

DCC Price Control: Processes and Procedures

Guidance

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Overview:

The Data and Communications Company (DCC) is required to report price control information by 31 July following the end of each regulatory year. We review the costs and must determine whether they have been economically and efficiently incurred. Any that have not been will be Unacceptable Costs under the Licence. These costs will either be excluded from any future calculation of the DCC's Allowed Revenues, or we may accept an undertaking from DCC on the future management of some or all of the Unacceptable Costs and/or on the DCC's future procurement of Relevant Service Capability.

Each July DCC can also propose an adjustment to its Baseline Margin values that are stipulated in the Licence. We assess any proposal received and determine whether or not to change the level of the margin values.

This guidance document sets out the general cost assessment process that we follow for the DCC price control. It describes our approach and the information we expect to be provided with to enable us to determine whether DCC's costs are economic and efficient. It explains what factors we may consider in deciding whether to accept an undertaking for Unacceptable Costs, as well as the way we determine whether to adjust DCC's Baseline Margin values.

The DCC, services users and other interested parties should read this document

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 which holds the Smart Meter Communication Licences.¹ DCC is a monopoly provider funded by gas and electricity consumers, so it is important there is close scrutiny of DCC's costs and revenues to ensure they provide value for money.

Under its Licence DCC has to submit information on its cost and revenue, and its incentive reporting to the Gas and Electricity Markets Authority (the Authority).² We expect DCC to demonstrate through its reporting that it has incurred costs as efficiently and economically as possible, doing everything it reasonably can to ensure value for money. The data we collect from DCC, together with information from other sources, will allow us to monitor and assess whether this was the case.

Following our first price control decision we committed to issuing a guidance document to clarify our approach and processes. This should help to ensure the principles and criteria that will apply in conducting our assessments are clear.

Associated documents

- Smart Meter Communication Licence
<https://epr.ofgem.gov.uk/Document>
- Data and Communications Company (DCC): Regulatory Instructions and Guidance 2017
<https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2017>
- Data and Communications Company (DCC): Regulatory Instructions and Guidance 2017
<https://www.ofgem.gov.uk/publications-and-updates/decision-dcc-s-operational-performance-regime>

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 (such Licences together referred to as 'the Licence' throughout).

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

The Data and Communications Company (DCC) has an essential role to play in the energy market. Its performance is critical to making the smart meter rollout a success, and enabling suppliers to provide a good service to their customers.

It is important that DCC receives sufficient funds to fulfil its role and deliver high quality services. It is equally important that we hold DCC to account for its costs, which are ultimately passed on to consumers. The price control mechanism under its Licence is designed to ensure that the costs DCC incurs to provide its services are economic and efficient.

DCC is required to report price control information by 31 July, following each Regulatory Year. Using this information, we assess the costs reported and if we consider that costs are not economic and efficient these will be Unacceptable Costs³ under the Licence.

For any costs that we determine are Unacceptable Costs we must direct whether they are to be excluded from any future calculation of DCC's Allowed Revenues, or whether to accept an undertaking from DCC. Any undertaking must relate to how DCC will manage Unacceptable Costs in the future and on the future procurement of Relevant Service Capability.

Each July, DCC can also propose an adjustment to its Baseline Margin values. We assess this proposal and determine whether or not to change the level of margin values set out in the Licence.

DCC may also submit a proposal for an adjustment to the External Contract Gain Share (ECGS) term in the Allowed Revenue Formula that reflects some part of a reduction in External Costs that DCC helped achieve.

This document is intended to inform stakeholders of the Authority's approach to cost assessment under the DCC price control and the determination of Baseline Margin adjustments. We published the first version of this documents in July 2015, based on the experience of the 2013/14 price control and to help clarify future price control processes.

This document provides an updated version to help ensure the principles and criteria that will apply in conducting our assessment are clear. The intention is to help make the cost assessment process easier to understand, so that DCC and stakeholders are better prepared to engage in the process.

This guidance is relevant to both ongoing and future cost assessments. We intend to keep both this guidance and our approach to cost assessment under review to make sure they align with policy developments and to deal with issues as they arise.

³ Unacceptable Costs are defined in Licence Condition 37.8(a) of the DCC Licence.

1. Introduction

Background

1.1. The Government granted the Smart Meter Communication Licences⁴ (“the Licence”) to DCC on 23 September 2013 following a competitive tender process. The Licence is for 12 years and will remain in place until 22 September 2025, unless it is extended or revoked. The Licence contains price control arrangements that restrict DCC’s revenues, to counter its monopoly position.

1.2. We have a role in ensuring that DCC’s costs are incurred economically and efficiently. DCC incurs costs and passes these onto users. We review these costs after the end of the regulatory year they were incurred in, an approach we call ‘ex post’.⁵ One of DCC’s key responsibilities is to effectively manage its external contracts and ensure value for money and good quality service for consumers. DCC must submit price control information by 31 July after the end of each Regulatory Year.⁶

1.3. The value of Baseline Margin (BM) allowed for each Regulatory Year is fixed in the Licence. Each July, DCC can apply to us for an adjustment to the values in the Licence. The Licence has criteria that DCC must demonstrate have been met in its application. These criteria relate to likely and material changes to its business activities, risks and timescales or deadlines. DCC may also submit a proposal for an adjustment to the External Contract Gain Share (ECGS) term in the Allowed Revenue Formula. This provides for an upward adjustment to the amount of Allowed Revenue that reflects some part of a reduction in External Costs that DCC helped achieve.

Purpose of this document

1.4. The Licence gives us power to issue, and from time to time revise, guidance about the procedure we will follow and the matters we will take into account when considering whether, and to what extent, to exercise our power in relation to:⁷

- giving a direction that costs that we consider were not economically or efficiently incurred (and so are defined as ‘Unacceptable Costs’ under the Licence) are to be excluded from any calculation of DCC’s Allowed Revenue; or

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

⁵ This is in contrast to an ex ante approach where costs are fixed up-front.

⁶ The regulatory year is a period of 12 months beginning on 1 April in any calendar year and ending on 31 March of the next calendar year. The DCC’s first regulatory year is deemed to have begun on 1 April 2013.

⁷ Licence Condition 37, part C.

- Accept an undertaking given by DCC with respect to the Unacceptable Costs on terms that relate to either or both of DCC's future management of Unacceptable Costs and its future procurement of relevant service capability.

1.5. The Licence also gives us power to issue, and from time to time revise, guidance about the procedure we will follow and the matters we will take into account when determining a proposed Relevant Adjustment to the Baseline Margin (BM) values and External Contract Gain Share (ECGS).⁸ In particular, for the BM values this guidance may set out the principles, method of assessment and types of criteria that we may apply when assessing a proposed Relevant Adjustment.

1.6. This guidance document will cover both our approach to cost assessment and proposals for Baseline Margin (BM) adjustments. It is not legally binding and DCC and other stakeholders should take their own legal advice on any questions relating to the interpretation and application of the Licence terms and conditions. This document should be read in conjunction with, not instead of, the relevant parts of the Licence. In the event of any inconsistency between the Licence and this document, the Licence Conditions take precedence.

1.7. This document should be read together with the Regulatory Instructions and Guidance (RIGs). They serve a very different purpose to this guidance document: they set out how DCC should report price control information as required under its Licence.

