arrangements. It should ensure that the design of the CRS and new switching arrangements is consistent with the operation of the smart meter arrangements, in particular, the loading of smart key and tariff data onto smart meters and the associated security requirements.

1.19. At an operational level these discussions are expected to take place in the Business Process Design workgroup.

### **Governance arrangements for CRS and switching**

1.20. DCC should actively contribute to the design of new licence requirements necessary to deliver and operate the CRS once the relevant service capabilities have been procured. It should seek to ensure that these are consistent with the TOM and the design principles.

1.21. It should actively contribute to the development of the SEC structure and governance arrangements and seek to ensure that these are consistent with the TOM and the design principles.

1.22. We expect DCC to be a key contributor to the assessment and design of these requirements as well as their impact assessment. At an operational level these discussions are expected to take place in the Regulatory Design workgroup.

### **Charging arrangements for the CRS**

1.23. DCC will contribute to the design and assessment of charging arrangements for the provision of the CRS. It should ensure that these can be executed in accordance with the terms of its licence. We expect DCC to provide input into the impact analysis of these new charging arrangements, including the expected materiality of its costs.

1.24. At an operational level these discussions are expected to take place in the Commercial workgroup.

### **Price control arrangements for the CRS**

1.25. Ofgem will lead the discussion with DCC and industry on the price control arrangements. We expect DCC to engage constructively in the development of proposals and to provide input into the impact analysis of the new price control arrangements.

1.26. At an operational level these discussions are expected to take place in the Commercial workgroup.

### **Delivery approach for the CRS and switching arrangements:**

1.27. DCC will have a key role in designing the delivery approach for the CRS. We expect DCC to call on its experience in implementing large scale IT projects with smart meters. We expect DCC to take a leading role in the design of the requirements and their impact assessment including undertaking specific work packages, developing proposals and consulting the industry where appropriate on how the delivery arrangements should operate and the roles and responsibilities of parties.

1.28. At an operational level these discussions are expected to take place in the Delivery Strategy workgroup.

## Appendix 5 – Cost recovery options

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1.29. When considering the timing, the level of uncertainty, and the timeframe our analysis supports costs for CRS being recovered under the current ex post framework, while all the options are considered as part of the SCR. We are interested in views on the introduction of an ex ante approach for the procurement costs.

1.30. In this appendix we set out a detailed analysis of the options we considered for the recovery of DCC's costs

1.31. We looked at the following cost recovery frameworks:

- **No change to the licence:** DCC is not able to recover its costs
- **Ex ante controls:** Costs are agreed before they incurred. We have considered variations of this approach with uncertainty mechanisms.
- **Ex post controls:** The current framework where DCC incurs costs and we determine whether they are economic and efficient.
- **Full Co-operative Model:** Industry control the costs of the central registration provider

### No change to the licence

1.32. In this option we do not put in place arrangements for DCC to recover costs even in the transitional period. Any additional costs it incurs will not be part of DCC's allowed revenue and it will be unable to include CRS costs as part of service charges.

1.33. This option being a viable option would be dependent on how much extra work (and the cost of that extra work) DCC actually have to do during that time. If this option were to be considered we would need to take into consideration the level of input and expectations about how much DCC would support the project.

### Assessment of benefits and risks

1.34. In the table below we set out the benefits and risks of this option. Overall we are concerned this option could restrict DCC's support of the development of CRS

| Benefits   | Risks   |
|--|---|
| <ul style="list-style-type: none"><li>• It could be seen as a strategic growth opportunity to secure the additional registration work.</li><li>• Could incentivise DCC to use existing staff time rather than recruiting new team – might be more efficient since these are just short term arrangements</li></ul> | <ul style="list-style-type: none"><li>• This might constrain DCC's input</li><li>• DCC may not be able to fully engage and we do not get the right level of technical input.</li><li>• It could distract resources from smart meter rollout</li></ul> |

## DCC's role in developing a Central Registration Service and penalty interest proposals

### Ex ante controls

1.35. Under this framework costs associated with CRS are fixed and an allowance agreed prior to the costs being incurred. DCC would need to submit their cost forecasts and we would scrutinise them.

1.36. When setting ex ante controls it is important there is sufficient knowledge and certainty about the scope of activity that an organisation will be undertaking. We must consider the timeframe we have to introduce the transitional arrangements. It will take time to agree the costs, and this could mean there is a delay in DCC participating in supporting CRS work.

