

## Notice of Price Control Decisions, Determinations and Directions

### To: Smart DCC Limited

1. This Notice of Decisions, Determinations and Directions is issued by the Gas and Electricity Markets Authority<sup>1</sup> ("the Authority") under the Licence<sup>2</sup> granted to Smart DCC Limited<sup>3</sup> ("the Licensee").<sup>4</sup>

### ***Purpose of this Notice***

2. The Licensee is subject to price control provisions set out in Chapter 9 of the Licence. On 31 July 2019 the Licensee submitted to the Authority the Price Control Information relating to Regulatory Year<sup>5</sup> 2018-2019 as required by Condition 32 of the Licence.
3. Licence Condition 36 Part C provides that the Licensee's Allowed Revenue<sup>6</sup> in relation to Regulatory Year t<sup>7</sup> is to be determined in accordance with the Principal Formula<sup>8</sup>. The Principal Formula includes terms reflecting:
  - a)  $IC_t$ , meaning the actual amount of the Licensee's Internal Costs<sup>9</sup>, as calculated for Regulatory Year t by the Licensee except to such extent (if any) as may be otherwise directed by the Authority acting under Part B of Licence Condition 37;

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<sup>1</sup> The Office of the Gas and Electricity Markets (Ofgem) supports the Authority in its day to day work. In this document 'we', 'us', 'Ofgem' and 'Authority' are used interchangeably.

<sup>2</sup> The Smart Meter Communications Licences granted pursuant to Section 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').

<sup>3</sup> Smart DCC Ltd is registered in England and Wales under Company Number 08641679.

<sup>4</sup> All terms used in this Notice shall have the meaning given to them under the Licence, unless expressly stated otherwise.

<sup>5</sup> Defined in Condition 1.4 of the Licence.

<sup>6</sup> Defined in Condition 35.5 of the Licence.

<sup>7</sup> The terms 'Regulatory Year t' and 'Regulatory Year t-1' are defined in Condition 35.5 of the Licence.

<sup>8</sup> Defined in Part C of Condition 36 of the Licence.

<sup>9</sup> Defined in Condition 35, Part B of the Licence

- b) the  $BM_t$  meaning the Baseline Margin that is specified for the Regulatory Year  $t$  in Appendix 1 to Licence Condition 36, as multiplied by the price index adjuster for that year, as described in Licence Condition 36.8;
- c)  $ECGS_t$ , meaning the amount of revenue adjustment in respect of External Contract Gain Share, as calculated for Regulatory Year  $t$  in accordance with Condition 39 (Determination of External Contract Gain Share), as described in Licence Condition 36.8;
- d)  $BMPA_t$  meaning the Baseline Margin Performance Adjustment, as calculated for the Regulatory Year  $t$  in accordance with Part F of Licence Condition 36.

4. This Notice sets out the Authority's:

- i. Direction excluding Unacceptable Costs in accordance with Licence Condition 37.8, on the basis that some Internal Costs were not economically and efficiently incurred;
- ii. Determination amending the Licensee's proposed Relevant Adjustment to the BM values specified in Licence Condition 36 Appendix 1, in accordance with Licence Condition 36 Appendix 2;
- iii. Determination amending the Licensee's proposed Relevant Adjustment of the ECGS term specified in Licence Condition 39;
- iv. Determination amending the Licensee's proposed Relevant Adjustment of the BMPA term specified in Licence Condition 38.

***ICt Internal Costs: Exclusion of Unacceptable Costs from any future calculation of the Licensee's Allowed Revenue***

5. Under Licence Condition 37, Part B, the Authority may:

(a) direct that any External Costs or Internal Costs that it considers were not economically and efficiently incurred in the Relevant Regulatory Year (the "Unacceptable Costs") are to be excluded from any future calculation of the Licensee's Allowed Revenue under Condition 36; or

(b) accept an undertaking given by the Licensee with respect to the Unacceptable Costs on terms that relate to either or both of:

- (i) the Licensee's future management of those costs, and

- (ii) the Licensee's future procurement of Relevant Service Capability.
6. The Authority has considered the Licensee's reports<sup>10</sup> dated 31 July 2019 and further information submitted by the Licensee between 31 July 2019 and the close of the price control consultation on 20 December 2019. The Authority has consulted<sup>11</sup> the Licensee and other relevant stakeholders on its proposed decisions and has duly considered all responses received. The Authority has considered the matters set out in Part B of Licence Condition 37.
7. Having regard to the provisions set out in Licence Condition 37, the Authority considers that £1.088 million of the Licensee's Internal Costs were not economically and efficiently incurred<sup>12</sup> and are Unacceptable Costs.<sup>13</sup>
8. The Licensee did not submit any undertaking with respect to the Unacceptable Costs.

