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Date: 24 March 2016

Dear Company Secretary,
Approval of statement pursuant to paragraph 19.5 of condition 19 (Charging Statement for Service Charges) of Smart DCC Limited's Smart Meter Communication Licence¹

This letter sets out the Authority's² decision to approve the form of the Charging Statement for Service Charges (statement) prepared by Smart DCC Limited (DCC) and its reasons for that decision.

Appendix 1 explains what DCC is and what its licence requires. The licence details DCC's obligations for its charging statement and other matters. To keep this letter short and easy to read we have used general descriptions of the relevant licence provisions rather than quoting the wording used in the licence. Refer to the licence for a full description of DCC's obligations.

Initial submission and consultation

On 24 December 2015 DCC submitted to us an updated statement for service charges that will fall due in Regulatory Year (RY) 2016/2017. Compared to the RY 2015/16 statement in place, the key material changes to the form of the statement DCC proposed included:

- Section A (Summary of Charges for RY 2016/17)
 - inclusion of a summary section for fixed communications hubs charges
 - the introduction of three new indicative explicit charges (additional testing support, additional communications hubs order management systems accounts, and elective service evaluations)
- Section D (Communications Hubs Charges and Explicit Charges)
 - inclusion of communications hubs forecast volumes to estimate communications hubs revenue
 - description of how monthly charges for communications hub services will be determined
 - inclusion of communications hubs charging periods
- Section F (Annexes)
 - Annex 3 (Estimated Explicit Charges Revenue and Explicit Charges – supporting information) contains further description of the three new indicative explicit charges which users may request

¹ The Smart Meter Communication Licences were granted under both the Gas Act 1986 and the Electricity Act 1989. For ease, in this letter we refer to these licences in the singular. DCC's licence can be found at <https://epr.ofgem.gov.uk/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 letter, 'we' and 'us' are used to refer to both 'Ofgem' and 'Authority').

- Annex 4 (Worked Examples) includes an example of how fixed communications hubs charges will be calculated in the total amounts payable shown on invoices.

The statement was in the form that DCC expected to use for the regulatory year starting on 1 April 2016. We consulted on the proposed statement in our letter dated 7 January 2016 and invited views on the form, in particular on whether it:

- provides sufficient clarity on the charges that service users will face
- is in a coherent and easy to navigate format
- is accurate in all material respects.

We received two responses (from energy suppliers) to our consultation.

Summary of responses and subsequent changes to the statement

Sufficient clarity on the charges that service users will face?

Both respondents requested more detail and transparency in the statement. The specific requests called for:

- a break-down of the value changes in DCC's estimated fixed revenue according to changes in the requirements placed on DCC and in its operating environment
- more transparency of the allocation of the new scope project costs to internal and external costs
- more detail on the activities and associated cost drivers underpinning cost changes in the commentary provided on cost variances.

Respondents commented that this would enable them to consider whether the costs were justified, and to anticipate future changes to their charges.

In response, DCC have explained:

- All movements in cost against the previous quarter are reported and explained during their quarterly finance webinars and at various bilateral sessions with parties.
- Their approach to setting charges is to allow for any future activities that come to light in any given quarter and to ensure that DCC is adequately funded to manage its forthcoming liabilities.
- As far as is possible, they always aim to provide as much notice as possible in relation to the future value of charges. However, DCC noted that it may need to revise its charging statement prior to the next scheduled annual revision. This could for example be necessary should the outcome of the commercial negotiations be different to what is anticipated, or more generally should any of DCC's assumptions prove to be significantly incorrect.

Ofgem view

When determining whether to approve the form of the statement, we must consider the purpose of the statement, namely to allow service users to make a reasonable estimate of what service charges they will be liable to pay DCC in 2016/17 in respect of the relevant services.

We consider that the charging statement generally provides sufficient detail in a clear enough manner to allow service users to make a reasonable estimate of the service charges they will be liable to pay DCC for the relevant services. There are a few exceptions where we considered the charging statement would benefit from further detail and clarification to enable service users to estimate charges. These are:

- The cost drivers for the three new indicative explicit charges (additional testing support, additional communications hubs order management systems accounts, and elective service evaluations).

