



Consultation Response

By email to smartmetering@decc.gsi.gov.uk

Ref: URN 11D/868

24 November 2011

Smart Metering Implementation Programme – DCC Licensing Team

Department of Energy and Climate Change

3 Whitehall Place

London SW1A 2AW

Dear Sir/Madam

ELEXON's response to DECC's Smart Metering Implementation Programme: a consultation on the detailed policy design of the regulatory and commercial framework for DCC (September 2011).

I welcome the opportunity to provide ELEXON Limited's views on the design of the regulatory and commercial framework for the DCC. We remain totally committed to the success of the smart arrangements and are therefore keen to ensure that all the new smart roles, including that of the DCC, are delivered effectively, efficiently and economically. We do so for two principal reasons:

- The DCC and its services are critical to both industry and consumer experience and confidence. Their success is therefore central to realising the benefits of the Smart Programme; and
- The DCC will be delivering meter data for use in existing industry systems and processes. An ineffective DCC could fatally compromise the quality of the data used in settlement and other billing processes. ELEXON provides the electricity settlement processes on behalf of the industry.

ELEXON has provided detailed responses to the majority of the questions and these are provided in the attached document. Should the Programme wish to discuss any of our responses we would be very willing to do so. We have not provided a response to Section 6; we believe that these technical questions are better answered by providers of communication services.

I would like to draw out the following points from our response for your overall attention.

Incentive Regime

Whilst ELEXON has successfully delivered the electricity trading arrangements for over 10 years without a contract or explicit incentives, it has sometimes proved challenging to demonstrate to BSC Parties how we are focused on managing costs and improving services. Therefore we have been wholly transparent in our activities and costs and employed vehicles such as our Business Plan and monthly reports to demonstrate our value.



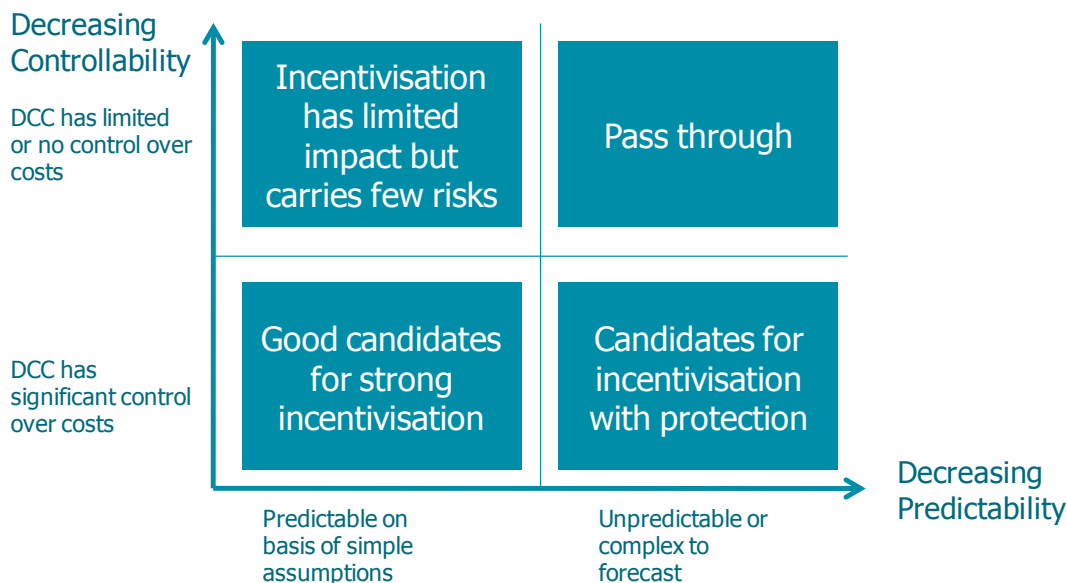
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Dependent on who is the eventual DCC, introducing an incentive regime may or may not of itself drive the right behaviours and outcomes. If well designed it could valuably distinguish the responsibilities of the DCC from those of its service providers, and help in monitoring and demonstrating the effectiveness and efficiency of the DCC.