#### **Direction as to Internal Costs**

9. The Authority hereby directs, pursuant to Licence Condition 37.8 (a) that £1.088 million of the Licensee's Internal Costs are Unacceptable Costs and are to be excluded from any future calculation of the Licensee's Allowed Revenue under Licence Condition 36.

#### ***CRSICt Centralised Registration Service Internal Costs: Exclusion of Unacceptable Costs from any future calculation of the Licensee's Allowed Revenue***

10. Under Licence Condition 37, Part B, the Authority may:
- (a) direct that any Centralised Registration External Costs or Centralised Registration Service Internal Costs that it considers were not economically and efficiently incurred in the Relevant Regulatory Year (the "Unacceptable Costs") are to be excluded from any future calculation of the Licensee's Allowed Revenue under Condition 36; or
- (b) accept an undertaking given by the Licensee with respect to the Unacceptable Costs on terms that relate to either or both of:

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<sup>10</sup> The Price Control Information Report submitted under Condition 32 and the annual report on cost performance required under Condition 37.3 of the Licence.

<sup>11</sup> The DCC Price Control Consultation is available at: <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201819>

<sup>12</sup> Details of the Internal Costs that were not economically and efficiently allowed are set out in our Price Control Decision 2018/19 which accompanies this Notice.

<sup>13</sup> Defined in Condition 37.8(a) of the Licence.

- (i) the Licensee's future management of those costs, and
- (ii) the Licensee's future procurement of Relevant Service Capability.

11. The Authority has considered the Licensee's reports<sup>14</sup> dated 31 July 2019 and further information submitted by the Licensee between 31 July 2019 and the close of the price control consultation on 20 December 2019. The Authority has consulted<sup>15</sup> the Licensee and other relevant stakeholders on its proposed decisions and has duly considered all responses received. The Authority has considered the matters set out in Part B of Licence Condition 37.

12. Having regard to the provisions set out in Licence Condition 37, the Authority considers that the values set out in Annex E of this direction of the Licensee's Centralised Revenue Service Internal Costs were not economically and efficiently incurred<sup>16</sup> and are Unacceptable Costs.<sup>17</sup>

13. The Licensee did not submit any undertaking with respect to the Unacceptable Costs.

### **Direction as to Centralised Registration Service Internal Costs**

14. The Authority hereby directs, pursuant to Licence Condition 37.8 (a) that the values set out in Annex E of this direction of the Licensee's Centralised Registration Service Internal Costs are Unacceptable Costs and are to be excluded from any future calculation of the Licensee's Allowed Revenue under Licence Condition 36.

### **BM<sub>t</sub> Baseline Margin Adjustment (BMA)**

15. Licence Condition 36 Appendix 1 ("Appendix 1") sets out the values for the BM term for each Regulatory Year. Licence Condition 36 Appendix 2 ("Appendix 2"), Part A, provides that the Licensee may propose a Relevant Adjustment to any one or more of the BM values specified for any one or more of the Regulatory Years. By Notice dated 31 July 2019, the Licensee proposed a Relevant Adjustment to the BM values specified in Appendix 1 for each Regulatory Year of the Licence.

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<sup>14</sup> The Price Control Information Report submitted under Condition 32 and the annual report on cost performance required under Condition 37.3 of the Licence.

<sup>15</sup> The DCC Price Control Consultation is available at: <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201819>

<sup>16</sup> Details of the CRS Internal Costs that were not economically and efficiently allowed are set out in our Price Control Decision 2018/19 which accompanies this Notice.

<sup>17</sup> Defined in Condition 37.8(a) of the Licence.

16. The Licence provides that the Authority will, at any time before the end of the Determination Period<sup>18</sup>, by direction given to the Licensee, determine any adjustment that is to be made to any BM value specified in Appendix 1 for the Regulatory Year to which that BM value relates. The Determination Period ends on 28 February 2020. The Authority must determine any adjustment that is to be made in accordance with Appendix 2 Part B.
17. In accordance with Appendix 2 Part B, the Authority has considered the proposal for a Relevant Adjustment to the BM values and the further information submitted by the Licensee and has consulted with the Licensee and with SEC parties. The Authority has had particular regard to the purposes that the BM term is intended to serve within the Price Control Conditions of the Licence and the basis on which the BM values were agreed during the Licence Application Process with respect to the Licensee's expected rate of return on its activities over time. The Authority has taken no account of the Licensee's general financial performance under the provisions, taken as a whole, of the Price Control Conditions.
18. The Licence gives the original values of the BM term in Licence Condition 36 Appendix 1 in the price base of 2013/14. The Relevant Adjustments to these terms are to be made in the same price base. Therefore the Relevant Adjustments specified by the Licensee in the 2018/19 price base are deflated by the price index adjuster (PIBM) for 2018/19.