Developing our approach

1.8. In this document, we are seeking to state and clarify a number of principles and issues. However, given that DCC is entering the operation phase, providing clarity must be balanced against the ability to consider new evidence. So this guidance document cannot be fully exhaustive in the level of detail and full range of issues and factors we may consider in assessing any price control or proposal to adjust the BM values.

1.9. We will continue to develop our approach to assessing costs and applications in respect of the BM and ECGS, drawing upon knowledge and approaches used elsewhere. This guidance will be reviewed and updated in future to reflect these changes, and other relevant amendments to DCC's regulatory framework, when appropriate.

⁸ Licence Condition 36, Appendix 2, Part D.

2. Cost assessment

Chapter summary

The procedure for our assessment of cost is outlined in this chapter. We set out some of the principles we will apply when determining whether costs have been economically and efficiently incurred, the methods of assessment we are likely to use, and the types of criteria we are likely to apply.

Procedure

2.1. DCC is required to report price control information by 31 July, following each regulatory year. It must report that information in accordance with the RIGs that we publish.⁹

2.2. The RIGs are the basis on which DCC must report price control information as required under the Licence. They contain detailed instructions on what to report and offer guidance on how to complete the reporting templates. This guidance document supports the RIGs by setting out some of the processes, principles and criteria that we will apply in conducting our assessment. DCC should engage with us early if there are particular questions or issues when it is preparing its cost reporting.

2.3. We are open to early engagement on any proposed significant changes in costs or submission structure. We are likely to signal to DCC if we are concerned that information we have received indicates that it intends to incur costs that may not be economic and efficient. We are not able to pre-approve any costs or specify definitively all the costs that might not be economic and efficient before the ex post cost assessment has been undertaken. This is because we can only complete our assessment of the costs once we have received all of the relevant information and have conducted our own analysis of it. The ex post nature of the DCC price control means that this cannot be done until after the costs have been incurred.

2.4. In accordance with Licence Condition 37 we assess whether costs associated with the Mandatory Business Services have been incurred economically and efficiently. We will carry out analysis of the information provided by DCC in its RIGS reporting and we may seek clarifications or further information.

2.5. The Licence does not prescribe dates for completing the cost assessment to be completed but we will always aim to direct our final decision before the end of the Regulatory Year following the year in which the costs were incurred. We will consult

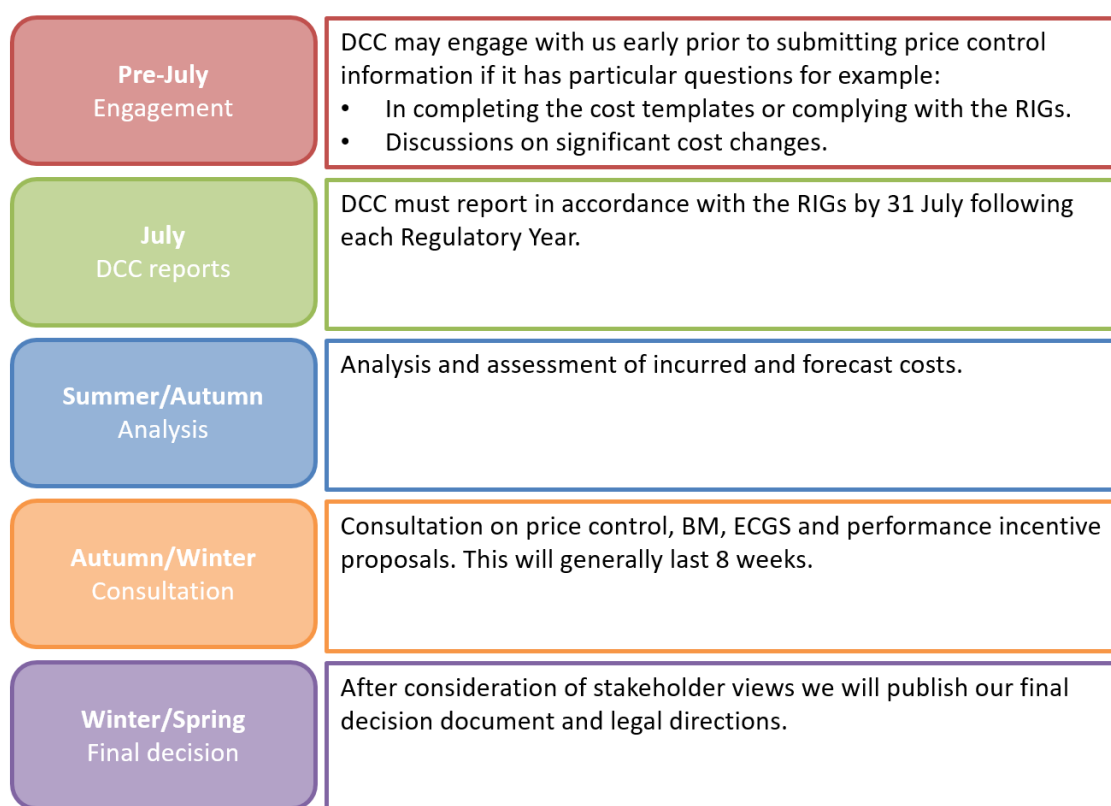
⁹ <https://www.ofgem.gov.uk/publications-and-updates/data-communications-company-dcc-regulatory-instructions-and-guidance-2017>

on our findings before making a final decision. The time taken to complete the cost assessment will depend on the complexity and range of issues we need to assess.

2.6. It is likely we will make our decisions on the price control, any ECGS application and BM adjustment and our assessment of performance against any Implementation Performance Incentive schemes to the same timescales. Where possible, we expect to consult on these together.

2.7. Figure 2.1 below sets out the key steps taken in the cost assessment process. The dates are indicative and may vary.

Figure 2.1: Timings of the cost assessment process



Cost assessment approach

2.8. The ex post regulatory framework requires us to review costs after they have been incurred. Economic regulation seeks to proxy or mimic competitive outcomes in monopolistic markets or businesses. Our role as economic regulator is therefore to introduce a proportionate degree of risk in order to give DCC incentives to manage its costs appropriately and ensure that the best possible outcomes for consumers are achieved.

2.9. In the following sections, we set out broad principles that we apply in our assessment of DCC's costs.

2.10. It is not possible to list an exhaustive set of principles and an approach for determining whether costs are economic and efficient. There needs to be flexibility to consider new evidence and scenarios not anticipated. Price control reporting will also inform our monitoring of DCC's compliance with its Licence obligations.

Principles

2.11. Here we outline some principles that we are likely to apply when we are reviewing the DCC's costs. This set of principles is not an exhaustive list but should make our approach clearer.

Material variations from the Licence Application Business Plan and updated forecasts need to be explained

2.12. DCC committed itself to the Licence Application Business Plan (LABP) as a condition of being granted the Licence.¹⁰ The framework allows DCC to depart from the LABP, as this reflects the level of uncertainty DCC is exposed to and the range of issues not known, or that were still to be clarified when the Licence and contracts were awarded.

2.13. It was anticipated that DCC's activities could change in nature and scope over the Licence term, however, DCC must always explain and provide sufficient evidence that it has made the most economic and efficient decisions.¹¹

2.14. Licence Condition 37 requires DCC to provide an explanation of material variations between the costs actually incurred and:

- Those estimated in the LABP.
- Those in any updated forecast.¹²

2.15. We expect DCC to demonstrate through its reporting that it has incurred all costs as efficiently and economically as possible, doing everything it reasonably can to ensure value for money.

