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DCC Operational Performance Regime: Principles and Objectives

Consultation

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Overview:

As a monopoly, the Data and Communications Company (DCC) needs incentives, which mimic competitive pressure, to ensure it efficiently manages its costs whilst delivering an appropriate quality of service. A key performance incentive in their licence is that DCC's baseline margin be put at risk each regulatory year.

Under current arrangements, DCC's margin is tied to meeting certain Implementation Milestones (IMs) set by the Department of Energy and Climate Change (DECC) and assessed by Ofgem as part of its determination of Allowed Revenue.

Once the IMs are complete, an Operational Performance Regime (OPR) will take over. DECC has provided an OPR framework in the licence for Ofgem to develop and populate by direction.

This document invites stakeholders to provide their views on the scope, principles and possible performance metrics of the OPR as well as complementary reporting metrics that will give a wider picture of DCC's performance but may not be incentivised. We will consult further over the summer and will work closely with DECC to ensure the finalisation of the IMs complements the introduction of the OPR.

Context

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 and it holds the Smart Meter Communication Licences[1]. Price control arrangements restrict DCC's revenues, to counter its monopoly position.

Under its licence DCC has to submit cost, revenue, and incentive reporting to the Gas and Electricity Markets Authority (the Authority)[2]. The Licence stipulates that DCC's baseline margin be put at risk each regulatory year. Under current arrangements, DCC's margin is tied to meeting certain Implementation Milestones (IMs) set by the Department of Energy and Climate Change (DECC) and assessed by Ofgem as part of its determination of Allowed Revenue. Once the IMs are complete, an Operational Performance Regime (OPR) will take over. DECC has provided a framework in the licence for Ofgem to develop and populate by direction.

This document invites stakeholders to provide their views on the scope, principles and possible performance metrics of the OPR. It also asks for stakeholders' views on performance indicators to be initially reported against, and which may form part of the OPR later. Finally, this document sets out our high level timetable for developing and implementing the OPR.

Associated documents

- Data Communications Company (DCC): Price Control Decision 2014/15 https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-decision-regulatory-year-201415
- Data Communications Company (DCC): Regulatory Instructions and Guidance https://www.ofgem.gov.uk/ofgem-publications/88046/dccrigs2014.pdf
- Smart Meter Communication Licence https://epr.ofgem.gov.uk/Document
- DCC Price Control Guidance: Processes and Procedures: https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-guidance-processes-and-procedures

[1] 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 in respect of both those licences. Those licences are together referred to as 'the licence' throughout this document.

[2] 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.

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Executive Summary

Introduction

DCC has an essential role to play in the energy market. Its performance is critical to the success of the smart meter roll out and enabling suppliers to provide a good service to their customers thereafter. Suppliers, Network Operators and other DCC users are dependent on the DCC when installing and operating smart meters. Without an effective DCC, the benefits case for smart meters cannot be achieved.

As a monopoly, DCC is not subject to competitive pressures which drive effective performance. In the absence of these competitive pressures, incentive-based regulation can be used to ensure that DCC is responsive to the needs of its users and delivers good consumer outcomes.

When drafting the DCC licence, DECC recognised the need for incentives. The licence stipulates that DCC's baseline margin be put at risk each regulatory year. DECC has provided a framework in the licence for Ofgem to develop and populate by direction an Operational Performance Regime (OPR) which will place performance incentives on DCC once operational.

In the early operational phase we want DCC to be focused on supporting the roll out of smart meters by delivering a good service to its Users. We propose to place particular emphasis on facilitating an efficient and effective installation experience and providing reliable and dependable systems so that consumers can enjoy the benefits that smart meters offer.

Our Approach

Before designing the OPR itself, it is important to agree its scope and principles by which it should operate. We set out proposals for the OPR's scope and principles in this consultation.

We propose that the scope of the OPR should only concern DCC's core smart metering activities to allow for a stable, predictable incentive on DCC. Incorporating new projects within the OPR would require it to be frequently revised. DCC's margin at risk is relatively small at circa £2-3m per year. We recommend taking a targeted approach to applying the OPR within our proposed scope rather than stretching it thinly to cover every core business activity.

In developing the OPR, we propose some principles that should guide our work and would like to hear your views on these:

- **Responsive to user needs** - We anticipate that Users' needs will initially be focused on facilitating the roll out and system stability. The OPR should aim to incentivise DCC to meet those needs.
- **Flexible** – Users' priorities will evolve over time. The OPR must be flexible enough to evolve accordingly.

- **Output focused** - Rather than focusing on a rigid set of inputs for DCC to follow, we believe that the OPR should be output focused. This approach directly ties DCC's performance to consumers' experience of smart meters.
- **Clear and credible** – Clear metrics will provide greater certainty to users in terms of the desired behaviours we expect from DCC. Credible, achievable targets must be set for DCC in order to drive performance.