### **Determination as to $BM_t$ Baseline Margin Adjustment**

19. Having regard to the provisions of Appendix 2, the Authority hereby amends the proposed Relevant Adjustment and determines the adjustment to the BM values set out in Licence Condition 36 Appendix 1. The adjustment that is to be made to the BM values is set out in Annex A of this direction.

### **BMPA<sub>t</sub> Baseline Margin Performance Adjustment**

20. Licence Condition 36.12 contains a formula for the calculation of the BMPA<sub>t</sub> term for the Relevant Regulatory Year and provides that it is the BMOPA<sub>t</sub> the value of which is determined in accordance with the provisions of Part C of Licence Condition 38.

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<sup>18</sup> Defined in Licence Condition 36 Appendix 2 Part E as being the period running from the close of the Application Window (ie 31 July 2015 for the Regulatory Year 2014/15) until the end of the first month of November after that closure, or such later date as may be directed by the Authority in a Counter-Notice served under Appendix 2 Paragraph A8. The Authority served such a Counter-Notice on 12 August 2019, which stated that the Determination Period would end on 28 February 2020.

21. The  $BMOPA_t$  formula provides for each of its terms to be zero unless determined otherwise in accordance with such calculations as may apply to the term Operational Performance Regime as defined in the Licence as set out in Schedule 4.
22. Under License Condition 38.9, the Authority directed to populate the provisions of Schedule 4 of the Licence on 4 September 2017 to take effect on 1 April 2018.
23. Under Licence Condition 38.8 the effect of the BMOPA term is to provide for an adjustment to the Allowed Revenue of the Licensee, where appropriate, to reflect the Licensee's performance against certain Operational Performance Regime performance measures and, subsequently, against other measures.
24. The Licensee did not meet the contractual commitments in CSP contracts and therefore under  $SDM1$  – DCC WAN Coverage and Reliability performance measure as defined in OPR direction<sup>19</sup>  $SDM1_t = - TPLI_{SDM1t}$ ;  $TPLI_{SDM1t}$  has the value £1.267 million.
25. The Licensee's Reported Performance Level (RPL) for SUM2a was between the Minimum Performance Level (MPL) and Target Performance Level (TPL), therefore  $SUM2a_t = -£0.038$  million as calculated by the OPR direction and the Regulatory and Instructions Guidance (RIGs).
26. Licence Condition 36.12 contains a formula for the calculation of the  $BMPPA_t$  term for the Relevant Regulatory Year<sub>t</sub> and provides that it is the  $BMPPA_t$  the value of which is determined in accordance with the provisions of Part D of Licence Condition 38.
27. For the purposes of paragraph 27,  $BMPPA_t$  means a Baseline Margin Project Performance Adjustment, being the amount of an adjustment that is determined in respect of Project n in Regulatory Year t in accordance with the terms of a BMPPA Scheme made by the Secretary of State under Appendix 1 (Baseline Margin Project Performance Adjustment Schemes) which has effect as part of this Condition.
28. The  $BMPPA_t$  formula provides for its term to be zero where in respect of any Regulatory Year t the Secretary of State has not made any BMPPA Scheme that results in the determination of a Project Performance Adjustment in that Regulatory Year as set out in Licence Condition 38.13.
29. The Licensee did not achieve milestone 2A and 3A of the BMPPA.

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<sup>19</sup> <https://www.ofgem.gov.uk/system/files/docs/2017/09/direction.pdf>

30. The Licensee did partially achieve milestones 1A, 1B, 2B and 3B of the BMPPA, but not by the required date<sup>20</sup>.

31. Having regard to the Conditions and calculations set out in Condition 38, the Authority hereby determines that the value of the BMPPA term for Regulatory Year 2018/19 are to be adjusted in accordance with the values in the table at Annex C to this Notice.

**Determination of the value of the terms  $BMOPA_t$  and  $BMPPA_t$  for purposes of calculation of the value of the  $BMPA_t$  term:**

32. Licence Condition 36 sets out the calculations for determining the amount of BMPA term that applies for the purposes of the Principal Formula set out under Part F of Condition 36.

33. Having regards to the provisions of Condition 36, the Authority hereby determines that the value of the BMPA term for Regulatory Year 2018/19 is negative £1.398 million.