2.16. The qualitative questions in the RIGs require DCC to explain how and why DCC has selected materiality thresholds to apply to its cost justifications. Our

¹⁰ This is explicitly stated in the definition of the LABP under Licence Condition 37. The LABP is the plan submitted in the course or as a consequence of the Licence application process. It contains estimates of revenues, costs, capital investments and cash flows for each Regulatory Year of the Licence Term, and was taken into account by the Secretary of State in determining the grant of the Licence

¹¹ Under Licence Condition 37 DCC must also provide an explanation of any material revision to any financial or operational matter included in the LABP for the remaining years.

¹² Submitted under Licence Condition 32.

approach to scrutinising costs will depend on how well the costs have been justified in the regulatory reporting and this is further explained later on in this document.

Forecasts should reflect economic and efficient costs

2.17. The updated forecasts should only contain economic and efficient costs, so that they represent a reasonable baseline against which to compare costs at the next price control. The definition of costs under the Licence refers to them being economic and efficient. If DCC fails to justify any forecast costs as being economic and efficient we will remove them from the forecasts as part of the determination.

2.18. If DCC goes on to incur costs previously removed from the forecast, it must justify these costs as part of its price control reporting in future Regulatory Years. In doing so, it must explain these as changes from the updated forecasts.

2.19. When updating the forecast for any price control submission DCC must:

- consider the certainty and likelihood of the forecast cost being incurred. DCC must include all costs in its forecast that meet the threshold of being significantly more likely than not to occur.
- justify with reasons why these costs are significantly more likely than not to occur.
- include within their justification consideration of how far in the future they are able to justify costs as significantly more likely than not to occur. DCC's ability to accurately forecast will naturally diminish the further out from the current regulatory year that DCC attempts to forecast. Hence, over time, as these forecast costs reach the threshold we would expect DCC to update its forecasts accordingly.
- ensure that treatment of costs included in the forecasts are consistent with any forecast costs that may relate to an application for a Relevant Adjustment to its BM.

2.20. Note that we expect there to be some variation between activities and projects in terms of how far in to the future DCC can determine that costs are significantly more likely than not to occur.

2.21. DCC must also ensure that forecast costs are consistent with a long-term strategy to review costs and ensure value for money over time.

2.22. Failure to include forecasts in the price control submission that the Authority later considers would meet the threshold of being significantly more likely than not to occur may risk DCC missing the opportunity to propose a related Relevant Adjustment to the BM.

DCC must demonstrate costs are economic and efficient

2.23. The Licence puts the burden of proof on DCC to justify costs as economic and efficient. If DCC fails to do this adequately we may determine that the costs were not incurred economically and efficiently and that they are therefore Unacceptable Costs.

2.24. We expect DCC now to have an understanding of our expectations about the level and quality of evidence it needs to provide, when it completes its returns under the RIGs. So the information that DCC provides in its reporting under the RIGs should be complete and comprehensive. It is vital that DCC engage with us early on in the process if they have any questions on the information it needs to provide.

2.25. DCC must report in accordance with the RIGs, but the RIGs will never prescribe exactly how and to what level DCC should justify every cost variation. It is DCC's responsibility to make the best case for each cost variation.

2.26. Good quality reporting is not necessarily about the quantity of evidence; it is about providing a sufficient level of detail and evidence to give confidence the outcomes achieved are the most economic and efficient.

2.27. Due to the uncertainties with the scope of DCC's activities associated with the smart meter roll out we cannot predict the types and nature of cost variations that might occur. However, to try to assist DCC as much as possible, below are some ways DCC can make sure it provides good quality reporting to support cost variations:

- Statements and opinions should be supported by evidence.
- Commentary should be supported by appropriate assessments and analysis demonstrating costs have been assessed and scrutinised.
- Justifications should include an explanation and evidence of how DCC has checked the costs agreed are competitive, and how they will remain so for the duration of any agreement.
- Where appropriate, evidence from independent sources should be used to strengthen justifications.
- Reporting should set out how different options have been considered, including how customer views have been sought and taken into account, and the analysis supporting the preferred option.
- Supporting evidence demonstrating how value for money was achieved should be included, such as evidence of effective internal processes (e.g. recruitment/procurement).
- How DCC uses the levers under the contracts to ensure value for money should be referenced and evidenced.
- A well structured, clear price control submission that meets the requirements of the RIGs may be beneficial in reducing the regulatory burden, reducing the

number of follow-up questions we have to ask, and may improve the overall quality of the reporting.

Justify material variations through good quality reporting

2.28. All material variations should be supported by evidence to demonstrate how DCC has ensured value for money. For example evidence that DCC has clear processes, strategies and assumptions in place for ensuring variations are incurred economically and efficiently.

2.29. If we have significant concerns with the justification provided or process in place for controlling costs it is likely that we will have to ask more questions and potentially require a more granular approach of explanation in order to complete our analysis of those costs. However, the level of detail that DCC provides should be proportionate and reflect the materiality of the variation.

Impact of decisions on future years

2.30. A decision for the current regulatory reporting year does not necessarily affect future decisions. If DCC incurs costs in a Regulatory Year that are found to be unacceptable, these would be excluded from that Regulatory Year and from forecasts.

2.31. However, if it incurs the same costs in a future Regulatory Year and can bring forward new evidence in the related price control to justify these costs are economic and efficient that regulatory year then these will be considered independently of the past decision. Similarly, the decision in a future price control will not have a retrospective impact on a past decision – i.e. we will not change any past decisions on Unacceptable Costs.

We expect a long-term strategy to be in place

2.32. As DCC has now reached operational phase, we expect DCC to have a strategy in place for ensuring that costs are economic and efficient over the duration of the Licence, recognising that this strategy will need to evolve over time.

Revenue reporting – Penalty interest rate

2.33. If DCC over-recovers revenue from users that breaches the 110% of Allowed Revenue for the year in question, we will consider whether a penalty interest rate should be applied on any of this over recovery.¹³ We expect DCC to provide a clear

¹³ Condition 36, Part G

and evidenced justification if it considers a penalty interest rate should not be applied.

2.34. In principle the occurrence of unanticipated cost variations may be an acceptable cause of over-recovery. However, DCC would need to ensure it provides sufficient detail on why this was the case and why it was beyond DCC's control to avoid any cost increase.

Methods of assessment

2.35. The methods we use to assess costs are likely to evolve over time but it is likely the following, will be a core part of our approach:

- Comparisons back to the LABP and updated forecasts.
- Analysis of price control information provided under the RIGs.
- Reference to other sources of information.

Comparisons

2.36. It is DCC's duty under the Licence to report and explain all material divergences from the LABP and updated forecasts as part of its reporting for the price control assessment, and to justify that those divergences are economic and efficient.

2.37. We will focus more on scrutinising the variation from the latest updated forecast as the LABP becomes a less relevant comparator over time. We consider it proportionate for DCC to reference justification and evidence from previous price control submissions rather than restate the justification for the entire variation from LABP year on year.

Analysis of price control information provided under the RIGs

2.38. The reporting under the RIGs gives us price control information for every regulatory year of the Licence on a consistent basis.¹⁴ They provide a template for DCC to provide¹⁵ a comparison between the actual incurred costs and those estimated in the LABP, and any updated forecast. The information provided allows us to look at the costs associated with the LABP separately to those costs that have been incurred as a consequence of new scope projects.