Proposals

We set out for each measure included in the framework outlined in DCC's licence, our initial thoughts on where these measures should perhaps be focused:

- **Service User** – To be responsive to Users' near-term priorities, performance metrics should be focused on the aspects of DCC's service that can impact on a successful roll out.
- **Service Delivery** - DCC systems must be reliable and dependable as they will underpin the effective functioning of the energy market. We can incentivise DCC to deliver this outcome given their close working relationship with Service Providers (SPs) and their role as a contract manager.
- **Value for Money** – The DCC price control already places incentives on DCC to ensure that its costs are economic and efficient. Nevertheless we are keen to explore further metrics under this measure, recognising some of the limitations of the current ex post price control arrangement. However, we do not expect to initially include this measure under the OPR.
- **Development and Innovation** – Although we don't intend to incentivise Development and Innovation at this time, we will consider reporting metrics to measure performance in this area.

We've also set out some examples of what metrics under each measure could look like. We invite respondents to comment on our proposed areas of focus and to suggest potential metrics.

We have proposed a targeted but flexible approach to implementing the OPR that evolves as Users' priorities change. Therefore, we are interested to hear suggestions from respondents on potential reporting metrics, against all four measures, which could be published in DCC's Annual Report in the short term and may become performance metrics under the OPR in the longer term.

Next Steps

We welcome your views and will feed them into the next phase of consultation through bilateral engagement and possible workshops over the summer, where we will develop and refine the OPR performance metrics and reporting metrics. We then plan to issue a consultation on our proposals following this engagement. We will refine our position based on responses to that consultation and hope to introduce the OPR in the autumn, by direction. We will work closely with DECC to ensure that the finalisation of the Implementation Milestones complements the introduction of the OPR.

1. Introduction

The Data and Communications Company

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 Smart Meter Communication Licence ('The Licence') to DCC 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. Ofgem is responsible for determining DCC's allowed revenue for each regulatory year as part of the price control.

1.3. The price control we run for DCC is different to that of other companies that we regulate. DCC incurs costs and passes these onto Users. We review these costs after the end of the regulatory year in which they were incurred – an approach we call 'ex post'[3][4]. If DCC's costs differ materially from those predicted in its business plan, it must explain and justify the differences to show that it incurred the extra costs economically and efficiently. Our decisions can affect money that DCC has already spent and money that it intends to spend.

1.4. In addition to the price control, DCC needs incentives which mimic competitive pressure to ensure it delivers an appropriate quality of service while efficiently managing its costs. As part of the price control arrangements, the Licence requires that 100% of DCC's smart meter-related margin should be put at risk. The licence contains an implementation performance regime. This consists of a series of implementation milestones (IMs) that DCC must achieve by specified dates. Failure to meet an IM by its due date results in DCC sacrificing a pre-agreed amount of its margin.

1.5. During the implementation phase DCC has had to be responsive to government or the regulator as the formal decision makers under the Smart Metering Implementation Programme Transition Governance Model[5]. The move to

[3] See here for the latest DCC price control decision: https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-decision-regulatory-year-201415

[4] DECC chose this approach so that DCC would be funded to deliver its objectives in an uncertain period as the regulatory framework develops and DCC prepares to support the smart meter rollout. For other companies, such as the networks, allowances are agreed up front

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/363674/transition_governance_overview.pdf

the operational phase marks an important shift of DCC's focus away from government and the regulator towards the needs of its Users.

The Operational Performance Regime

1.6. Ofgem is responsible for developing and implementing the OPR no earlier than 31 March 2016 but no later than 31 October 2018 following consultation with DCC, the SEC Panel and SEC Parties.[6]

1.7. The OPR framework[7] sets out four measures against which the operational performance of the DCC will be assessed:

- Service User Measure
- Service Delivery Measure
- Development and Improvement Measure
- Value for Money Measure

1.8. DCC's performance against the metrics established under the regime will determine the value of the margin that DCC is entitled to each regulatory year.

1.9. We are closely engaging with DECC to ensure that there is a smooth transition between the completion of the IMs, which is currently expected in late 2016, and the introduction of the OPR. The OPR is designed to incentivise DCC's core business activity, therefore a period of stabilisation may be needed before performance is assessed and subject to any financial incentives. Although the metrics themselves could be set, with a date for when they will take effect. This may mean that there is a period of time where there are no direct financial incentives in place[8]. However, DCC would be incentivised to ensure its performance is of a good standard during this period to be able to hit the performance metrics by the date they become effective.

The OPR and ex ante price control

1.10. Regulating monopolies such as the DCC should create value for money outcomes for consumers (both existing and future) by:

- encouraging companies to be responsive to their customers' needs and not the regulator or government
- improving the quality of services they provide
- managing costs efficiently

[6] LC 38 Part C of the Licence
[7] We've reproduced the framework, as set out in Schedule 4 of the licence, in Appendix 2.
[8] Note that 100% DCC's margin for each regulatory year would still be at risk but may be tied to performance metrics with target dates in a different period.