The consultation discusses a wide range of tools that may form part of an incentive regime. From our experience of delivering key central services to the industry, techniques should not be considered in isolation, rather as part of an integrated incentive framework. We would also urge that the model should not be overly complex. An unduly complex model dilutes messages and risks driving perverse behaviours. It can also become a significant and disproportionate burden to deploy, monitor and manage for both those subjected to it and those applying it.

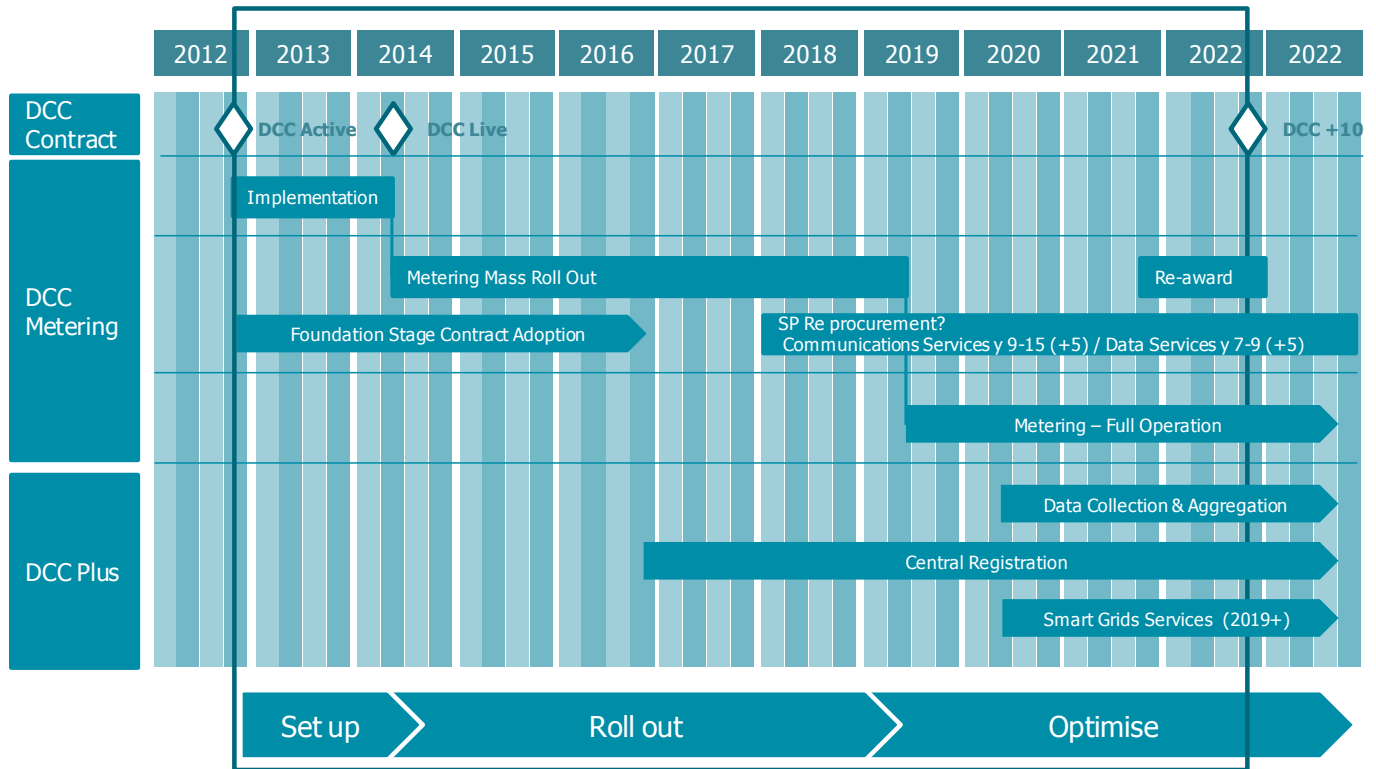
In setting the incentive regime we believe candidate areas should be assessed on two prime aspects:

- the extent to which the DCC can influence the successful outcomes from the activity; and
- the extent to which the DCC can predict the external inputs to the activity.