¹⁴ As required under Licence Condition 32.

¹⁵ As required under Licence Condition 37.

2.39. We will use the information provided under the RIGs, together with information from other sources, to determine whether costs reported were economically and efficiently incurred. To assess the management and change control of costs, we will closely scrutinise material variations, the process and controls DCC has in place, as well as how they have been applied.

2.40. If any changes are unsubstantiated we will look at these more closely and consider whether further action or a more granular approach is needed. To assess whether costs are economic and efficient we are likely to look at unit costs and also aggregate cost, and compare these to the LABP or to other benchmarks.

2.41. The information provided under the RIGs allows us to monitor effectively the revenue of DCC and to confirm that the revenues recovered are in line with the Licence. We will also use the price control reporting and information submitted as part of the RIGs to monitor DCC's compliance with its obligations under the Licence, for example in relation to cross subsidy, procurement, and its approach to setting charges.¹⁶

Reference to other sources of information

2.42. We look at information from other sources in addition to the information provided under the RIGs to determine whether costs were economically and efficiently incurred.

2.43. This may include:

- Performance information reported under the future quality of service RIGs, or from other sources.
- Other compliance documents or reporting submitted by DCC, for example the Regulatory Accounts, any BM notice it has submitted, and its procurement strategy. We will be checking these other sources of information for consistency and any differences in assumptions made by DCC.
- We may conduct a cost visit to ask additional questions or request supporting references and evidence.
- Consulting with stakeholders and DCC users will be a key part of the process and we will take into account any further information or evidence that they give us before making our final decision. We are aware of the commercial sensitivities of sharing costs but we expect DCC to be providing transparency to users and allowing them to scrutinise costs where possible.

¹⁶ Licence Condition 36, which obliges DCC to take all reasonable steps to secure that regulated revenue does not exceed a prudent estimate of allowed revenue for that regulatory year, and ensure that Service Charges do not need to be amended in the course of the year except in response to a reasonably unlikely contingency.

- It is likely we will use independent and market sources of information to compare cost and the DCC's evidence. We will probably check any financing rates and we would expect such rates to be competitive
- Where appropriate we may undertake specific benchmarking of certain Internal and External Costs. When considering the benchmarking of External Costs we are likely to look at comparable tasks and components.
- We may consider undertaking a forensic accounting audit to provide additional assurances about the information the DCC has provided. For example, this could provide assurances that goods paid for have been received or reviewing internal processes, procurement or risk management.

Types of criteria

2.44. The assessment we undertake in the price control is to find out if costs have been incurred economically and efficiently. There are certain types of criteria we will apply when reaching this decision. Some of them are:

- That evidence should be provided and clearly linked to explanation for variations.
- That benchmarking evidence is robust.
- That DCC must provide evidence it is delivering value for money.
- That shared service costs associated with new scope¹⁷ projects and CRS must be justified.
- There are clear controls, governance and processes in place.

2.45. These criteria are not exhaustive and we may expand the criteria we apply as appropriate.

Providing evidence

2.46. If no or insufficient justification or evidence is provided on how economic and efficient a cost is, it is likely to be considered to be unacceptable. We cannot assume costs are economic and efficient; the burden of evidence is on DCC.

2.47. We will consider the information available to DCC at the time when costs were incurred or forecast when assessing any evidence provided by DCC. This ensures that DCC is not penalised through hindsight after the submission, where better information becomes available and/or outcomes are known.

¹⁷ See definition in the Glossary.

Robust benchmarking

2.48. If DCC provides benchmarking evidence it should meet the following principles:

- We should be confident that DCC's approach and assumptions are objective.
- Its methodology should be clear so all stakeholders can understand it.
- The process and resulting assessment should be robust.
- It should consider the balance between costs and the quality of service.
- It is important the benchmarking technique is adaptable.
- If an approach imposes additional cost, it should only be used if it delivers much better information.
- There should be evidence to support assumptions, findings or decisions.
- If there are results above benchmarks, they need to be well justified.

DCC must provide evidence that it is delivering value for money

Internal costs

2.49. The Licence requires DCC to be delivering value for money for the duration of the Licence. We expect DCC to be able to demonstrate that it is reviewing and delivering value for money on an ongoing basis on any changes to the baseline internal scope that was anticipated in the LABP.

2.50. We will be looking for evidence that DCC is achieving value for money on internal costs associated with new scope projects. We expect DCC to be reviewing and evidencing how it is making sure costs remain economic and efficient.

Procurement of services

2.51. As part of the price control we will assess any procurement activity each regulatory year to ensure the outcomes are economic and efficient. When justifying these procurements, we expect DCC to:

- fully reflect on the feedback and learnings from any forensic audit reviews or previous price controls in its procurement strategy. DCC should clarify when it considers it appropriate to use the different approaches outlined in its strategy
- provide clear evidence to confirm that consistent sourcing strategies have been used and if not, why different procurement routes have been chosen
- ensure that appropriate due diligence is carried out sufficiently early on in any procurement process
- provide consistent evidence on the evaluation processes and criteria used, and sufficient justification for discounting shortlisted bidders and for award recommendations.

- confirm that the shortlisted bidder remains the most economic and efficient if changes in requirements occur midway through a procurement exercise
- provide clear explanations of governance arrangements where its parent company is involved in any procurement process, and to ensure that DCC follow its procurement strategy regardless of whether or not its chosen provider is its parent.

2.52. Where external services are procured for activities that are likely to be undertaken on a regular or ongoing basis, we expect DCC to consider whether it would be more economic and efficient to recruit the necessary skills to be able to undertake these activities in house.

External costs

2.53. We accept that the competitive procurement process run by government will have delivered value for money in the pricing of the external contracts. But DCC must still demonstrate that cost changes to the External Costs in respect of these contracts are justified as economic and efficient. We will be looking for evidence that DCC is effectively managing the contracts through effective negotiation, drawing upon appropriate commercial expertise, using all the levers it has available to secure value for money and manage performance.

2.54. We will be looking for evidence from DCC showing how it has ensured costs and rates agreed are competitive. DCC needs to provide benchmarking wherever possible to demonstrate that alternative options, including the counterfactual, have been considered and evaluated. Evidence that costs have been robustly assessed and scrutinised by DCC will be a valuable input into our assessment.

2.55. If DCC considers its approach to service provider management, including the ultimate apportionment of costs between DCC and service providers, is economic and efficient in the wider context of the programme and delivers greater benefit for consumers, it must be able to evidence and justify it as such. This is particularly true where DCC's decisions would result in consumers paying more for a service. DCC must provide explanations for how it has ensured commercial negotiations, separately and in aggregate if appropriate, have resulted in economic and efficient outcomes.

2.56. As DCC re-procures the external contracts, any part of the external contracts, or procures new Fundamental Service Provider contracts as defined by their Licence, we expect DCC to demonstrate that these new contracts deliver value for money. In those instances, we will be looking for evidence that DCC followed a robust procurement process and managed the determination of the final price of those contracts similarly to how they manage change to existing contracts, for example through effective negotiation and use of commercial expertise. If any part of an FSP's contract is re-procured, this needs to be evidenced as the best solution to secure an economic and efficient outcome.