- ensuring that new investments are as efficient as possible.

1.11. Ex ante price control regimes, where costs are agreed in advance of being incurred, deliver these outcomes more effectively than ex post regimes. Ex ante regimes provide more certainty to the licensee and industry and encourage a longer term strategy for cost control.

1.12. We intend for DCC to move from the current ex post to an ex ante price control as soon as possible after go live. We are already working with DCC to start this transition. For example, for DCC's role in Centralising Registration Systems as part of the switching programme we are exploring the potential for introducing a price control model that seeks to drive some ex ante cost control behaviours. We also welcome the commitment from DCC to publish an annual business plan. This longer term view of DCC's costs is a first step in providing the detailed forecast of costs that will be needed to determine allowed revenue in advance of incurring costs under an ex ante price control. We are keen to explore whether any incentives set under the OPR can help facilitate this transition.

Comparison with other incentive regimes

1.13. Ofgem applies incentive regulation to gas and electricity networks, offshore transmission, the system operator, interconnectors and now the DCC. There are a number of features of the DCC and its licence arrangements that make it different to other incentive regimes. These will need consideration when finalising the OPR as it may mean our experience of incentive regimes elsewhere cannot directly be applied to DCC. It will also mean that our approach needs to be flexible, recognising that we may need to change the regime to respond to learning and experience in the first few months of operation. The differentiating features include:

- **Margin incentive** – In regulatory regimes where companies are subject to ex ante price control, their allowed revenue can be incentivised through various cap and floor regimes. This is where incentives are set such that if a company's pre-agreed revenues exceed the cap then the excess is returned to consumers. Conversely, if their revenues fall below the floor then consumers top up developers' revenues to the level of the floor. DCC's ex post regime means that revenues are determined after costs are incurred leaving little scope to set incentives on allowed revenue. For this reason, DCC's pre-agreed margin is put at risk against a set of incentives.

- **Downside only** – DCC's ex post price control is also the reason that the incentives placed on DCC can only be downside- ie where poor performance is penalised by reducing DCC's margin that they can recover. There is no mechanism under this regime for DCC to be rewarded for outperforming targets and increasing their margin beyond what is set out in the licence.

- **Lack of benchmarks –** DCC is a new company with no direct comparators that are developing exactly the same service in the GB energy sector. At the moment, it is therefore not straightforward to monitor, assess and benchmark DCC's performance based on experience elsewhere. However, we

expect that in the future benchmarking of the DCC will become easier, although there will continue to be no direct comparators. In comparison, it is easier under network regulation to set incentives through using performance benchmarking across the different companies to help set the right targets and incentives.

Purpose of this consultation

1.14. This consultation will set out:

- Our approach to incentivising DCC's operational performance.
- Our proposed scope, including how we will apply the OPR framework set out in the licence and complement it with further DCC reporting.
- The proposed principles we will follow in developing the OPR.
- Our proposed objectives under each OPR measure to meet the behaviours and outcomes. We also set out some example measures that could meet some of our proposed objectives.
- Finally, we set out our next steps for implementing the OPR.

1.15. We would like respondents' views on our approach to developing the OPR, the suitability of our objectives and thoughts on any metrics that may better meet the proposed objectives. We also invite respondents' thoughts on potential complementary monitoring of performance that may not initially form part of the OPR but may do at a later point.

1.16. As our next steps illustrate, this consultation represents the first stage in engagement only. We are not consulting on final measures to be introduced under OPR or how they will be weighted. This will be developed and finalised through further consultation.

2. Our Approach

Chapter Summary

This chapter sets out how we will apply the Operational Performance Regime (OPR). Firstly, it considers scope. We propose that the OPR should only apply to core business activities in the early operational phase and that a targeted approach should be taken to applying the OPR within that scope. Secondly, it considers the principles by which the OPR should be developed. We propose that the OPR should be responsive to User needs, flexible, output focused and clear and credible.

Question 1: Do you agree with our approach to apply the OPR to core smart metering activities only?

Question 2: Do you agree with complementing the OPR with further reporting in order to provide transparency and potentially form the basis of future OPR metrics?

Question 3: Do you agree with our proposed principles for developing the OPR metrics?

Scope

2.1. We consider that the OPR should only apply to core smart metering activities in the early operational phase while specific projects which materially changed the scope of its core business, such as adopting and enrolling the first generation of smart meters, are excluded. This should allow for a stable, predictable incentive on DCC. Incorporating projects under the OPR would require the regime to be frequently revised and may detract focus from delivery of DCC's enduring mandatory business.