### Assessment of benefits and risks

1.37. In the table below we set out the benefits and risks of this option. There are benefits in a movement to an ex ante approach, particularly with the incentives this places on DCC. However, given DCC's support of CRS is due to start this year we would leave a very short time frame to agree ex ante controls. Any regime which is agreed will be reviewed as part of the working groups, so may only be in place for 3 years.

1.38. The activity around the procurement is likely to be more certain, and we are interested in views on whether these costs could be subject to an ex ante control. This would provide certainty around these costs that are likely to be the most material costs in the transition phase but it would mean wider consequential changes to the Licence. It would also mean time would need to be taken to scrutinise and set the level of costs.

| Benefits   | Risks   |
|--|---|
| <ul style="list-style-type: none"><li>Provides certainty for both DCC, and users</li><li>More in line with RIIO</li><li>In line with aspiration to move to ex ante</li><li>Costs escalations are not born by consumers which places strong incentives on DCC to manage its costs efficiently</li></ul> | <ul style="list-style-type: none"><li>There is still some uncertainty with the scope of DCC activity and the timing of the SCR</li><li>The transitional arrangement will only be in place for a short period. The work on assessing the appropriate enduring arrangements will start straight away</li><li>We may need to think of suitable characteristics for a re-opener</li></ul> |

### Uncertainty Mechanisms

1.39. Ex ante controls with various types of uncertainty mechanism can be used to reflect uncertainties and factors that are beyond an organisation's control. The RIIO Handbook summarises different types of mechanism that have been used by Ofgem in network regulation.<sup>32</sup>

1.40. Examples of ways uncertainty mechanisms could be adopted in ex ante controls are:

- **A sharing factor:** If DCC overspends its ex ante allowance, only a set percentage of any overspend would go through into DCC revenue allowances. Similarly if there was any underspend, a set percentage of that would be taken off DCC allowances and passed back to customers.
- **A pre-determined revenue trigger event:** We may be able to define what we think the ex-ante cost allowance should be reasonably well given what we currently know about the required scope. We could then define certain "trigger events" (that are outside of DCC's control) that would materially change our cost allowance.

1.41. Adding an uncertainty mechanism into the transitional arrangements would increase the complexity, and this seems disproportional for this phase of the work given the timeframe the regime could be in place for.

1.42. When considering the enduring arrangements ex ante controls with an uncertainty mechanism could be used to balance the incentive to keep costs efficient against factors that are not within DCC's control.

### Ex post controls

1.43. In an ex-post regime costs associated with CRS would be treated in the same way as DCC's current mandatory business service costs. It would effectively be an expansion of the current framework. DCC would incur costs associated with CRS and we would assess whether they are economic and efficient. DCC must include CRS costs in its budgets and forecasts.

1.44. In the table below we set out the benefits and risks of this option. When considering the timing, the level of uncertainty and the timeframe, our analysis supports costs for CRS being recovered under the current ex post review.

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<sup>32</sup> <https://www.ofgem.gov.uk/ofgem-publications/51871/riiohandbook.pdf>



## DCC's role in developing a Central Registration Service and penalty interest proposals

| Benefits  | Risks  |
|---|--|
| <ul style="list-style-type: none"><li>• Same process as current regime</li><li>• Simpler change to implement and more proportional given the duration it will be in effect for and materiality of costs</li><li>• Provides the flexibility so DCC can fully contribute to the COS, and if scope increases</li></ul> | <ul style="list-style-type: none"><li>• High degree of cost uncertainty</li><li>• Incentives are not as strong to keep costs efficient</li></ul> |

### Full Co-operative Model

1.45. The Full Co-operative Model is where there is industry oversight of the costs related to CRS. This would require an industry board/body that can scrutinise and sign off the costs.

1.46. In the table below we set out the benefits and risks of this option. It is not clear that the current governance arrangements are in place to support this option but this could be an issue that is considered for the enduring solution.

| Benefits  | Risks  |
|---|--|
| <ul style="list-style-type: none"><li>• This would be similar to the way SECAS costs are controlled and they are then treated as pass through</li><li>• Reduces regulatory burden</li><li>• Allows industry more scrutiny</li></ul> | <ul style="list-style-type: none"><li>• During the transition there could be ambiguity regarding what is expected of DCC. Under the enduring regime the role and costs should be clearer</li><li>• There could be issues of commercial sensitivity and data protection</li></ul> |

### Materiality of costs

1.47. In this section we provide a high level summary of the assumptions and set out how we approached developing cost and resource scenarios. This analysis helped us to consider the materiality of the costs we expect DCC to incur during the transitional phase. We are unable to provide detailed information at this stage due to commercial sensitivities.