Centralised Registration Service (CRS) costs

2.57. Consistent with Internal and External costs, we also require evidence and justification that costs incurred and forecast in relation to CRS are economic and efficient. These costs are part of DCC's allowed revenue and are subject to ex-post plus reporting requirements, but the full explanation still needs to be provided as part of the final annual submission.

Shared service costs

2.58. A shared services charge¹⁸ was agreed as part of the LABP to cover support services. It is an amount paid by the DCC for shared services sourced from DCC's parent company. It was calculated as a percentage of internal costs set out in the LABP, as part of the Licence competition.

2.59. We appreciate the benefits for the shared services charge and note that the shared service charge was considered competitive at Licence award because it was included as an element of the bid. DCC also provided sufficient evidence demonstrating value for money for the shared service charge over the course of the licence based on costs submitted in the 2015/16 price control. We do not therefore require further justification for the shared service charge associated with baseline activity for price control purposes.


2.60. DCC must provide evidence why any shared service costs associated with new scope projects and CRS are economic and efficient and deliver ongoing value for money, particularly if any part of these projects are being provided by third parties. We expect DCC to have in place a process for demonstrating that the cost is economic and efficient, and related to some associated activity received from the parent company.

2.61. In the absence of any evidence explaining the relationship between the new scope activity or CRS and the shared service cost, it is likely we will not consider the cost economic or efficient.

Clear controls, governance and processes are in place

2.62. To make sure DCC is incurring costs economically and efficiently we expect it to have sufficient controls, a robust governance framework, and processes around costs. Where they are relevant to how DCC has incurred certain costs we would

¹⁸ The definition of the shared service charge is taken from the RIGs is the amount paid by the Licensee for shared services sourced from the Licensee's parent company. This is comparable to a corporate overhead charge as it recovers an allocation of group overhead.



DCC Price Control: Processes and Procedures

expect evidence to support how these have been appropriately applied and that they remain fit for purpose. We expect DCC to be managing risks and have a clear strategy in place; we will be looking for evidence where possible that DCC has taken appropriate measures to mitigate risks and as a result it only incurs economic and efficient costs.

3. Unacceptable cost

Chapter Summary

This chapter sets out the procedure we will follow and the matters we will take into account in considering whether and what extent to exercise our power to give a direction or accept an undertaking in relation to Unacceptable Costs.

Procedure

3.1. The Licence defines 'Unacceptable Costs' as any External or Internal Costs that we consider were not economically and efficiently incurred in the relevant Regulatory Year.¹⁹ Once we have identified such Unacceptable Costs we will then need to consider whether to direct that they be excluded from any future calculation of DCC's allowed revenue or to accept an undertaking from DCC on the future management of those costs and/or their future procurement of relevant service capability.²⁰

3.2. When deciding whether to make a direction or to accept an undertaking we will consult with DCC and other stakeholders. We aim to publish our consultation document in autumn each year. In it we will set out our findings from our review of the costs reported and our proposals for those costs we consider are unacceptable. We will invite views not only on our findings but also on whether those costs should be removed from a future calculation of revenue or be subject to an undertaking.

3.3. If we identify any Unacceptable Costs DCC may propose an undertaking in respect of those costs DCC feels it would be appropriate to provide one. We would only expect DCC to propose an undertaking in exceptional circumstances and we would consider such proposals on a case-by-case basis.

3.4. If DCC provides any such proposed undertaking it should not prejudice any argument DCC wants to make in relation to questioning our findings that certain costs are unacceptable. We will consider any arguments by the DCC about the acceptability of the reported costs alongside any evidence received from other stakeholders in response to our consultation. Once we have made our final decision on the presence of Unacceptable Costs we will consider whether to accept any undertaking that has been proposed.

¹⁹ Licence Condition 37.8(a)

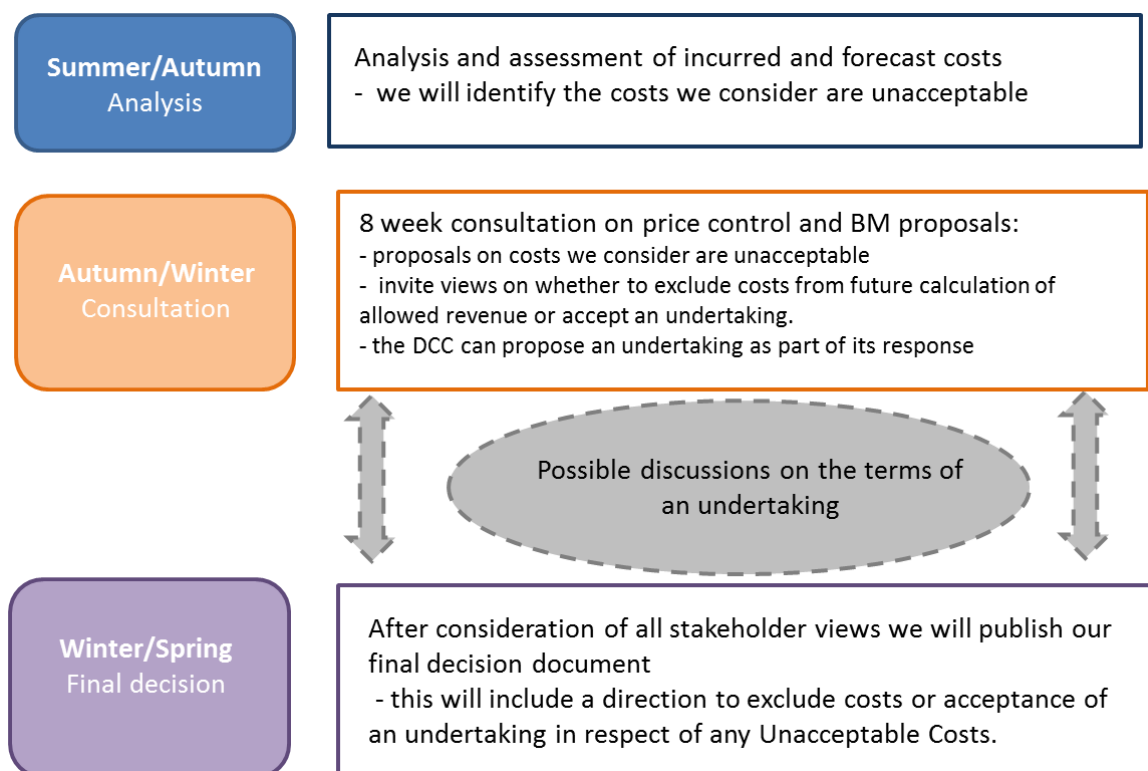
²⁰ Licence Condition 37, Part B, The Authority's powers in respect to costs

3.5. When considering whether to accept an undertaking there might be further communication between DCC and Ofgem on the detail of the terms of the undertaking before we issue our final decision.

3.6. If in response to our consultation we receive evidence that leads us to conclude that further costs are unacceptable in response we would notify DCC and invite them to provide an undertaking, if appropriate. We would specify that DCC would need to provide any such undertaking to us within a certain timescale so that we had time to consider it as part of making our final decision.

3.7. Figure 3.1 below sets out the key steps in determining whether Unacceptable Costs should be directed to be excluded from a future calculation of Allowed Revenue and how DCC may submit an undertaking. The dates are indicative and may vary.