2.2. This approach allows for the possibility of incentivising DCC for one-off activities in a bespoke manner rather than adapting the OPR to the role. The costs associated with these one-off activities were not included in DCC's bid and the scope and DCC's role in these areas are still to be determined.

2.3. In line with the framework set out in the licence, we estimate the amount of money that will be at risk under the OPR at circa £2-3m for each regulatory year.[9] In comparison to other monetary incentive schemes, this is a relatively small amount. For example, one of the financial incentives placed on the System Operator allows it

[9] Condition 38.11 of the licence states that at the amount of margin at risk in each Regulatory year must not be less than 100% of Baseline Margin.

to earn up to £30m per year through the Balancing Services Incentive Scheme (BSIS).[10]

2.4. Given the relatively small amount of money at risk, we believe that the number of incentives should be relatively few in number to achieve meaningful behavioural change in DCC. The greater the number of performance metrics in the regime the less likely it is that the OPR will provide clear and credible incentives to drive the desired behaviours from DCC.

2.5. The limited scope of the OPR reinforces the importance of DCC being transparent in order to provide industry with confidence in its performance. We intend to complement the OPR by requiring DCC to include further performance metrics in their Annual Service Report[11]. This will highlight to industry where DCC is doing well and areas for improvement. We are open to the possibility that, while it may not initially form part of the OPR, some of this complementary information may form the basis of future OPR metrics.

Principles

2.6. In developing the performance metrics that will populate the OPR, we propose a set of principles to guide our work. Through the design phase we will ensure that any proposed metrics are evaluated against the following principles:

Responsive to User needs

2.7. For DCC to be effective once operational, it must be responsive to the needs of its Users and ultimately consumers, not the regulator or government. DCC will need to have appropriate processes in place to ensure that Users' needs are met and risks and issues are managed appropriately. Similarly, DCC will need to have appropriate feedback loops in place to ensure those processes are working effectively.

Flexible

2.8. Users' priorities will evolve over time which means the OPR framework should be capable of evolving accordingly. In the near term, we anticipate that Users' needs

[10] More information on the on the BSIS can be found here: http://www2.nationalgrid.com/UK/Industry-information/Electricity-system-operator-incentives/BSIS/

[11] Under condition 34 of the licence, the Authority may require DCC to include appropriate (statistics based) performance measures within the Annual Service Report, provided the Authority consults in advance. However, there is a specific requirement on DCC to have regard to the need for exclude, so far as is practicable, any matter that relates to the affairs of a person if the publication of that matter would prejudice, or be likely to prejudice, their commercial interests.

will be focused on facilitating the roll out and system stability. In mass roll out, suppliers will be dependent on the DCC when installing and commissioning smart meters. It is important that first time success in this regard is maximised, and commissioning times minimised, in order to minimise inconvenience to consumers and minimise roll out costs while meeting the 2020 roll out obligation. Consumers will want to see immediate, reliable benefits from their smart meter, such as reduced estimated billing. Again, DCC will be a key dependency in offering these benefits.

2.9. However, as DCC systems and the roll out evolve over time, Users' priorities may change. The OPR must be capable of adjusting its focus in response and we expect to issue further directions in the future to evolve the OPR. Our proposed complementary reporting in the Annual Service Report will facilitate OPR flexibility.

Output focused

2.10. Rather than focusing on a rigid set of inputs for DCC to follow in the anticipation that they will provide good outcomes for consumers, we believe that the OPR should be output focused. This approach directly ties DCC's performance to consumers' experience of smart meters.

2.11. Output focused incentives will provide DCC with the responsibility to deliver for consumers along with the flexibility of how best to do so. DCC has a wealth of mechanisms, or "levers", which it can draw upon to manage Service Providers (SPs)[12] in the delivery of good outcomes for consumers. DCC will have freedom to use their discretion in delivering these outcomes in a manner as they best see fit.

2.12. Finally, output focused incentives provide greater certainty for Users in terms of the level of performance they should expect from DCC. This should allow Users to incorporate their interactions with DCC into their own planning with greater confidence, for example suppliers factoring DCC into their roll out plans.

Clear and credible

2.13. Coupled with being output focused is the need to ensure the incentives are as clear as possible. Clearly defined incentives will give greater certainty to both DCC and its Users in terms of the desired behaviours expected from DCC.

[12] Bodies awarded a contract to be a service provider of the DCC's services. The Communications Service Providers (CSPs) are awarded a contract to be a service provider of the DCC's communications services. Arqiva Limited and Telefónica UK Limited have been currently appointed to provide these services. The Data Service Provider (DSP) is 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.

2.14. Credible targets must be set for DCC in order to drive performance. If the targets set aren't realistically achievable, DCC will not have an incentive to change its default behaviour as necessary to meet them. If the targets aren't appropriately challenging, DCC will not find it necessary to appreciably change its default behaviour, which would call into question the value of the OPR. Therefore, the targets must be both achievable and challenging at the same time.