- The draft statement described the services offered and how the charges would be recovered but did not explain the variables that would determine the quotes provided to users requesting these services.
- We consider a description of these variables to be informative to users estimating their potential DCC charges.
- The estimated impact of the revised DCC plan on external costs.
 - The draft statement referred to changes to external contract costs related to different versions of the Great British Companion Specification (GBCS) releases and to the Smart Metering Implementation Programme (SMIP) Contingency Request which we considered some users may not be sufficiently familiar with to appreciate the potential impacts.
 - We consider it important to clarify whether the estimated impact of the revised DCC plan had been included in the costs since the statement also mentioned that DCC's contract negotiations with service providers have not concluded and may lead to an adjustment to charges in 2016/17.
- The approach DCC has taken to factoring in uncertainty in its wider costs at the time of setting the charges.
 - The draft statement explained the prudent estimate in terms of an amount required to ensure operating liquidity over a three week period.
 - We sought clarification from DCC on whether there were any other aspects of their approach to uncertainty.
 - We consider this explanation to be important in helping to inform users' views on the structure and stability of their charges.

DCC has addressed our comments above by:

- Expanding on the explanations in Annex 4 (Worked Examples) on the drivers of indicative explicit charges for the three new services.
- Amending the description of the external cost allowances that DCC have made in the charges related to the revised DCC plan in the introduction and Section B (Estimated Revenue) of the statement.
- Clarified (in section 1: introduction) that the external cost allowance that DCC have made in relation to the revised DCC plan is the only area where an allowance has been made for uncertainty in the cost estimate in the introduction to the statement.

While we do not think further details are necessary at this stage, we will remain open to considering further cost breakdowns in areas where they could be usefully provided by DCC. In any consideration of cost breakdowns, we would take into account their value for the purpose of the charging statement. This would include the potential negative effect that cost breakdowns could have by obscuring the key details of the charges.

The issue of transparency has significance beyond the statement. We encourage DCC to be transparent when consulting with industry on changes to costs. We appreciate that DCC needs to be mindful of commercial sensitivities but we see benefits in allowing industry to scrutinise the costs before they are incurred and in service users having sufficient detail on cost drivers to anticipate how it will impact their businesses.

Coherent and easy to navigate format?

Both respondents were supportive of the format and structure of the statement and commented that it was easy to navigate.

Ofgem view

We consider that the statement is coherent and easy to navigate.

Is the statement accurate in all material respects?

Only one respondent addressed this question directly in their response. This respondent said it did not have sufficient additional supporting information to confirm accuracy of the information provided in the statement.

Ofgem view

We consider that the statement is accurate in all material respects.

Other issues

We received various comments that were not directly relevant to the content of the statement for 2016/17, including regarding:

1. limiting the level of change between the costs presented in DCC's quarterly indicative charging statement updates and notified charges
2. more scrutiny of and transparency of costs DCC submits in its price control reporting
3. more face-to-face industry meetings in place of the quarterly finance webinars.

In response to the first two points, DCC has referred to its comments on transparency above. In response to the third point, DCC has also explained that:

- the quarterly finance webinars are one of the mediums through which it engages with stakeholders on its charges
- it considers these sessions to be an efficient way to engage with different parties and to provide a platform to explain changes in costs and progress in the DCC plan
- during those webinars, it offers the opportunity for any party to submit questions prior to, during, and after the quarterly finance webinars
- in addition, it offers face to face meetings post the webinar sessions in order to provide further information, if required, in relation to charges and budgets
- it will consider offering more face-to-face engagement and bilateral meetings where it would add value and where there is a sufficient level of interest.

In response to point 2 above, DCC also noted that all explanation to demonstrate how costs have been incurred economically and efficiently will be provided as part of the annual price control submission while their understanding is that this consultation is on the form of the charging statement only (and that any assessment of costs is carried by Ofgem during its ex post price control review).

Ofgem view

In response to the issues raised around transparency, we see benefits in allowing industry to scrutinise costs before they are incurred and recommend DCC and service users continue to engage on the best format to allow for this.