Figure 3.1: Determination of Unacceptable Costs and process for submitting an undertaking



Contents of undertaking

3.8. The content and form of the undertaking will be dependent on the nature of the Unacceptable Costs identified, but we set out in this section some broad principles and expectations:

- We will be looking for DCC to make the best case, setting out why an undertaking is equivalent to or better than the exclusion of costs
- We would expect it to set out how the costs will be managed in future to make sure DCC will be able to avoid, prevent, or mitigate a further occurrence of the same or any similar costs.
- For most costs we would expect clearly defined proposals on how to manage the Unacceptable Costs back over time through identifying efficiency savings, and a commitment to implement those proposals. We will look for clear commitments and explanations on how future efficiencies would be achieved.

Factors when directing the exclusion of Unacceptable Costs or accepting an undertaking

3.9. How we exercise our power to give a direction in respect of the Unacceptable Costs or accept an undertaking will be dependent on the types and nature of any Unacceptable Costs that have been incurred. The factors we take into account may evolve over time, but when considering whether to make a direction or accept an undertaking we will: ²¹

- Consider all of the responses to our consultation.
- Consider any undertaking DCC submits. We expect any undertaking proposed to provide equivalent or additional value to consumers over a direction to exclude costs.
- Consider the extent DCC was able, or should have been able to control or influence the value and the occurrence of the Unacceptable Costs. This includes whether DCC has used all the levers it has to manage external contractors e.g. the levers it has under the contracts, or how the Unacceptable Costs were agreed by DCC through its change control process.
- Take into account the DCC's role in procuring the relevant service capability that gave rise to the Unacceptable Costs. We will consider whether DCC had adequate processes for the management or procurement of products or services where costs were incurred, and if they were followed.
- Consider the likelihood that DCC will be able to recover any Unacceptable Costs through future procurements.
- Consider whether the Unacceptable Costs could be managed back and the extent to which DCC will be able to avoid, prevent, or mitigate a further occurrence of the same or any similar Unacceptable Costs. ²²
- We may also consider any actions DCC that has already taken to ensure the Unacceptable Costs are recovered or will not reoccur.
- The impact that excluding the Unacceptable Costs could have on the operation of the DCC's activities.

²¹ These criteria reflect the factors we must consider under Licence Condition 37 and some additional factors that we may also take into consideration.

²² This refers to the same or similar unacceptable category of costs

4. Baseline margin adjustment

Chapter Summary

This chapter outlines the procedure for submitting a proposal for an adjustment to the Baseline Margin values. We provide some principles that we will apply when assessing a proposal, what we expect to be included in a proposal and an outline of our method of assessment.

4.1. The Baseline Margin (BM) adjustment mechanism was included in the Licence to recognise the uncertainty when the Licence was granted over the nature, risk and scope of DCC's Mandatory Business over time. It is intended to ensure that DCC is compensated for material changes in certain aspects of its Mandatory Business under the Licence including the activities it carries out, the risk it faces or the timescales and deadlines that it must meet.

4.2. It is not an annual review of the margin agreed at bid, and does not protect DCC against increases in costs that do not correspond to material changes in the criteria outlined in the Licence. It should reflect the value that DCC has added for energy consumers.²³ This should be justified in its proposal and related to changes in the criteria outlined in the Licence.

4.3. It is important to note that a proposed adjustment should not be based on variations to cost if there has not been any associated burden or requirements on DCC to carry out additional activities.

Procedure

Timings

4.4. The Licence²⁴ has a clear process for proposing an adjustment to the BM values. This includes submitting a proposal, the circumstances under which DCC may propose an adjustment and the information that must be included in any proposal.

4.5. The notice for the proposed adjustment must be submitted during the month of July (the 'Application Window'). Although the Licence contains a hard deadline for submitting any proposal, this process does not preclude DCC from engaging with us on the detail of its submission before it formally makes it. Ofgem will make a final

²³ It is reasonable to assume that any new explicit requirements in the Licence or SEC are considered to already achieve this aim. The changes would also need to meet the materiality and other criteria for a Baseline Margin Adjustment.

²⁴ Licence Condition 36, Appendix 2.

decision once an application has been submitted, and any engagement ahead of this submission is without prejudice to our final decision.

4.6. We may ask DCC for more information if we need it to assess the proposal.²⁵ To minimise the need for this, DCC should ensure that it makes the best case it can when it first proposes the adjustment.

4.7. The Licence sets a deadline for us to determine any adjustment duly applied for. The Determination Period runs from 31 July until the end of November in the same year. We can extend the Determination Period by up to three months. We recognise that there is some interaction between the decisions relating to the price control and application for adjusting the BM values, so we aim to publish our decisions on both of these at the same time. In order to keep the price control and BM decisions together, we anticipate extending the BM decision every year that an application is made by DCC.

4.8. Before making our final decision, we will consult with DCC and stakeholders on our proposed position. Then we will take into account further information or evidence provided to us before making our final decision.

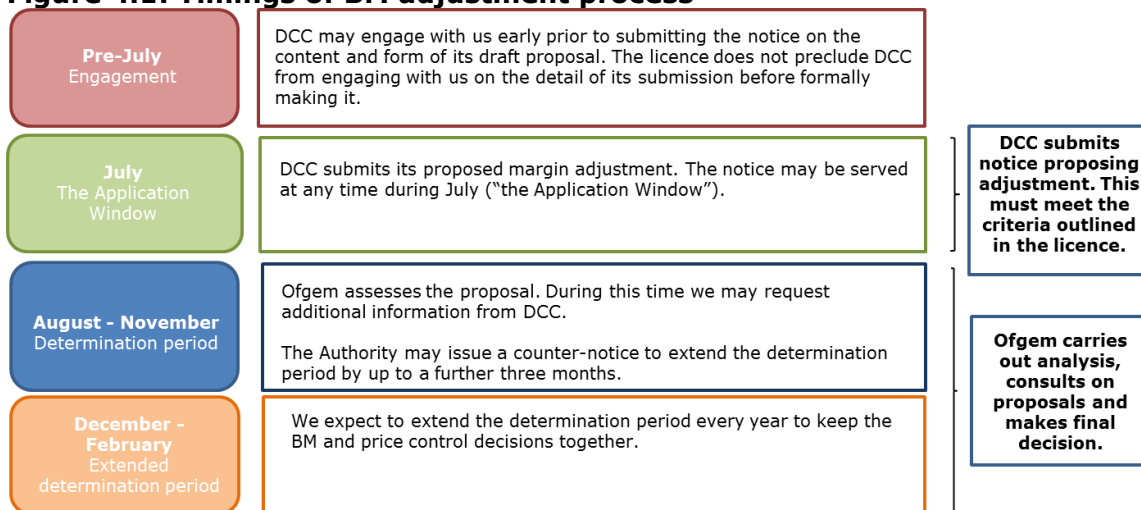
4.9. It is DCC's responsibility to make a case for any proposed adjustment and to include in the notice everything that the Licence requires it to include i.e. it is DCC's responsibility to ensure that it will be 'duly made'. DCC should provide sufficient evidence to support its case.

4.10. If we accept a proposal as being 'duly made' we may still need more information in order to determine the adjustment, if any, to make to the BM values in the Licence. We will direct DCC to supply information we need to determine the proposed Relevant Adjustment.²⁶ However if the notice does not contain all of the information the Licence requires of it, it will not be considered 'duly made'.

²⁵ We will direct DCC to provide this information as allowed under Licence Condition 36, appendix 2, Part B, paragraph A9.

²⁶ Licence Condition 36, appendix 2, Part B.