3. Designing the incentives

Chapter Summary

This chapter sets out our initial proposals for designing the OPR incentives. Firstly, we propose that the OPR should initially focus on the Service User and Service Delivery measures under the OPR framework. The other measures, Value for Money and Development and Innovation, may become more prominent later. Secondly, we set out for each measure, our initial thoughts on potential performance metrics that could be incentivised under the OPR or complementary reporting metrics that could be published in DCC's Annual Service Report. We welcome respondents' proposals and intend to use the metrics suggested by respondents as a starting point for further development in workshops later in the year.

Question box

Question 4: Do you agree with our proposal to prioritise the Service User and Service Delivery measures only in the immediate term?

Question 5: Do you have views on how DCC's operational performance can be measured without a baseline to compare it to?

Question 6: What specific performance metrics do you think will drive good consumer outcomes under each measure if incentivised?

Question 7: What other metrics do you propose DCC should report on as part of wider reporting and/or which could become part of the OPR in the longer term?

Question 8: Are there any other points we should consider when designing the OPR?

Prioritising objectives

3.1. The licence states that the OPR must not differ substantially from the framework set out by DECC in Schedule 4 of the licence[13]. Schedule 4 sets out four measures under which OPR metrics are to be populated - Service User, Service Delivery, Development and Improvement and Value for Money.

3.2. As we set out in the previous chapter, we expect Users' priorities in the near term to be facilitating the roll-out and system stability. On this basis, we consider that performance metrics in the OPR which are financially incentivised should only

[13] Condition 38.11(b) of the Smart Meter Communication Licence. We've reproduced Schedule 4 of the licence in Appendix 2.

focus on the Service User measure and Service Delivery measure when first implemented. We know that Users' priorities may change as the DCC becomes more established. Therefore, performance metrics under the Value for Money and Development and Innovation measures may be introduced in time.

Establishing a performance baseline

3.3. It is important to note that DCC is not yet providing a live service and therefore has no operational experience to date. This means that there is currently no baseline to measure DCC's performance against. In designing the OPR we will need to consider how best to solve this challenge. Possible options could be to:

- Base any incentives on improvement rates from when DCC goes live.
- Include a discretionary reward scheme in the OPR. We use these schemes for other companies we regulate to encourage and drive performance in areas that cannot be easily measured or incentivised through more established, mechanistic regimes[14].
- Include a target setting methodology that takes into account previous years' performance.

3.4. We would welcome respondents' thoughts on ways to incentivise DCC from 'go-live' without a baseline of performance to measure improvements against.

3.5. The lack of baseline is one of the key reasons we are keen to ensure that DCC's reporting through its Annual Service Report includes a broader set of metrics that could provide a sufficient baseline to track performance against if they were to be incentivised under the OPR at a future date.

Objectives and example metrics

3.6. We are interested to hear suggestions from respondents on potential metrics, against all four measures. Some metrics may form part of the initial OPR with the financial incentives attached, others may form part of the complementary reporting in the Annual Service Report and others may initially be included in the Annual Service Report and be incorporated into the OPR at a later date.

3.7. Below, we set out for each measure our initial thoughts on where these measures could be focused in order to deliver our proposed objectives. We have also set out some examples of what metrics under each measure could look like. We

[14] For example: https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/gas_drs_decision_document_2013-2015.pdf

invite respondents to comment on our proposed areas of focus and to suggest metrics. Our intention is to use the suggested metrics as a starting point for development through stakeholder engagement and further consultation later in the summer.

Part A: Service User Measure

3.8. Performance metrics could be focused on aspects of DCC's service to incentivise DCC to be responsive to Users' needs:

- *Provision and effective commissioning of communications hubs* - communications hubs are devices that connect smart meters to the DCC Wide Area Network (WAN). DCC procures and distributes these communications hubs to suppliers. Suppliers install them as part of the smart meter installation. When they are installed and successfully connect the meter to the network, the meter is 'commissioned' and consumers can begin to enjoy the benefits of smart meters. This process needs to be quick and effective to ensure consumers get a good installation experience and suppliers maximise the number of installs carried out each day.

- *Minimising second visits because of DCC WAN issues* - The DCC WAN will not cover all of Great Britain from the first day it is online. Instead, its coverage will be expanded over time. DCC will provide suppliers with coverage maps setting out where and when DCC will provide coverage. The more accurate these maps are, the easier it will be for suppliers to plan their roll outs and the more likely consumers will have a hassle free installation experience. Where a supplier installs a smart meter but fails to commission it, this may prompt a second visit, inconveniencing the consumer and delaying the provision of smart meter benefits. It is important that this negative outcome is minimised.

- *Efficient management of DCC Service Desk incidents* - DCC's Service Desk functions as the main conduit for engaging Users. All DCC issues that users face will be reported through it. It is important that the Service Desk is quick and effective in resolving issues that are reported.

