

To: The holder of the Smart Meter Communication Licence

**Gas Act 1986 – Section 23(2)
Electricity Act 1989 – Section 11A(2)**

Notice of statutory consultation on a proposal to modify the standard conditions of the smart meter communication licence

1. The Gas and Electricity Markets Authority ('the Authority')¹ proposes to modify the standard conditions of the smart meter communication licence granted or treated as granted under section 7AB(2) and (4) of the Gas Act 1986 and section 6(1A) and (1C) of the Electricity Act 1989 ('the DCC Licence') by amending Licence Condition 35 (Definitions for the Price Control Conditions) and Licence Condition 36 (Determination of the Licensee's Allowed Revenue).
2. The reasons why the Authority proposes to make these licence modifications have been published by the Authority in the following documents:
 - a) Final proposals for DCC's penalty interest rate – 6 April 2016
 - b) Proposals for DCC's role in developing a Central Registration Service (CRS) and penalty interest proposals – 17 December 2015.
 - c) DCC's role in developing a Central Registration Service (CRS) and penalty interest proposals – 28 July 2015.
3. The effects of the proposed modifications are described in the documents referred to in paragraph 2 of this Notice. and, in particular, the following documents:
 - a) Final proposals for DCC's penalty interest rate – 6 April 2016
 - b) Proposals for DCC's role in developing a Central Registration Service (CRS) and penalty interest proposals – 17 December 2015.
 - c) DCC's role in developing a Central Registration Service (CRS) and penalty interest proposals – 28 July 2015.
4. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively they are available from our Research and Information Centre, 9 Millbank, London, SW1P 3GE (020 7901 7003).
5. Any representations with respect to the proposed licence modifications must be made on or before 5 May 2016 to: Laura Nell, Head of Smarter Metering, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to smartermarkets@ofgem.gov.uk .
6. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We

¹ The terms "the Authority", "we" and "us" are used interchangeably in this document.

prefer to receive responses in an electronic form so they can be placed easily on our website.

7. If we decide to make the proposed modifications they will take effect on a date not less than 56 days after the decision is published (in the absence of any appeal).

.....
Rob Salter-Church
Partner, Consumers and Competition
Duly authorised on behalf of the
Gas and Electricity Markets Authority

6 April 2016

For the avoidance of doubt, proposed additions are shown as double underlined and proposed omissions are shown as strikethrough. We have only shown those licence conditions where modifications are proposed.

Condition 35. Definitions for the Price Control Conditions

Introduction

- 35.1 This condition has effect on and after 23 September 2013 as one of the Price Control Conditions of this Licence.
- 35.2 In this Licence, a Price Control Condition is any condition the purpose of which, whether on its own or in combination with any other Price Control Condition, is to limit or control the charges of, or the revenue of, the Licensee.

Part A: Defined terms used in the Price Control Conditions

- 35.3 Part B below sets out most of the defined words and expressions (all of which begin with capital letters) that are used in the Price Control Conditions of this Licence, and gives their definitions next to them (“the Chapter 9 Particular Definitions”).
- 35.4 But words and expressions used in the Price Control Conditions that are defined for any of the purposes of this Licence in Condition 1 (Definitions for the Conditions of this Licence) have in this Chapter 9 the meaning given to them in that condition.

Part B: The Chapter 9 Particular Definitions

- 35.5 In the Price Control Conditions, unless the context otherwise requires:

Allowed Revenue	means the total amount of revenue determined on an accruals basis in relation to each Regulatory Year in accordance with the Principal Formula set out at Part C of Condition 36 (Determination of the Licensee’s Allowed Revenue) after the deduction of value added tax (if any) and any other taxes based directly on the amount concerned.
Average Specified Rate	means the rate that is equivalent to the average value of the Official Bank Rate of the Bank of England during the period in respect of which the calculation falls to be made.
Baseline Margin	means in relation to 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	means the amount (if any) of reduction in the Baseline Margin determined in accordance with the provisions