Figure 4.1: Timings of BM adjustment process



Proposing an adjustment

4.11. DCC may propose an adjustment to the BM values by submitting a notice to the Authority. This notice must be duly made, which means it must comply with the Licence in terms of the timeframes and criteria for submitting it, and the information it contains.

Criteria for proposing an adjustment

4.12. The notice must meet the criteria stated in the Licence. The starting point for a Relevant Adjustment is that it must relate to a material variation, whether as an aggregation of incremental but non-material changes, or a discrete but material change, that has taken place or is likely to take place in one or more of the aspects of the mandatory business of the licensee as outlined in the Licence.²⁷

4.13. DCC may propose a Relevant Adjustment where it can identify a change in its mandatory business that has had a consequential impact on one or more of the aspects set out in its licence (e.g. volume, characteristics or mixture of activities, risks and/or timescale or deadlines). For example, DCC may propose a Relevant Adjustment based on undertaking a new activity that wasn't envisaged when the values of the BM in Appendix 1 were first agreed, and as a consequence the total volume of activities comprising DCC's business has increased. A change in cost is not a reason to propose an adjustment alone.

4.14. If a Relevant Adjustment is proposed in relation to aggregating incremental but non-material changes, DCC should make this clear in the notice.

²⁷ Licence Condition 36, appendix 2, paragraph A3.

Contents of the notice

4.15. The notice must also contain all information requested in the Licence (shown in Licence Condition 36, appendix 2, part A). If it does not then we will not consider it to have been 'duly made'.

4.16. For a notice to meet all the requirements of licence, we would expect the broad structure of the notice to include, but not be limited to, the following:

- A description of the variation which forms the basis of the notice and why DCC considers it a change from what was known when the values of the BM were first agreed, with reference to relevant evidence
- How this variation has affected one or more of the aspects of DCC's Mandatory business (volume, characteristics or mixture of activities, risks and/or timescale or deadlines)
- The calculations and assumptions behind the proposed Relevant Adjustment to the BM values for each regulatory year
- Why a BM adjustment is appropriate and justified with reference to the benefits that DCC is currently or will provide to consumers

Likelihood of variation taking place and grounds for proposing an adjustment

4.17. The notice must be served during the first Application Window after the date the grounds for proposing the Relevant Adjustment first arose.²⁸

4.18. We consider that grounds for proposing a Relevant Adjustment will have arisen when DCC is able to demonstrate that a variation has taken place or is significantly more likely than not to occur using actual and forecast levels of expenditure, use of resources, or performance of activities that could not have been available when the original BM terms were first agreed.

4.19. Accordingly, when determining whether a Relevant Adjustment has been duly made in line with the Licence, we will consider:

- (i) when the grounds for proposing the Relevant Adjustment in question first arose; and
- (ii) is the Application Window applied for the first Application Window after that date?

4.20. When considering when 'grounds' in question first arose, Ofgem will have particular regard to cost forecasts submitted by DCC in its application. Costs must be

²⁸ See paragraph 4.6 for a clarifying event

included in DCC's forecasts, following the guidance on forecasts given above²⁹, when they are significantly more likely than not to occur.

4.21. We acknowledge that DCC's level of certainty over the activities comprising its mandatory business, and consequentially its resources and costs, will change over time. This can have implications for DCC when applying for an adjustment to its BM given that DCC's ability to accurately forecast will naturally diminish the further out from the current regulatory year that DCC attempts to forecast.

4.22. In some circumstances, 'grounds' in respect of an underlying variation may therefore arise in a later Application Window, in which case it may be appropriate for a further application for a Relevant Adjustment to be made. This might occur, for example, in relation to an enduring activity where it was not possible to accurately forecast the impact on DCC's Mandatory Business beyond the first few years in the original application. Here we would expect DCC to consider the impact of that enduring activity on their business as far into the future as is possible to meet the "significantly more likely than not" forecasting threshold. This should be reflected in DCC's forecasts and any application for an adjustment to DCC's BM to the extent it is possible to quantify that impact.

The Authority's right to propose an adjustment

4.23. The Authority may also propose an adjustment to the baseline margin values in the Licence. We are only likely to do this when it is in the consumer's interest to propose an adjustment. To propose an adjustment, the Authority must give a notice to DCC, which must follow the same procedure, meet the same criteria, and use the same information as set out in the Licence and discussed above.

Approach

Principles

Third parties

4.24. There may be some circumstances where DCC can justify a margin on third party external service provider contract. DCC would have to put forward a case justifying how such instances meet the Licence criteria for an adjustment. It would also have to put forward a case for the appropriate level of margin to be applied. It should not automatically be assumed that this would be the same as for internally provided services.

²⁹ See paragraphs 2.17 to 2.20.

4.25. Also, DCC can propose an adjustment relating to a contract with a third party based on work DCC carries out, for example, the managing the contract or risk that DCC faces.

Quantifying risk

4.26. Where an application is associated with risk, proposed adjustments to baseline margin values should be linked to and consistent with the risks that DCC is actively managing. These risks should be valued and DCC should provide supporting evidence to justify their approach. As such, we expect to see consistency between the risks within the DCC risk registers and any risks identified in a baseline margin application. If DCC is unable to evidence how it is effectively managing risk this could undermine a proposal for a baseline margin adjustment.

Underestimation at bid stage

4.27. If the volume or scope of work³⁰ was underestimated by DCC, based on known assumptions and uncertainties at the bid stage, then it is unlikely that this will meet the criteria for a margin adjustment. Unless there have been changes or uncertainties which it was not possible to anticipate at the time, or DCC was specifically instructed to exclude costs due to uncertainties with details.³¹ This is because a proposed adjustment must relate to new information that could not have been available when the values of the BM terms were first agreed.

Methods of assessment

4.28. DCC must identify all potential variations that could result in proposing a Relevant Adjustment. We will assess the notice and evidence provided to us for each Relevant Adjustment. We will check the evidence DCC provides to ensure that:

- Those Relevant Adjustments relate to variations to the volume, characteristics, mixture of activities, risk, and/or timescales DCC itself incurs.
- That variations relate to information on actual and forecast levels of expenditure, use of resources, or performance of activities that could not have been available when the original BM terms were first agreed.³² We will check what information was available through the competitive Licence bid process.
- The variations have been quantified, are material and are likely to take place. We will expect it to be clear whether these are discrete material variations or aggregated non-material variations. The materiality and likelihood should be underpinned by analysis and evidence.

³⁰ For example if DCC had underestimated the scope of work that a particular function would have to do in order to deliver the scope of activities that were known at bid.

³¹ For example, because the scope or detail was uncertain.

³² This could cover costs or activities that were known at bid but excluded because of uncertainties with the scope of the role and /or details.

4.29. We will consider this analysis and any assumptions that DCC has made when determining materiality and likelihood. If we disagree that the variation is material or likely at the time of application, we will consult on the basis that we do not find that their grounds have arisen to warrant the proposed adjustment. We would take the views of this consultation into consideration before making our final decision. If we remained of the view that grounds had not arisen, then DCC may apply when they can demonstrate that the grounds have arisen.³³

4.30. Materiality should be considered in terms of the variation in activity, risk or timescales etc. that lead to the Relevant Adjustment, not in terms of cost - i.e. DCC should have seen a material change in its volume, mix, or characteristics of activities, or its risk or timescales, and not just a material change in the cost of known activities.