Example metric – DCC Service Desk

3.9. The SEC Subsidiary document on Incident Management Policy sets a process for raising and categorising incidents with the Service Desk and how they will be managed by DCC.[15] We could incentivise DCC to be responsive and transparent in their dealings with Users to ensure this process runs smoothly.

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3.10. A Service Desk metric could focus on incentivising the reduction of resolution and clearance times of incidents and the extent to which they re-occur. Alternatively, margin could also be put at risk against escalated incidents being brought before the SEC Panel and the Panel's finding DCC at fault [16].

Part B: Service Delivery Measure

3.11. Whereas Service User measures centre on DCC's interactions with their Users, Service Delivery concerns the reliability and dependability of DCC systems. These systems must be reliable and dependable to unlock the benefits of smart meters and underpin the effective functioning of the energy market.

3.12. While DCC's Service Providers (SPs) are contracted to build and maintain a reliable smart metering communications system (and are directly incentivised to do so[17]), DCC has a vital role to play in delivering good outcomes.

3.13. DCC has a wealth of mechanisms, or "levers", which it can draw upon to formally manage SPs' performance. DCC is responsible for overseeing the design and build of systems that the SPs are contracted to deliver. DCC is also accountable for the Systems Integration Testing (SIT) in accordance with the requirements of the SEC. As a result, DCC has close relationships with the SPs which can support a reliable and dependable service throughout the country. This gives DCC the ability and necessary flexibility to deliver good outcomes for Users and consumers.

3.14. Performance metrics could be focused on incentivising DCC to solve the underlying root cause of any service issues leading to Users raising incidents with DCC. These are termed as 'Problems' under the incident management policy and would be resolved as a single piece of work. As services become more established and system stability improves after initial go-live, the root causes of any incidents raised should diminish.

Example –Solving Problems

3.15. We could incentivise DCC to minimise the numbers of Problems raised by tying DCC's margin to the volume of Problems it manages. Alternatively, the metric could focus on incentivising the reduction of resolution and clearance times of Problems and the extent to which they re-occur. Notwithstanding the service failure

https://www.smartdcc.co.uk/media/343845/draft_version_1.1_of_the_incident_management_policy.pdf

[16] Incidents can be escalated to nominated individuals with necessary authority for a variety of reasons such as failure to meet the target response time.

[17] A process exists in the SEC, whereby certain service failures by DCC Service Providers will trigger payments to DCC Users. These payments are capped at 15% of operational payments to the DCC Service Providers per month.

provisions on DCC's SPs in the SEC, we think it is important to incentivise DCC to actively manage its SPs to ensure a reliable service for users, which ultimately delivers better outcomes for consumers.

Part C: Value For Money Measure

3.16. The ex post price control already provides incentives on DCC to deliver value for money by ensuring that its allowed revenue includes only economic and efficient costs year on year. We are also introducing a penalty interest rate regime on DCC to discourage over recovery via its charges from Users[18].

3.17. However, we are aware of the limitations of the ex post regime and consider that there could be other ways to incentivise DCC to develop a longer term strategy to manage costs and transition to an ex ante price control. Areas to focus on under the value for money measure could include:

- Building on the robustness and transparency of DCC's business plan, with a view to moving to an ex ante price control in the future.

- Ensuring DCC places enough focus on long-term external cost management

3.18. On balance, we don't think it is suitable to add further incentives on the value for money measure in the short term, over and above the arrangements in the current price control. While value for money is important, we expect Users' priorities to be for DCC to focus on facilitating the rollout and system stability.

3.19. We also consider that there are practical limitations of the incentive mechanism which underpins the OPR and the ex post price control arrangement that limits the rewards available to DCC for outperformance. The financial incentive under the OPR puts DCC's margin at risk for poor performance – a downside incentive. The assessment of costs after they have been incurred under the ex post price control doesn't provide an upside sharing factor for any internal cost efficiencies made by DCC.

3.20. Nevertheless we're keen for views as to whether it is proportionate to introduce incentives for this measure under the OPR in the future.

Example – Development of a robust business plan

3.21. DCC has recently taken the welcome initiative to engage with stakeholders and draft a business plan. We could incentivise DCC to further engage with

[18] https://www.ofgem.gov.uk/publications-and-updates/final-proposals-dcc-s-role-developing-centralised-registration-service-and-penalty-interest-proposals

stakeholders and develop the long term business plan. This would help DCC demonstrate that it is transparent and responsive to Users, that Users are willing to pay for service improvements that DCC may be considering and that cost forecasts are robust. In turn, this could help improve standards under the Service User and Service Delivery metrics. The long term business plan would be an important input for developing the ex ante price control.