## DCC's role in developing a Central Registration Service and penalty interest proposals

### **Our assumptions**

1.48. The roles we envisage DCC resources contributing to the Switching Programme are:

- project management of DCC's activities
- business process design
- technical systems and security design
- regulatory design and development support
- procurement strategy design and management
- implementation and testing approach development

### **Cost and resource scenarios**

1.49. We have considered different high and low impact cost scenarios to indicate the potential magnitude of costs DCC could incur.

1.50. In creating these scenarios, we envisage that a mixture of seniority and capability of staff would always be appropriate for DCC to source across the business functions.

1.51. We have varied our assumptions around the quantity of resource (number of Full Time Equivalent staff) required for each of the business function above. For example, we have varied the number of technical systems design and security analysts DCC would contribute during the Detailed Level Specification phase (in Regulatory Years 2016/17 and 2017/18) to reflect different levels of potential complexity in the design baseline.

1.52. We have also varied our assumptions on the cost of this resource. For example, we expect that the cost of procuring the right mixture of capabilities could vary for the more specialist resource required to support systems design. In making our assumptions on resource costs, we have drawn on a range of data points for benchmarking salaries for the roles involved.

## Appendix 6 – Consequential changes

### Consequential Licence changes


In this appendix we outline the detailed consequential changes by licence condition. The table sets out the licence conditions, whether we are proposing a consequential change and our reasoning for this. There are a number of obligations which would now capture CRS. We are proposing that where there is any compliance reporting that will follow the modification need to include CRS, DCC will need to consider this when they next review the documents.

We also considered whether there are any issues that should be explored in the industry working groups as part of the enduring framework. The proposed changes are published alongside this consultation in a tracked version of the licence.

| Type of change                           | Licence Condition (LC)                               | Brief description  |
|--|--|--|
| Licence Conditions that require changing | LC 1: Definitions for the Conditions of the Licence  | Include the new definitions for CRS.   |
|  | LC 6: Authorised business of the licensee            | Define CRS as a new service under Mandatory Business Services.   |
|  | LC 15: Incorporation of energy registration services | Licence condition re-written and called Incorporation of Central Registration Service  |
|  | LC21: Roles in relation to Core Industry Documents   | Moved the definition of Core Industry Codes to LC 1, as this definition also applies to the new LC15                                 |
|  | LC 22: The Smart Energy Code                         | Include CRS in the list of Mandatory Business Services listed in LC22.20 and remove LC22.21 as this reference is no longer relevant. |

## DCC's role in developing a Central Registration Service and penalty interest proposals

|  |   |  |
|--|---|--|
|  | LC 30: Requirements for the regulatory accounts   | Include CRS in the list of Mandatory Business Services in LC30.17  |
| <b>Licence Conditions where obligations will apply</b> | LC 7: General control for the authorised business<br>LC 8: Security controls for the authorised business<br>LC 9: Independence and autonomy of the licensee<br>LC 10: Protection of confidential information<br>LC 11: Duties arising from the licensee's special position<br>LC 12: Appointment and duties of compliance officer<br>LC 16: Procurement of relevant service capabilities<br>LC 18: Charging Methodology for Service Charges<br>LC 19: Charging statement for service charges<br>LC 24: Availability of all necessary resources<br>LC 27: Indebtedness and transfers of funds<br>LC 28: Disposal of relevant business assets<br>LC32: Reporting of price control information<br>LC 34: Annual service report to the authority<br>LC37: Assessment of mandatory business costs<br>LC 42: Management orders for the licensee<br>LC 43: Arrangements for the handover of business | <p>As a Mandatory Business Service it is appropriate the obligations under these Licence Conditions apply to CRS</p> <p>Where there are regulatory reports or strategies which need to be reviewed or approved once the Licence modification is made, in the next review DCC undertakes it will need to take into consideration CRS, and make amendments as appropriate.</p> |



## DCC's role in developing a Central Registration Service and penalty interest proposals

### **Licence conditions that need to be reviewed as part of industry working groups**

LC 5: General objectives of the licensee  
LC17: Requirements for the provision of services  
LC 18: Charging Methodology for Service Charges  
LC 20: Determination of disputes by the authority  
LC 21: Roles in relation to core industry documents  
LC 26: Financial stability and financial security  
LC31: Reporting of quality of service information  
LC 34: Annual service report to the authority  
LC 35-LC38: Price control conditions  
LC40: Determination of the VAS contribution

Regulatory and commercial obligations that should be reviewed in the enduring framework

Also, there could be interactions with the development of the operational performance regime and quality of reporting requirements that should be considered in the enduring framework.