4.31. We will review the analysis and basis of the calculation for the proposed changes. We will check for consistency against other sources of information.

4.32. We will have regard to the purposes that the BM term is intended to serve and the basis on which the values in the Licence were agreed with respect to DCC's expected rate of return on its activities over time.³⁴ Where the application for additional margin relates to baseline scope³⁵ DCC will retain the margin rate at which the Licence was awarded on the basis that the award was the result of a competitive tender.

4.33. The margin rate applied to any variation associated with new scope activity is not necessarily the same as the margin applied at Licence award. DCC should therefore provide justification for the level of margin it is applying for on each variation. We are doing work in this area and considering different models, and may give more detail in future versions of this guidance.

4.34. We will consider any proposed adjustment to the BM values along with the price control reporting. For example, if the variation is linked to cost changes, to meet the certainty criteria we can only consider it once these costs have been included for assessment in the price control, either as actual costs or forecast costs. If we find that these costs were not incurred economically and efficiently then we would not consider a BM adjustment for the variation that was linked to them. If forecast costs were found not to be significantly more likely than not to occur then we would reject a BM proposal associated with them. However, when those forecasts meet the threshold then DCC could propose a BM adjustment in a future Application Window.

4.35. We will look for consistency in the justification of information reported under the price control and the BM proposal.

³³ See paras 4.18-4.23

³⁴ Licence Condition 36, Appendix 2, Part B, paragraph A10.

³⁵ See glossary for definition.

4.36. We may also look for consistency in materiality. While there may be valid reasons for there to be different materiality thresholds between the price control and the BM adjustment, we would expect any significant difference to be justified.

5. External Contract Gain Share (ECGS)

Chapter Summary

This chapter outlines the procedure for submitting a proposal for an adjustment to the External Contract Gain Share (ECGS) term in the Allowed Revenue Formula. We provide some principles that we will apply when assessing a proposal, what we expect to be included in a proposal and an outline of our method of assessment.

5.1. The DCC Allowed Revenue formula includes an External Contract Gain Share (ECGS) term. The effect of the application of External Contract Gain Share is to provide for an upward adjustment to the amount of Allowed Revenue that reflects some part of the reduction in External Costs that DCC helped achieve. This term is zero unless DCC applies to vary the relevant term within Allowed Revenue for one or more regulatory years from 2015/16 to 2025/26.

Procedure

Timings

5.2. The licence has a process similar to the BM adjustment mechanism for proposing an adjustment to the ECGS values. The notice for the proposed adjustment must be served in the month of July (the 'Application Window'). DCC may engage with us on the detail of its submission before it formally makes it, however, Ofgem will make a final decision once a duly made application has been submitted, and any engagement ahead of this submission is without prejudice to our final decision.

5.3. We may ask DCC for more information if we need it to assess the proposal. To minimise the need for this, DCC should ensure that it makes the best case it can when it first proposes the adjustment.

5.4. The Licence sets a deadline for us to determine any adjustment duly applied for. The Determination Period is the same as for the BM adjustment process and runs from 31 July until the end of November in the same year. We can extend the Determination Period by up to three months.

5.5. Before making a decision we will consult DCC on our proposed decision, and will take into account further information or evidence provided in response to the consultation before making our final decision.

Proposing an adjustment

5.6. DCC may propose an adjustment to the ECGS values by submitting a notice to the Authority. This notice must be duly made, which means it must comply with the

Licence in terms of the timeframes and criteria for submitting it, and the minimum information requirement. This criteria is contained in paragraphs A3-A5 of Appendix 1 to condition 39.

5.7. Crucially, the notice must clearly identify the activities that are subject of the proposal under the relevant External Service Provider Contract(s).

5.8. As per the process for the BM application, any ECGS notice must be served during the first Application Window after the date on which the grounds for proposing the adjustment first arose. If DCC fail to notify during the correct application window, then they will lose the opportunity for an adjustment related to those changes.

5.9. If DCC proposes an adjustment which spans several years of its Licence, and it is accepted by Ofgem, but the values for future years are not certain at the time of the original application, DCC should apply for the specific values in the first application window after such values becomes certain. DCC may reference relevant parts of the original application to avoid repetition in any subsequent related applications.

Methods of assessment

5.10. When assessing DCC's proposal against the criteria in the licence we will, at a minimum, consider the following:

- **Original costs:** we will require evidence of how the costs of the activities that form the basis of an ECGS proposal were originally included in the contracts prior to any change.
- **Evidence of amendment:** we will require evidence to show how the contracts have been amended to implement a change in activities that has resulted in a cost saving.
- **Efficiency:** we will need to understand how any change to the contract has led, or will lead to an efficiency. This can be evidenced through a change in costs as identified in the price control reporting or, if this relates to a future change, a comparison of any forecasted saving against the counterfactual (i.e. the cost in the absence of the change to the contract). DCC will also need to evidence why the efficiency delivers a net saving overall i.e. that costs have not increased elsewhere as a result of the change.
- **DCC's role:** any proposal should describe how DCC was, or will be, instrumental in achieving efficiency through a collaborative process. Ultimately, we need to understand how the efficiency could not be introduced without DCC's involvement.
- **Size of the Relevant Adjustment:** the proposal should clearly present the calculations behind any Relevant Adjustment, referring back to contract and price control information where necessary. DCC should explain and justify the relevant adjustment in relation to the efficiency using relevant evidence. This could include, for example, any regulatory precedent for gain shares in other relevant price control frameworks.

Appendices

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Appendix 1 – 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 scope

Activity associated with delivering the requirements provided to the Licensee during the DCC Licensing Competition. This includes both activities that the Licensee was expected to fully cost in the LABP and activities that were known but not fully scoped at that time and so not able to be fully costed (for example, enrolment and adoption of SMETS1 meters, and development of Dual Band Communication Hubs).

Baseline Margin

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

C

Centralised Registration Service (CRS)

A future component of the switching service, procured by the 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 appointed to provide these services.

D

Data and Communications Company (DCC)

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

Data Services Provider (DSP)

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

E

[External Contract Gain Share](#)

The DCC Allowed Revenue formula includes an External Contract Gain Share (ECGS) term. The effect of the application of External Contract Gain Share is to provide for an upward adjustment to the amount of Allowed Revenue that reflects some part of the reduction in External Costs that DCC helped achieve.

[External Costs](#)

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

I

[Internal Cost](#)

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

L

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

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

M

[Mandatory Business Costs](#)

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

[Mandatory Business Services](#)

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

N

[New scope](#)

Activity associated with delivering requirements additional to those that the Licensee was expected to deliver at the time of Licence Award. The Centralised Registration Service is considered new scope.

O

[Ofgem](#)

Office of Gas and Electricity Markets

P

[Pass-Through Costs](#)

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

R

[Regulatory Accounts](#)

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

[Regulatory Instructions and Guidance \(RIGs\)](#)

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

[Regulated Revenue](#)

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

[Regulatory Year](#)

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

[Relevant Services Capability](#)

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

[Relevant Adjustment](#)

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

S

[Smart Energy Code \(SEC\)](#)

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

SECCo

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

SEC Panel

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

Service Charges

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

Shared services

Support services sourced from the licensee's parent company and covered by the Shared services costs under Section 3.3.1 of the LABP.

Smart Meter

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

Smart Meter Communication Licence

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

U

Unacceptable Costs

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