3.22. DCC could engage stakeholders to develop their long term business plan as is currently done by regulated network parties under the RIIO framework[19]. Ofgem could convene a Stakeholder Panel to assess the plan. The Panel could assess its suitability, provide feedback and highlight areas of best practice. The feedback and best practice could be fed into the next year's plan by DCC, driving performance year on year.

3.23. If this was to be included as part of the OPR in the future, a proportionate amount of DCC's margin could be tied to the suitability of the plan. The degree to which DCC's margin would be at risk to discretionary judgement would have to be considered. Guidance could be issued to provide clarity to both DCC and the Stakeholder Panel as to our expectations in developing the plan. We have issued guidance for other qualitative incentive schemes, such as the Electricity Transmission Stakeholder Engagement Incentive Scheme[20]. We would need to consider carefully the amount of margin potentially assigned to this incentive in future given its discretionary nature.

Example – Management of external costs

3.24. DCC does not directly build and maintain the smart metering communications system. This work is carried out by external service providers. Therefore, the majority of DCC's charges are made up of these external costs. DCC's ex post price control already incentivises DCC to ensure that external costs are economic and efficient. However, a drawback of the ex post regime is that it drives DCC to focus on the short term costs rather than longer term cost control[21].

3.25. To mitigate this in the future, we could develop a metric to encourage DCC to fully explore and secure any longer term efficiencies in the external contracts at the earliest opportunity. Further development of this metric would need to consider all existing incentives under DCC's current ex post price control to avoid any double penalty on DCC for any failures in this area.

[19] RIIO (Revenue=Incentives+ Innovation+Outputs) is Ofgem's framework for setting price controls for network companies.
[20] https://www.ofgem.gov.uk/sites/default/files/docs/2014/04/et_se_incentive_-_guidance_doc_0.pdf
[21] Note that there is a gainshare mechanism in place between DCC and the Service Providers to incentivise efficiency savings. However this is an upside only mechanism which only deals with contract changes and not necessarily long term overarching external cost control.

Part D: Development and Improvement Measure

3.26. DCC will have a key role in delivering greater functionality at lower cost per User which will foster greater competition in smart energy. Although we don't intend to incentivise Development and Innovation at this time, we will consider reporting metrics that could be included in DCC's Annual Service Report. This approach will enable performance to be baselined and for metrics to be financially incentivised through the OPR in future if appropriate.

3.27. Reporting metrics could be focused on the following areas to facilitate development and innovation:

- *Responsiveness to requests for Elective Communication Services* – Beyond the standard set of services Users will receive from DCC, they may request additional services at an additional cost.[22] DCC could be required to report on their performance in terms of how they respond to these requests.

- *Facilitating Smart Energy Code (SEC) modifications through effective impact assessments* – The SEC is a multi-party agreement that governs the relationship between DCC and its Users. There is a modification process to change the SEC[23], which will act as the main conduit for the development and evolution of DCC services. Often when a change to the SEC is proposed, it will have an effect on DCC systems. In this scenario, DCC is required to develop an impact assessment so that the costs and benefits of changing the SEC can be properly weighed up. We could require DCC to report on the effectiveness of their impact assessments in order to transparently demonstrate to Users how well they are facilitating SEC modifications.

- *Maximising coverage for the end of roll out* – as technology develops and/or costs decrease it may be possible to improve coverage levels beyond what is currently contracted so that more consumers can benefit from smart meter benefits. DCC could be further incentivised to find efficient solutions to any current gaps in service[24].

3.28. While we are not setting out specific examples of what reporting metrics could look like under this measure, we welcome any suggestions respondents may propose.

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[22] See condition 17, part C of the licence for more details.
[23] More details of the modification process can be found here: https://www.smartenergycodecompany.co.uk/docs/default-source/modifications/guide-to-the-sec-modifications-process-v1-0.pdf?sfvrsn=16
[24] See condition 17 appendix 1 para A6 which requires DCC set out steps to secure the eventual provision of Smart Meter Communication Services to premises, or areas, falling within a Servcie Exemption Category.

4. Next steps

4.1. This consultation represents the first step towards implementing the OPR. We will take on board the views of our respondents in adjusting and refining our overall strategy for implementing the OPR. In the next phase of consultation, through bilateral engagement and a possible workshop over the summer, we will:

- Work with stakeholders to examine, test and refine potential performance metrics.
- Work with stakeholders to examine what combinations of metrics will best incentivise DCC to perform and how these metrics should be weighted.
- Examine what timescale the OPR should be assessed over – ie. should performance under the OPR be assessed over a single regulatory year or over multiple years as is the case with the IMs. We will also consider when the OPR will formally commence after DCC go-live.

4.2. We then plan to issue a consultation on our initial proposals following this engagement. We will refine our position based on responses to that consultation and hope to introduce the OPR in the autumn, by direction. Note that these timescales are subject to final decisions on the conclusion of the Implementation Milestones (IM) regime. We will work closely with DECC to ensure the finalisation of the IMs complements the introduction of the OPR.