# Appendix 7 – Penalty interest proposals

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## Issue

### Magnitude

1.7. Table A7.1 below presents the prudent estimate and estimated correction factor as a proportion of DCC's estimated revenue taken from the latest publications of its charging statements and indicative budgets.<sup>33</sup>

**Table A7.1**

| <b>Proportion of estimated AR</b>  | <b>RY 2014/15</b> | <b>RY 2015/16</b> | <b>RY 2016/17</b> |
|------------------------------------|-------------------|-------------------|-------------------|
| Prudent estimate                   | 17%               | 8%                | 6%                |
| Correction factor (for RY 2014/15) | 10%               | 4%                | 1%                |

## Changes to the Licence

### Interest accrued

1.8. We propose to amend the definition of regulated revenue in **Licence Condition 35.5** as per the changes tracked in red below:

**Regulated Revenue** means in relation to each Regulatory Year the actual revenue, measured on an accruals basis:

(a) received by the Licensee through Service Charges that are levied in accordance with the provisions of Condition 18 (Charging Methodology for Services) and Condition 19 (Charging Statement for Services) **including any interest earned on Service Charges**; or

(b) otherwise received by the Licensee in relation to the carrying on of the Mandatory Business, after the deduction of value added tax (if any) and any other taxes based directly on the amount concerned.

Paragraph (a) above shall be deemed to include any and all amounts paid by SEC Parties under the SEC to persons (other than the External Service Provider) engaged

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<sup>33</sup> Available here: <http://www.smartdcc.co.uk/charges>

## DCC's role in developing a Central Registration Service and penalty interest proposals

(indirectly pursuant to an External Service Provider Contract) in the business of financing Communications Hubs.

### Incentives to overcharge

1.9. We propose to amend the calculation of the correction factor (K) set out in **Licence Condition 36 Part F** as per the changes tracked below:

$$K_t = (AR_{t-1} - RR_{t-1} - DBC_{t-1}) \times [INT_t \pm + (ASR_t) / 100]$$

Option B: Power to Direct an unspecified alternative to the Bank of England base rate as a penalty interest rate on over-recoveries:

*INT<sub>t</sub> takes the value of 1, unless a Direction is given by the Authority for the purposes of changing the value.*

Option C: Power to require DCC to report to the Authority to explain any over-recovery which exceeds a certain percentage of allowed revenue. If DCC does not sufficiently justify the over-recovery we will then consult and direct a penalty interest rate consisting of a certain number of percentage points above the Bank of England base rate:

*INT<sub>t-1</sub> takes the value of 1, unless RR<sub>t-1</sub> exceeds [110-115]% of AR<sub>t-1</sub>. In this case:*

*(i) the Licensee must provide an explanation for that event in writing to the Authority by 31 July in the associated Regulatory Year<sub>t-1</sub> ;*

*(ii) the Authority may Direct INT<sub>t</sub> to have the value [X].*

### Options assessment

1.10. Table 4 below presents our more detailed assessment of the range of options we have considered for introducing a penalty interest rate on DCC for over-recovering charges.