**Adjustment to the EGCS term of Principle Formula**

34. Licence Condition 39 establishes the mechanism for determining the amount of the External Contract Gain Share (EGCS) term that applies for the purposes of the Principal Formula set out under Part C of Condition 36. By Notice dated 31 July 2019, the Licensee proposed a Relevant Adjustment to the value of the EGCS term for Regulatory Years 2020/21 to 2025/26.

35. The Licence provides that the Authority will, at any time before the end of the Determination Period, by direction given to the Licensee, determine any adjustment that is to be made to the EGCS term for the Regulatory Years referred to in the proposal. The Determination Period ends on 28 February 2020.

36. In accordance with Condition 39, the Authority has considered the proposal for a Relevant Adjustment to the EGCS values alongside the further information submitted by the Licensee.

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<sup>20</sup> These milestones relate to the R2.0 Project. More details regarding this can be found in the The DCC Price Control Consultation available at: <https://www.ofgem.gov.uk/publications-and-updates/dcc-price-control-consultation-regulatory-year-201819> and in the decision document which accompanies this Notice.

## **Determination as to ECGS term of the Principle Formula**

37. Having regard to the provisions of Condition 39, the Authority hereby determines that the value of the ECGS term for Regulatory Years 2020/21, 2021/22, 2022/23, 2023/24, 2024/25 and 2025/26 are to be adjusted in accordance with the values in the table at Annex B to this Notice.

## **Further Direction**

38. Where the Authority has determined costs as not economic and efficient in the Price Control decision 2018/19, the Licensee must make subsequent Relevant Adjustments to incurred and forecast costs in the RIGS submission for consideration of the 2019/20 Price Control.

39. Pursuant to its powers under Licence Condition 2 Part C, the Authority hereby directs the Licensee to provide to the Authority a calculation of its Allowed Revenue in accordance with the Principal Formula for Regulatory Year 2019/20 taking into account the determinations and direction above no later than 31 July 2020.

40. The reduction to incurred and forecast Internal Costs and Centralised Registration Service forecast costs for Regulatory Year 2018/19 is set out in Annex D and E of this direction. Detailed cost breakdown will be provided to DCC in the form of a copy of the Regulatory Instructions and Guidance with amended values.

41. The Directions in this Notice have immediate effect and remain in effect until such time as the Authority may revoke or amend them in writing.

42. This Notice of Decisions, Determinations and Directions and the Data Communications Company (DCC): Price control decision 2018/19 dated 27 February 2020 together constitute Notice of the Authority's reasons for the above decisions pursuant to section 38A of the Gas Act 1986 and section 49A of the Electricity Act 1989.



**Rachel Clark**

**Director, Retail Systems Transformation**  
**Duly authorised on behalf of the Gas and Electricity Markets Authority**  
**27 February 2020**



ANNEX A:

**Relevant BM Adjustment (£ million in 2013/14 prices) for each Regulatory Year determined in response to Notice submitted by Licensee dated 31 July 2019**

2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
-	-	-	-	-	-	-
2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
1.518	2.235	3.414	-	-	-	n/a

We have categorised the BM adjustment by relevant driver to ensure that the correct proportions of the BM are allocated to either the OPR or the BEIS-led project incentive regimes.

Driver	BM adjustment (£ million)			
	2020/21	2021/22	2022/23	Total
Core	0.852	1.071	3.046	<b>4.969</b>
Release 2.0	0.071	0.000	0.000	<b>0.071</b>
SMETS1	0.595	1.164	0.368	<b>2.128</b>
<b>Total</b>	<b>1.518</b>	<b>2.235</b>	<b>3.414</b>	<b>7.168</b>

ANNEX B:

**Relevant ECGS Adjustment (£ million) for each Regulatory Year**

2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
-	-	-	-	-	-	-
2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
2.758	1.229	1.151	1.248	1.418	0.406	n/a

ANNEX C:

**Relevant BMPPA Adjustment (£ million) for relevant Regulatory Year**

Project Activity Amounts	BM reduction (£ million)
	2018/2019
1A	0.008
1B	0.008
2A	0.021
2B	0.005
3A	0.026
3B	0.026
<b>Total</b>	<b>0.093</b>

ANNEX D:

**Internal Costs determined as not economic and efficient under the price control (£ million) and forecast costs not meeting the 'significantly more likely than not to occur' threshold for each Regulatory Year**

2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
-	-	-	-	-	1.088	-
2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
-	47.257	45.879	45.907	45.452	18.880	n/a

ANNEX E:

**CRS Internal Costs determined as not economic and efficient under the price control (£ million) and forecast costs not meeting the 'significantly more likely than not to occur' threshold for each Regulatory Year**

2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
-	-	-	-	-	-	-
2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
-	3.449	3.389	3.389	3.389	1.412	n/a