4.3. Our current intention is to develop the complementary reporting metrics to be included in DCC's Annual Service Report as part of this work. However, this work may need to be placed on a longer timescale should the resource commitment associated with our core OPR work be greater than expected.

Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from DCC Users who will have direct interactions with DCC.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 6 May 2016 and should be sent to:

Robyn Daniell
Smarter Metering
Ofgem
9 Millbank
London
SW1P 3GE
smartermarkets@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

CHAPTER: Two

Question 1: Do you agree with our approach to apply the OPR to core smart metering activities only?

Question 2: Do you agree with complementing the OPR with further reporting in order to provide transparency and potentially form the basis of future OPR metrics?

Question 3: Do you agree with our proposed principles for developing the OPR metrics?

CHAPTER: Three

Question 4: Do you agree with our proposal to prioritise the Service User and Service Delivery measures only in the immediate term?

Question 5: Do you have views on how DCC's operational performance can be measured without a baseline to compare it to?

Question 6: What specific performance metrics do you think will drive good consumer outcomes under each measure if incentivised?

Question 7: What other metrics do you propose DCC should report on as part of wider reporting and/or which could become part of the OPR in the longer term?

Question 8: Are there any other points we should consider when designing the OPR?

Appendix 2 – Schedule 4 of the DCC Licence

Schedule 4: The Operational Performance Regime

Introduction

4.1 In accordance with Part C of Condition 38 (Determination of the BMP Adjustment), this Schedule 4 establishes the Operational Performance Regime under which the operational performance of the Licensee will be monitored against the four headings outlined below as SUM, SDM, DIM, and VMM.

4.2 The performance monitoring to which paragraph 4.1 refers is for the purposes of calculating the amount of each of the algebraic terms within the formula set out at paragraph 9 of Condition 38 that determines the value of the BMOPA term in Regulatory Year t.

Part A: Service User Measure (SUM)

SUM 1	See Part E below
SUM 2	
SUM 3	
SUM 4	

Part B: Service Delivery Measure (SDM)

SDM 1	See Part E below
SDM 2	
SDM 3	
SDM 4	

Part C: Development and Improvement Measure (DIM)

DIM 1	See Part E below
DIM 2	
DIM 3	
DIM 4	

Part D: Value for Money Measure (VMM)

VMM 1	See Part E below
VMM 2	
VMM 3	
VMM 4	

Part E: Interpretation

4.3 In accordance with paragraph 9 of Condition 38, this Schedule 4 is to be read for illustrative purposes only, pending the further development and populating of the above provisions by the Authority pursuant to and in accordance with paragraphs 10 and 11 of Condition 38.

Appendix 3 - Glossary

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.

Authority
The Gas and Electricity Markets Authority

B

Baseline Margin (BM)
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 performance 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.

C

Centralised registration service (CRS)
A future service, procured and run by DCC to facilitate switching at gas and electricity premises.

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 currently 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. Smart DCC Ltd was granted the Licence by the Secretary of State with effect from 23 September 2013.

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 smart meter communication 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.

I

Implementation Milestone
The targets DCC is required to achieve as laid out in Schedule 3 of the Smart Meter Communication Licence in order to earn its full Baseline Margin.

Implementation Performance Regime
The incentive regime which determines the amount of margin that DCC is able to recover in the implementation phase as set out in schedule 3 of the Smart Meter Communication Licence.

Internal Cost
In relation to each Regulatory Year the sum of the 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 (and may include costs incurred in respect of the governance and administration of the SEC that are not included in the pass-through costs).

M

Mandatory Business Costs
Costs associated with the provision of Mandatory Business Services under or pursuant to the SEC.

O

Ofgem
Office of Gas and Electricity Markets

Operational Performance Regime (OPR)
The incentive regime which subjects 100% of DCC's margin at risk to be applied with effect from the start of the regulatory year immediately following the Regulatory Year in which the Completion of Implementation is achieved. As listed under Schedule 4 of the Smart Meter Communication Licence.

R

Regulatory Instructions and Guidance (RIGs)
The document of that name issued by the Authority under Licence Condition 33 for purposes relating to the obligations of the Licensee under Licence Condition 31 (Reporting of Quality of Service Information) and Licence Condition 32 (Reporting of Price Control Information). Provide the basis on which the licensee must report price control information as required under the Licence.

S

Service Providers (SPs)
Bodies awarded a contract to be a service provider of the DCC's services. The Communications Service providers (CSPs) are awarded a contract to be a service provider of the DCC's communications services. Arqiva Limited and Telefónica UK Limited have been currently appointed to provide these services. The Data Service Provider (DSP) is 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.

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

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

Smart Meter
A 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 Gas Act 1986 and Sections 6(1A) and (1C) of the Electricity Act 1989.

Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall 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?
6. Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk