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Dear Jacqui

### **Operational Performance Regime – Final Proposals**

Thank you for providing the opportunity to respond to your consultation on the final proposals for the Operational Performance Regime. This constitutes the response of Smart DCC Ltd, as licensee. I can confirm that we are content for this response and the supporting annex to be treated as non-confidential and suitable for publication.

In the annex to this letter, we have provided detailed responses to the specific questions raised in the consultation, together with some additional points which are relevant. However, there are a number of more general points that we have summarised below.

#### *Design of the Scheme*

We are pleased that Ofgem has recognised the inherent uncertainty associated with bringing a piece of highly complex national infrastructure into operation. The one thing that is certain is that there will be challenges in the early life and there will be a process of stabilising and then optimising the service which could take some time.

Whilst the proposal for an interim regime is a welcome initiative, we now know that DCC has been directed on to a plan for R1.3 with a go-live date of 10 April 2017, together with a month of contingency which could result in this date moving further out.

In addition, our experience following the introduction of R1.2 is that service users have been very slow to make use of the service, preferring to focus on end-to-end testing and proving of their own business processes. We have no reason to believe that their behaviour will be any different following go-live of R1.3.

Current forecasts of Communications Hub requirements only imply a ramp up in installations from the autumn of 2017. The total requirement forecast for the whole of the 2017/18 regulatory year reduced by 26% between the November and December 2016 submitted forecasts and we believe this may well reduce further.

In previous discussions with Ofgem, it has been recognised that it was appropriate for there to be a period of bedding in for the R1.3 release before OPR was activated. This reflects the inevitability of there being teething troubles when launching a system of this scale and complexity, and the atypical behaviour we will see from users, due to lack of volume and a focus on proving exercises, such as end-to-end testing.

Introduction of a performance regime will inevitably drive DCC's behaviour to focus on optimising its outcomes under the scheme. Hence, there is a real risk that a premature introduction will actually be detrimental to service users, as DCC could be diverted from focussing on delivering sustainable long-term solutions to any issues emerging and instead focuses on what is current and measured.

In the initial discussions around OPR, it was envisaged that R1.3 would go live in September 2016, thus providing a natural bedding-in period, ahead of the activation of OPR in April 2017. One of the consequences of the current plan for R1.3 is that this period has now been eliminated.

This brings the significant issue that DCC will have two years margin placed at risk, from the moment of go-live, with no time to stabilise the service and with potentially unpredictable behaviour from users. Even with the protection offered by the interim regime, we could find ourselves subject to a very significant reduction in margin, disproportionate to the true impact on our users.

As it now appears that it will take a number of months before any volumes of installations start to grow, this brings into question whether it is sensible to activate the regime until a reasonable level of activity is being observed.

#### Alternative Proposal:

In light of this, DCC would like to make the following alternative proposal:

- Informal reporting against the OPR measures will be made available to Ofgem as it becomes available post April 2017.
- OPR would be activated on 1 April 2018, but under the terms of Ofgem's proposed enduring regime. The interim regime would no longer be required.
- On the assumption that Ofgem requires the 2016/17 and 2017/18 margins to be placed at risk, then this should be spread over the remaining years of the licence (2018/19 onwards).
- Subject to any further discussion, all other aspects would follow the proposals described by Ofgem for the enduring regime

We believe that this has the following benefits:

- It provides a pragmatic response to the planned go-live date for R1.3 and recognises the likelihood of low usage in the subsequent months, thus freeing up DCC to deal with early-life problems and optimise performance ahead of any significant ramp-up by users.

- The timeframe proposed better aligns with the contractual liabilities of the fundamental service providers, thus ensuring that DCC has sufficient commercial leverage to address performance issues.
- It ensures that margin for each year is placed at risk, whilst the spreading of margin further incentivises DCC to maintain and enhance service levels over the long-term.
- It removes the potential unfairness of margin at risk being front-loaded to the time when there is greatest uncertainty over performance, but simplifies the scheme by removing the requirement for an interim regime.
- It may enable elements of the enduring regime to be modified based on 2017/18 experience, for example, it would allow formal metrics to be added/changed in response to Ofgem/industry demand.
- It will allow methodological issues, such as the balance between DCC and service user responsibility, to be clarified and then codified, before the scheme comes into formal use.

We hope that Ofgem accepts our assessment of the need to shift the commencement of OPR and the potential for both simplification of the scheme and the benefits to users which might be obtained by doing so. However, we also acknowledge that there may be other means through which our issues could be addressed and hence would be very keen to discuss any such options with Ofgem.