**Table A7.1 – Options analysis**

| Option   | Incentive strength   | Risk  | Other benefits  | Overall assessment   |
|--|--|---|---|--|
| <b>A) Do nothing</b><br><i>(The base rate will apply to any over recoveries )</i>  | <ul style="list-style-type: none"> <li>Weak incentives for DCC to manage the prudent estimate efficiently</li> </ul>   | <ul style="list-style-type: none"> <li>Greater consumer detriment</li> <li>Time lag to impose a regime in future</li> <li>Risk to small Suppliers</li> <li>Low risk to DCC</li> </ul>   | <ul style="list-style-type: none"> <li>Certainty in charges</li> <li>Flexibility to respond to uncertainties</li> </ul>   | <p>The level of concerns regarding the magnitude of the prudent estimate and the time lag in future to introduce a mechanism supports considering taking the power to direct</p> |
| <b>B) Power to direct any penalty interest rate</b><br><i>(No detail of when it might be introduced or form)</i>   | <ul style="list-style-type: none"> <li>Uncertain regulatory regime for DCC</li> </ul>  | <ul style="list-style-type: none"> <li>Insufficient incentives and signals for DCC to manage the prudent estimate efficiently</li> <li>Less transparency of future penalty regime for Service Users and DCC</li> </ul>                                | <ul style="list-style-type: none"> <li>Provides more opportunity to consider the appropriate materiality threshold for over-recovery of charges</li> <li>Enables a Direction if needed in future</li> </ul>   | <p>Signals to DCC that it must charge accurately. However, it is less transparent</p>  |
| <b>C) Report and Direct</b><br><i>(Reporting requirement above a threshold, if unsatisfactory explanation we consult &amp; direct penalty interest rate to apply)</i>                          | <ul style="list-style-type: none"> <li>Firm signal on materiality</li> </ul>   | <ul style="list-style-type: none"> <li>The materiality threshold for over-recovery of charges is set too low or too high relative to the uncertainty DCC faces</li> <li>Insufficient incentives on DCC to manage the prudent estimate</li> </ul>      | <ul style="list-style-type: none"> <li>Enables a Direction when changes are needed and provides time for DCC to adjust its practices</li> <li>Provides DCC with an opportunity to explain its performance</li> <li>Could form part of annual price control reporting</li> </ul> | <p>Good balance between the strength of incentive and flexibility</p>  |
| <b>D) Power to direct the penalty interest rate if exceed a threshold</b><br><i>(Once a threshold is exceeded, we would consult and direct the penalty interest rate)</i>                      | <ul style="list-style-type: none"> <li>Firm signal on materiality</li> </ul>   | <ul style="list-style-type: none"> <li>During implementation, DCC could still be penalised for circumstances outside its control if the materiality threshold is set too low</li> <li>There may be more in year changes to Service Charges</li> </ul> | <ul style="list-style-type: none"> <li>Enables a Direction when changes are needed</li> <li>Optionality to set penalty interest rate appropriately given circumstances</li> </ul>   | <p>If the materiality threshold is set too low the penalty will apply. Risks with option E might materialise</p>   |
| <b>E) Immediate effect – penalty interest rate set</b><br><i>(An interest rate above the base rate for over-recovery over certain limit would apply. This could be reviewed by Direction.)</i> | <ul style="list-style-type: none"> <li>Firm signal on materiality but large and sudden change from current arrangements</li> <li>Gives DCC more certainty on the consequences of material over-recovery</li> </ul> | <ul style="list-style-type: none"> <li>During implementation, DCC may be penalised for circumstances outside its control if the materiality threshold is set too low</li> <li>There may be more in year changes to Service Charges</li> </ul>         | <ul style="list-style-type: none"> <li>Immediate effect of change but no time for DCC to adjust</li> </ul>  | <p>Risks to implementation of DCC's services if the materiality threshold is set too low, as evidence base needs strengthening</p>   |



## Appendix 7 - Glossary

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### A

#### Allowed Revenue

Total amount of revenue determined on an accruals basis in relation to each Regulatory Year in accordance with the Principal Formula set out in Part C of Condition 36 after the deduction of value added tax (if any) and any other taxes based directly on the amount concerned.

#### Annual Survey of House and Earnings (ASHE)

Annual survey that provides data on levels, distribution and make-up of earnings and hours worked for UK employees by sex and full-time/part-time status in all industries and occupations

#### Authority

The Gas and Electricity Markets Authority

### B

#### Baseline Margin

In each Regulatory Year an amount of additional revenue, over and above the sum of the Licensee's Internal Costs and External Costs that the Secretary of State has agreed shall be included (subject to the operation of the Baseline Margin Performance Adjustment) in the Licensee's Allowed Revenue, and is determined in accordance with the provisions of Part C of Condition 36.

#### Baseline Margin Implementation Performance Adjustment

The amount of reduction in the Baseline Margin determined in accordance with the provisions of Part B of Condition 38.

#### Baseline Margin Implementation Total

The Licensee's Baseline Margin, in total, for the period running from 23 September 2013 until the end of the Regulatory Year in which completion of implementation occurs.