Performance Adjustment	of Part B of Condition 38 so as to secure, with respect to the applicable period, the effect set out in Part A of that condition.
Baseline Margin Implementation Total	means the Licensee's Baseline Margin, in total, for the period running from 23 September 2013 until the end of the Regulatory Year 2015/2016 (and, arising from the Licence Application Process, is calculated for the purposes of Schedule 3 to this Licence to have the value of £7.687 million, subject to adjustments for inflation as set out in paragraph 35.6.
Baseline Margin Performance (BMP) Adjustment	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 the provisions of Condition 38 (Determination of the BMP Adjustment).
Baseline Margin Operational Performance Adjustment	means the amount (if any) of reduction in the Baseline Margin determined in accordance with the provisions of Part C of Condition 38 so as to secure, with respect to the applicable period, the effect set out in Part A of that condition.
External Contract Gain Share	means the component of the Allowed Revenue of the Licensee that is determined in accordance with the provisions of Condition 39 (Determination of External Contract Gain Share) so as to secure the effect set out in Part A of that condition.
External Costs	means in relation to each Regulatory Year the actual amount of the costs that were economically and efficiently incurred by the Licensee in procuring Fundamental Service Capability during that period.
Internal Costs	means 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 Pass-Through Costs).
Pass-Through Costs	means in relation to each Regulatory Year the sum of the amounts that are specified as Pass-Through Costs in paragraph 8 of Condition 36.
Regulatory Year t	means the particular Regulatory Year for the purposes of which any calculation is required to be made under the Price Control Conditions.
Regulatory Year t-1	means the Regulatory Year immediately preceding the

Regulatory Year t (and any similar expressions are to be read accordingly).

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

Value Added Service (VAS) Contribution

means the component of the Allowed Revenue of the Licensee that is determined in accordance with the provisions of Condition 40 (Determination of the VAS Contribution) so as to secure the effect set out in Part A of that condition.

35.6 The value of the Baseline Margin Implementation Total shall be the sum of:

- (a) £1.769 million;
- (b) £3.194 million multiplied by the value of PIBM in Regulatory Year 2014/15; and
- (c) £2.724 million multiplied by the value of PIBM in Regulatory Year 2015/16,

where PIBM is the price index adjuster applied to the Baseline Margin in each Regulatory Year and calculated in accordance with Part C of Condition 36 (Determination of the Licensee's Allowed Revenue).

Part C: Matters agreed by the Secretary of State

35.7 A reference in this condition or in any of the other Price Control Conditions to a value or amount agreed by the Secretary of State is a reference to that value or amount as agreed by the Secretary of State during or as a consequence of the Licence Application Process.

Part D: Guide to abbreviated price control terms

35.8 Most of the defined terms in the Chapter 9 Particular Definitions set out above appear in formulas embedded in the Price Control Conditions in the following abbreviated forms:

Allowed Revenue	AR
Average Specified Rate	ASR
Baseline Margin	BM
Baseline Margin Implementation Performance Adjustment	BMIPA
Baseline Margin Implementation Total	BMIT
Baseline Margin Operational Performance Adjustment	BMOPA
Baseline Margin Performance Adjustment	BMPA
External Contract Gain Share	ECGS
External Costs	EC
Internal Costs	IC
Pass-Through Costs	PTC
Regulated Revenue	RR
Value Added Service Contribution	VASC

Condition 36. Determination of the Licensee's Allowed Revenue

Introduction

- 36.1 This condition has effect on and after 23 September 2013 as one of the Price Control Conditions of this Licence.
- 36.2 The purpose of this condition is to establish the mechanism for determining the amount of Allowed Revenue that may be recovered by the Licensee through Service Charges levied in respect of its provision of Mandatory Business Services.

Part A: Conditions supplementary to this condition

- 36.3 This condition is supplemented by:
- (a) Condition 37 (Assessment of Mandatory Business costs), which provides for the Authority to determine the treatment of any costs associated with the provision of Mandatory Business Services that the Authority considers were not economically and efficiently incurred;

- (b) Condition 38 (Determination of the BMP Adjustment), which provides for the Allowed Revenue to be adjusted upwards or downwards to reflect the Licensee's performance against certain specified incentives; and
- (c) Condition 39 (Determination of External Gain Share) and Condition 40 (Determination of the VAS Contribution), which provide for the Allowed Revenue to be varied to reflect benefits arising from, respectively, the Licensee's management of External Service Provider Contracts and its provision of Value Added Services.

Part B: Duty of the Licensee with respect to Regulated Revenue

- 36.4 The Licensee, in setting Service Charges for its Mandatory Business Services, must take all reasonable steps to secure that, in Regulatory Year t, its Regulated Revenue does not exceed a prudent estimate of its Allowed Revenue for that Regulatory Year.
- 36.5 For the purposes of paragraph 36.4, and subject to paragraph 36.6, a prudent estimate of Allowed Revenue is the Licensee's best estimate of Allowed Revenue as adjusted to ensure that (disregarding any within-year adjustments that may be permitted in circumstances prescribed by the Charging Methodology of the Licensee) the Service Charges as they apply for Regulatory Year t will not need to be amended in the course of that year except in response to a reasonably unlikely contingency.
- 36.6 The adjustment to which paragraph 36.5 refers must not be such as to result in an expectation that Regulated Revenue will significantly diverge from the Allowed Revenue in Regulatory Year t.

Part C: Determination of the Allowed Revenue (AR) term

- 36.7 The amount of the Licensee's Allowed Revenue in relation to Regulatory Year t is to be determined in accordance with the following formula (in this condition, the Principal Formula):

$$AR_t = EC_t + IC_t + PTC_t + BM_t + BMPA_t + ECGS_t - VASC_t + K_t$$

- 36.8 In the Principal Formula above:

- AR_t means the amount of the Allowed Revenue in Regulatory Year t.
- EC_t means the actual amount of the Licensee's External Costs, as calculated for Regulatory Year t by the Licensee, except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.
- IC_t means the actual amount of the Licensee's Internal Costs, as calculated for Regulatory Year t by the Licensee, except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Condition 37.
- PTC_t means the total amount of Pass-Through Costs incurred by the Licensee in Regulatory Year t, and is the sum of:

- (i) the amount that is equal to the total annual fee paid by the Licensee to the Authority during Regulatory Year t as determined in accordance with Part A of Condition 4 (Licensee’s payments to the Authority); and
- (ii) the amount that is equal to the payments made by the Licensee during Regulatory Year t to SECCo Ltd for purposes associated with the governance and administration of the SEC.

BM_t means the amount of the Licensee’s Baseline Margin that is specified for the Regulatory Year; t in Appendix 1 (which has effect as part of this condition) (or such other amount as may have been determined for that Regulatory Year pursuant to the provisions of Part D below), as multiplied by the price index adjuster (PIBM) for that year, which in the Regulatory Year 2013/14 shall have the value of 1 and in each subsequent Regulatory Year is derived from the following formula:

$$PIBM_t = \left[1 + \frac{RPI_t}{100} \right] \times PIBM_{t-1}$$

where RPI_t means the percentage change (whether it is positive or negative) between (i) the arithmetic average of the Retail Prices Index numbers published or determined with respect to each of the six months from July to December (inclusive) in Regulatory Year t–2, and (ii) the arithmetic average of the Retail Prices Index numbers published or determined with respect to the same months in Regulatory Year t–1 (and “Retail Prices Index” has the meaning given to that term in Part G below).

BMPA_t means the Baseline Margin Performance Adjustment, as calculated for the Regulatory Year t in accordance with Part E below.

ECGS_t means the amount of revenue adjustment in respect of External Contract Gain Share, as calculated for Regulatory Year t in accordance with Condition 39 (Determination of External Contract Gain Share).

VASC_t means the amount of the Value Added Services Contribution, as calculated for Regulatory Year t in accordance with Condition 40 (Determination of the VAS Contribution).

K_t means the correction factor, whether positive or negative, as calculated for Regulatory Year t in accordance with the formula set out in Part F below.

Part D: Adjustment mechanism for the Baseline Margin term

36.9 The amount of the Baseline Margin term as specified in Appendix 1 for any one or more of the Regulatory Years to which that Appendix applies may be varied in such manner and to such extent as may be directed by the Authority in accordance with and subject to the provisions of Appendix 2 (Adjustment mechanism for the BM term), which has effect as part of this condition.

Part E: Calculation of the BMP Adjustment (BMPA) term

36.10 For the purposes of the Principal Formula, the total amount of the Baseline Margin Performance Adjustment term (BMPA) will be calculated for Regulatory Year t in accordance with the following formula:

$$\text{BMPA}_t = \text{BMIPA}_t + \text{BMOPA}_t$$

36.11 For the purposes of paragraph 36.10, the value of the term BMIPA_t :

- (a) shall be determined in accordance with the provisions of Part B of Condition 38 (Determination of the BMP Adjustment) until the end of the Regulatory Year in which Completion of Implementation (within the meaning given to that term in Condition 5 (General Objectives of the Licensee)) is achieved (or such earlier date as the Authority may specify in a direction given to the Licensee under paragraph 36.13); and
- (b) thereafter shall be zero.

36.12 For the purposes of paragraph 36.10, the value of the term BMOPA_t :

- (a) shall be zero until the end of the Regulatory Year 2015/16 (or such later date as the Authority may specify in a direction given to the Licensee under paragraph 36.13); and
- (b) thereafter shall be determined in accordance with the provisions of Part C of Condition 38 (Determination of the BMP Adjustment).

36.13 A direction that is given for the purposes of paragraph 36.11 or 36.12 will be of no effect unless, before issuing it, the Authority has first:

- (a) by Notice given to the Licensee and published on the Authority's website, set out the revised date that it proposes to specify in the direction;
- (b) set out in that Notice a statement of the reasons why the Authority proposes to specify that date;
- (c) specified in the Notice the period (which may not be less than 28 days from the date of the Notice) within which representations may be made to the Authority about its proposals; and
- (d) considered any representations duly received in response to the Notice.

36.14 The Authority must have regard to any representations duly received in response to its Notice under paragraph 36.13 and must give reasons for its decisions in relation to them when giving the relevant direction.

Part F: Calculation of the correction factor (K)

36.15 For the purposes of the Principal Formula, the correction factor (K) shall in the Regulatory Year 2013/2014 have the value of 0, and in each subsequent Regulatory Year shall be calculated in accordance with the following formula:

$$K_t = \left[\frac{(AR_{t-1} - RR_{t-1} - BDC_{t-1}) \times \left(1 + \left(\frac{ASR_t}{100} \right) \right)}{100} \right] + \left[\frac{((AR_{t-1} - RR_{t-1} - BDC_{t-1}) \times F_t) \times \left(\frac{INT_t}{100} \right)}{100} \right]$$

36.16 In the formula for the K term above:

AR_{t-1} means the amount of Allowed Revenue in Regulatory Year t-1.

BDC_{t-1} means the contribution to bad debt within the Licensee's Internal Costs in Regulatory Year t-1, and will be zero except where the Licensee has failed to comply fully with its obligations under or pursuant to the SEC in relation to the management of SEC Parties' credit cover and the recovery of bad debt, in which event it will have such value as may be determined by the Authority.

RR_{t-1} means the Regulated Revenue in Regulatory Year t-1.

(Definitions) ASR_t means the Average Specified Rate, as defined in Condition 35 for the Price Control Conditions), in Regulatory Year t

F_t means the factor determined in accordance with paragraph 36.17

INT_t means the interest rate adjustment in Regulatory Year t made in respect of the relevant amount of over-recovery of Regulated Revenue as determined in accordance with paragraph 36.17.

36.17 The value of the interest rate adjustment INT_t is determined as follows:

- (a) if, in respect of Regulatory Year t-1, RR_{t-1} exceeds the threshold of 110 per cent of AR_{t-1} , the Licensee must, by no later than 31 July of the Regulatory Year t, explain and demonstrate to the Authority in writing why that event is justified. After considering the explanation provided and after consulting with the Licensee and SEC Parties, the Authority may direct the Licensee to apply the value of 3 to INT_t for any proportion (F_t) of the difference between RR_{t-1} and AR_{t-1} that the Authority determines has not been justified by the Licensee; or
- (b) if the Authority has not directed the Licensee to apply any value to INT_t , it will take the value of 0; and
- (c) the Authority may adjust the threshold percentage and the value of the interest rate adjustment INT_t that are set out in paragraph (a) above in respect of any Regulatory Year by direction, after consulting with the Licensee and SEC Parties.

Part G: Interpretation

36.187- For the purposes of this condition, **Retail Prices Index** means:

- (a) the general index of retail prices that is published by the Office for National Statistics each month in respect of all items; or
- (b) if that index in respect of any month that is relevant for the purposes of this condition has not been published on or before the last day of February, such price index as the Authority, after consultation with the Licensee, may determine to be appropriate; or
- (c) if there is a material change in the basis of that index, such other index as the Authority, after consultation with the Licensee, may determine to be appropriate.

36.198 Appendices 1 and 2 follow immediately below.