Impact of Authority's price control decisions, directions and determinations for RY 2014/15

Alongside our decision and directions relating to the price control assessment for RY 2014/15³, we provided DCC with consent to having a notice period of less than 3 months for making amendments to the service charges for RY 2016/17⁴. This consent was granted to enable DCC to amend its service charges to reflect the price control decisions so that consumers could benefit from reduced charges from 1 April 2016. DCC issued notice of this change to the charges on 15 March 2016, to come into effect on 1 April 2016. However, as the net impact of the price control was a £48k reduction in allowed revenue, once DCC applied rounding of the estimated allowed revenue to the nearest £0.1m, it does not lead

³ DCC: Price control decision 2014/15: <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-decision-regulatory-year-201415>.

⁴ Consent to reduce the notice period for proposing an amendment to the Service Charges in respect to price control determinations for Regulatory Year 2014/15. Licence condition 19.9 and 19.10 set out the terms of DCC's obligations to give notice to the Authority before amending its service charges.

to a change in the charges for the regulatory year 2016/17. It will however be passed back to DCC's users in later years, inclusive of the interest rate applied under DCC's licence.

Authority's decision

Having had regard to all responses received to our consultation, we have considered whether the proposed changes contained in the statement submitted by DCC are consistent with the requirements of condition 19 of DCC's licence and DCC's wider licence and statutory obligations. We have also had regard to our principal objective and general duties in considering whether to approve the form of the statement. We are satisfied that approval of the form of the statement is consistent with the above.

Pursuant to paragraph 19.5 of condition 19, the Authority hereby approves the form of the statement annexed to this letter.

This letter constitutes Notice of the Authority's reasons for the decision pursuant to section 38A Gas Act 1986 and s.49A Electricity Act 1989.

Yours sincerely,

Laura Nell
Head of Smarter Metering

Duly authorised on behalf of the Gas and Electricity Markets Authority

Appendix 1: What is DCC and what does its licence require?

What is DCC?

DCC is a new licensed entity that we regulate. It is a central communications body appointed to organise the communications and 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 (service users).⁵

DCC is developing and planning to deliver these data and communications services by contracting with external service providers. We expect DCC to start offering data and communications services to its service users in 2016. In the interim, DCC is taking steps to ensure that it can provide these services. These involve testing the systems being built by the service providers to make sure they work together and work with the systems of the service users.

What does DCC's licence require?

Under its licence, DCC has to maintain the charging statement in a form that we have approved.⁶ On 25 March 2015 we approved the form of the 2015/16 charging statement, and on 20 August 2015 we approved additional changes that DCC proposed to the form of the statement for the same regulatory year (2015/16). DCC levies charges on service users, and the charging statement must set out the basis on which the charges will be payable.⁷ These charges are formally known as 'service charges'. The charging statement must enable service users to make a reasonable estimate of the charges they will face and must be prepared in accordance with the charging methodology in the Smart Energy Code.⁸

DCC's licence⁹ requires it to periodically review the information in the charging statement. Further, at least once in each regulatory year (beginning on 1 April of each year), DCC must make any changes necessary to ensure the charging statement continues to be accurate and reliable in all material aspects. The Licence and the Smart Energy Code (Section J.4) contains a further obligation, which limits the ability of DCC to amend the service charges more than once in each calendar year (subject to certain caveats).¹⁰

What are we approving?

To be clear, we have no role in approving DCC's service charges (which are included in the updated form of the statement) in advance of the regulatory year commencing. Our approval is of the *form* of the statement. As part of our price control determination, we will have a role in assessing whether costs were economically and efficiently incurred.

⁵ Condition 6 of DCC's licence sets out the activity that the licence authorises DCC to carry out in GB.

⁶ Licence condition 19.5.

⁷ Licence condition 19.3.

⁸ Licence condition 19.1. The Smart Energy Code is a new industry code. It is a multiparty agreement which defines the rights and obligations between DCC and service users.

⁹ Licence condition 19.14.

¹⁰ Licence condition 19.11 also sets out conditions that must be met before the service charges can be amended more than once in a regulatory year.