#### Baseline Margin Performance (BMP) Adjustment

As defined in Licence Condition 35, means the component of the Licensee's Allowed Revenue that is determined in accordance with Part E of Condition 36 and subject to the operation of such provisions of Condition 38 (Determination of the BMP Adjustment) as applicable for that purpose.

### C

#### Central registration service (CRS)

A future service, procured and run by the DCC to facilitate switching at gas and electricity premises.



## DCC's role in developing a Central Registration Service and penalty interest proposals

### Change of Supplier Expert Group (COSEG)

Expert group formed by Ofgem with representatives from suppliers, networks, industry code experts, consumer representatives and government to help develop key aspects of the change of supplier process.

### Communications hub

As defined in Licence Condition 1, means a component, forming a part of the Smart Metering System installed at an Energy Consumer's premises, that enables data to be communicated to the Licensee from authorised devices within the premises that are connected to, or form part of, that system, and vice versa.

### Communications Service Provider (CSP)

Bodies awarded a contract to be a service provider of the DCC's communications services. Arqiva Limited and Telefónica UK Limited have been appointed to provide these services.

## D

### Data and Communications Company (DCC)

This is a company that manages the data and communications to and from domestic consumers' smart meters

### Data Services Provider (DSP)

Body awarded the contract to deliver systems integration, application management and IT hosting services to the DCC. CGI IT UK Limited has been appointed to provide these services

### Department for Energy and Climate Change (DECC)

The UK government department responsible for energy and climate change policy

## E

### External Costs

As defined in Licence Condition 35 of the Licence. The fundamental service capability predominately comprises of the communication service providers (CSP) and the data service providers (DSP). This definition means that costs associated with other externally procured contracts, for example the Smart Metering Key Infrastructure (SMKI) contract are reported under internal costs.

## F

### FTE

Full Time Equivalent



## DCC's role in developing a Central Registration Service and penalty interest proposals

### G

#### [Gainsharing](#)

Gainsharing is where Service Providers are able to implement efficiency improvements or through implementation of other changes costs of delivering services is reduced. The cost savings would be shared.

#### [Gas Transporter](#)

There are eight large Gas Transporters (GT), each of which covers a separate geographical region of Great Britain. There are also a number of independent GTs (iGTs) that typically provide network services for new developments.

#### [Great Britain Companion Specification \(GBCS\)](#)

The GBCS describes the detailed requirements for communications between Devices in consumers' premises, and between Devices and the Data and Communications Company (DCC).

### H

#### [HMRC](#)

Her Majesty's Revenue and Customs - the tax authorities in the UK.

### I

#### [Industry codes](#)

Industry codes and agreements underpin the gas and electricity markets and set out detailed rules for the gas and electricity markets that govern market operation and the terms of connection and access to the energy networks. The codes are contracts between signatories and provide a level playing field for services provided by central/monopoly providers, and contain interoperability requirements between competitors.

#### [Internal Cost](#)


As defined in Licence Condition 35 of the Licence. Costs (excluding external costs and pass-through costs) that were economically and efficiently incurred by the Licensee for the purposes of the provision of Mandatory Business Services under or pursuant to the SEC

### L

#### [Licence Application Business Plan](#)

The plan submitted in the course or as a consequence of the licence application process. It contains estimates of revenues, costs, capital investments and cash flows for each regulatory year of the Licence Term, and was taken into account by the Secretary of State in determining the grant of the Licence.

### M



## DCC's role in developing a Central Registration Service and penalty interest proposals

### Master Registration Agreement (MRA)

The Master Registration Agreement (MRA) is a governance mechanism to manage the processes established between electricity suppliers and distribution companies to enable electricity suppliers to transfer customers. It includes terms for the provision of Metering Point Administration Services (MPAS) Registrations.

### Mandatory Business Costs

Costs associated with the Authorised business of that consists of the operation or provision, on behalf of or to SEC parties, of Mandatory Business Services under pursuant to the SEC.

### Mandatory Business Services

As defined in Licence Condition 1 of the Licence, means the services comprising of the Mandatory Business of the Licensee. These are the Core Communication Services and the Enabling Services.

## O

### Ofgem

Office of Gas and Electricity Markets

### ONS

Office for National Statistics

## P

### Pass-Through Costs

The amount equal to the total amount fee paid by the licensee to the Authority and the payments to SECCo Ltd for purposes associated with the governance and administration of the SEC.

## R


### Registration

Each network company is required by its licence to maintain a register of supply points connected to its network. This register includes an address and unique reference number for each supply point as well as the identity of the supplier responsible for it.