It should also be noted that the SEC places substantial reporting requirements on DCC, and hence a wide range of measures of DCC performance will be available to industry parties, as a matter of course. Therefore, Ofgem should not be concerned that DCC performance will not be visible during the 2017/18 period.

#### *Incentive properties*

Ofgem's consultation describes OPR as an "incentive scheme" but, as currently defined, as a penalty-only mechanism, the reality is that there is little positive incentive associated. Whilst DCC will strive to give the best possible service to its customers, it would be a perfectly rational response if we focussed on minimising the margin which is disallowed, rather than on improving the service. It is difficult to see how this can be viewed as a positive outcome for our service users.

We note the explanation in the consultation as to why an upside element is not permissible, but do not find it persuasive. Ofgem's proposition that the prospect of a reward might drive us to spend inefficiently brings into question the quality of price control scrutiny which Ofgem is able to bring to bear.

In reality, there are now a number of instances when Ofgem has disallowed DCC expenditure where it is not convinced of the justification. In our experience, Ofgem should have more confidence in its ex-post price control processes to detect any contributing inefficiencies.

Ofgem should also be mindful of the incentive properties of continually seeking to penalise, but never to reward. We firmly believe that the long-term efficiency and effectiveness of the Smart Meters Programme will be enhanced through DCC being encouraged to innovate both in respect of its systems and processes. Therefore, we would wish to reiterate that being driven to manage to a set of narrow measures is likely to be to the detriment of users and consumers.

### *Choice of metrics*

We wish to restate our concerns about the choice of metrics.

Based on other examples of Ofgem policy development, DCC has always been under the impression that OPR would require the development of a set of appropriate performance metrics. In our view, the most transparent and effective approach to doing this would have been to work with Industry and Ofgem to create a suite of reporting which reflects stakeholder needs and holds us to account for performance of DCC's systems and processes.

As we have stated previously, the metrics proposed were not designed for use as performance targets, but rather as thresholds which would drive reporting and a requirement for further information to be provided to SEC parties. These were defined early in the programme, long before the true complexity of the infrastructure was fully understood by BEIS, Ofgem, Industry and DCC alike, and have not been revised to recognise this.

As there was no intent to link these measures to the OPR, then we saw no urgency to revise them for that purpose.

Whilst we acknowledge that the opportunity to propose a modification to the code does exist, this will take time and ultimately may not be supported by SEC parties and/or allowed by the Authority.

However we note Ofgem's statement (in para 3.19) about keeping minimum and target levels under review. We interpret this statement to be a recognition of the inherent uncertainty in actual performance levels, and the need to have targets which are stretching but also realistic.

Whether referring to the proposed Interim regime, or likewise, under our alternative proposals, we would suggest that this be a formal topic for discussion during 2017/18.

The consultation proposes additional reporting measures. In principle, we are very willing to provide further reporting where this would be of benefit to industry and/or Ofgem. However, Ofgem should be cognisant of the extensive additional reporting that is already required by the SEC. This will give considerable visibility to industry parties and Ofgem as to the performance of the DCC.

Furthermore, a number of the proposed additional measures will require development of reporting systems and/or negotiation with the service providers to make relevant data available. In our view, it is appropriate that suitable cost-benefit analysis is undertaken, prior to commissioning of any such reporting, to confirm that the benefits justify the expense.

Finally, once the infrastructure has stabilised and suppliers are starting to install material volumes of smart meters, we would recommend an open process of engagement with industry parties to identify and prioritise reporting requirements that would offer real benefit for them. This would provide a suitable mechanism to define the future direction of the OPR.

## *Methodology*

In the design and operation of an incentive regime, it is important that there is no ambiguity over the precise operation of the scheme, such as the definitions of data and measures, data sources, calculation methods and conditions for exclusion that will be applied when reporting against metrics.

For that reason, DCC has committed to the production of an OPR methodology paper which will provide the definitive statement of the reporting requirements and how these will be met. This will also provide an important reference for the assurance regime, and will draw together existing material from the performance management methodology, supplementing it as appropriate. We anticipate being able to share this document with Ofgem in advance of the introduction of the regime.

In conclusion, DCC is in agreement with Ofgem in recognising the need for a suitable performance regime covering DCC live services; however this needs to be designed to reflect the reality of bringing into operation such a novel and complex piece of infrastructure.

We hope that Ofgem will consider carefully our suggested re-casting of their proposals to better mirror the current view of programme timescales, and potentially use this time to develop a more balanced and informative set of performance metrics, and engaging with Industry in the process .

If you have any questions on our response, please do not hesitate to contact me.

Yours Sincerely



**Helen Fleming**  
Director of Policy

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