### Regulatory Accounts

As defined in Licence Condition 1, means the accounts of the Licensee produced in accordance with the provisions of Condition 30 (Requirements for the Regulatory Accounts).

### Regulatory Instructions and Guidance (RIGs)



## DCC's role in developing a Central Registration Service and penalty interest proposals

Provide the basis on which the licensee must report price control information as required under the Smart Meter Communication Licence.

### Regulated Revenue

The actual revenue in a regulatory year, measured on an accruals basis received by the Licensee through Service Charges that are levied in accordance with the provisions of Condition 18.

### Regulatory Year

As defined in Licence Condition 1, means a period of 12 months beginning on the 1 April each calendar year and ending on 31 March of the next calendar year.

### Relevant Services Capability

As defined in Licence Condition 1, means the capability procured (or provided from within the Licensee's own resources) in accordance with Condition 16 (procurement of Relevant Service Capability) for the purposes of securing the provision of Mandatory Business Services under or pursuant to the Smart Energy Code. This means the internal and external resources which the DCC relies upon in order to provide services to DCC Users

### Relevant Adjustment

Means an adjustment that is proposed in accordance with the requirements of Licence Condition 36, Appendix 2.

## S

### Significant code review

The significant code review (SCR) mechanism is designed to facilitate complex and significant changes to the codes that energy companies are required to abide by. It enables Ofgem to undertake a review of a code-based issue and play a leading role in facilitating code changes through a review process.

### Smart Energy Code (SEC)

The SEC is a new industry code which is a multiparty agreement which will define the rights and obligations between the Data and Communications Company (DCC) and the users of its services Suppliers, network operators and other users of the DCC's services who will all need to comply with the Code

### SECCo

A company established under the SEC, owned by SEC Parties and which acts as a contracting body for the SEC Panel.

### SEC Panel

Panel established to oversee the Smart Energy Code with powers and duties as set out in Section C of the SEC.



## DCC's role in developing a Central Registration Service and penalty interest proposals

### Service Charges

The charges levied by and payable to DCC in connection with the operation or provision of Mandatory Business Services under or pursuant to the SEC

### Shared services

Support services sourced from the licensee's parent company and covered by the Shared services charge under Section 3.3.1 of the Business Plan. The terminology used in the RIGs is shared services but this charge covers corporate overheads.

### Smart Meter

Smart meter is a meter which, in addition to traditional metering functionality (measuring and registering the amount of energy which passes through it) is capable of providing additional functionality, for example two-way communication allowing it to transmit meter reads and receive data remotely. It must also comply with the technical specification set out by the Smart Metering Programme.

### Smart Meter Communication Licence

The Smart Meter Communication Licences granted pursuant to Sections 7AB(2) and (4) of the Electricity Act 1989 and Sections 6(1A) and (1C) of the Gas Act 1986.

### Supply Point Administration Agreement (SPAA)

This industry code sets out the inter-operational arrangements between gas suppliers and GTs. It is a multi-party agreement to which all domestic gas suppliers and all gas transporters are required by their licences to sign and comply with.

### Switching programme

This programme concerns the process used by industry to transfer a consumer from one supplier to another. Smart metering presents an opportunity to improve this process. Ofgem's ambition is for a fast, reliable and cost-effective process that facilitates competition and builds consumer confidence.

### Switching process

The process by which a consumer transfers from one supplier to another.

## U

### Unacceptable Costs

Unacceptable Costs has the same definition as give in Licence Condition 37. This means that any external costs or internal costs that the Authority considers were not economically and efficiently incurred in the relevant regulatory year.

### Uniform Network Code (UNC)

The Uniform Network Code defines the rights and responsibilities for all users of gas transportation systems and provides all system users with equal access to the transportation services.

## Appendix 8 - feedback questionnaire

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1.11. Consultation is at the heart of good policy development. We're keen to consider any comments or complaints about the way we've conducted this consultation. We'd particularly value your answers to these questions:

1. Do you have any comments about the overall process for this consultation?
2. Do you have any comments about the tone and content of the report?
3. Was the report easy to read and understand? Could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?

1.12. Please add any further comments and send your response to:

**Andrew MacFaul**  
Consultation Coordinator  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
[andrew.macfaul@ofgem.gov.uk](mailto:andrew.macfaul@ofgem.gov.uk)