The challenges faced by the DCC across the first licence period are largely unique. We therefore believe that this needs to be recognised within any incentive regime and would recommend a model that allows differentiation between the distinct phases of implementation, rollout and service optimisation. The drivers and approximate timings are shown in the diagram overleaf:

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We would also suggest that the Programme uses the feedback from this consultation and provides further definition around the desired incentive regime prior to the start of the DCC award process. The alternative of allowing DCC licence applicants a totally free rein to propose their own incentive regimes will pose a substantial issue for the Programme in evaluating different offerings and could risk challenge on award.

We have discussed the Performance Incentive regime in more detail in an attachment to this response which forms our response to Question 83.

Licensing Process

We agree the content of the DCC licence outlined in the consultation and that the licence conditions are established as 'Special' Conditions.

Whilst recognising the need to establish the DCC in a timely fashion, the indicative timings of some of the stages are very tight and leave neither DECC nor bidders much flexibility. We are particularly concerned about the limited opportunity to assess the service provider contracts during the ITA stage. Dependent on the number of parties still in negotiation and the firmness of the contracts at this stage, this exercise could prove a significant burden and hence cost for applicants and the Programme. It may indeed serve only to prompt the introduction of cost reopeners for DCC, which will drive subsequent variations and escalating costs. We also urge the Programme to provide clarity on the likely start date of the award process. The current Q2 milestone for starting the award process is too broad and



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suggests either a 4 or 6 month lead time from now: such planning assumptions are key to allowing bidders to understand when to commence mobilisation, provide confidence in the process and drive costs.

We also urge early sight of the detailed DCC requirements in order to resolve the speculation and uncertainty that currently exists. This includes establishing clarity on the boundaries of responsibility between the DCC, its users, service providers and other bodies for all aspects of the end to end smart solution (e.g. security) and establishing the DCC service (e.g. the differing responsibilities of the SMIP, DCC and Service Providers during the key implementation phase). We believe that this could be achieved through DECC's suggestion of issuing a draft of the SEC in Q1 2012 (in plain English form). Taking such steps would greatly assist potential bidders and allow them to more fully assess and cost the opportunity and its inherent risks.

Communicating clear requirements in a timely manner will ensure the best possible outcome for the award process for both DECC and any bidders

If you would like to discuss any areas of our response, please contact me on 020 7380 4337, or by email at chris.rowell@elexon.co.uk.

Yours faithfully

Chris Rowell
Smart Programme Director



A consultation on detailed policy design of the regulatory and commercial framework for DCC

Chapter 2: Proposed regulatory approach to DCC

The Prohibition Order

Question 1: Please provide views on the approach to basing the prohibition upon contracting with all licensed suppliers in respect of all domestic smart meters, and on the way in which the specific wording of the prohibition should be developed.

This reflects the primary purpose of the DCC and thus correctly targets the prohibition. Keeping the area narrow also limits the risk of inadvertent capture. We therefore support the suggested approach

Question 2: Do you think there will be any persons other than DCC who might inadvertently be captured by a definition structured in this way?

We see little scope for any other persons to be inadvertently captured by the drafting. We suggest however that the wording be checked against the role of Meter Operator /Installer. It is feasible that a Meter Operator/Installer may seek to contract to offer services to all licensable suppliers in relation to every Smart Metering System. If this were to occur the Meter Operator/Installer will be communicating information to the meter on behalf of a supplier when installing or physically working on the meter. To avoid this situation the definition could refer to '**remote**' communication with the meter, as this will be limited to the DCC role.

Question 3: Do you have any other comments on the form of the licensable activity?

No

Consequential Changes to Legislation

Question 4: Please provide comments on the proposed changes to legislation identified in Table 2.1 and Table 2.2 and any other possible changes that you consider might be appropriate.

We have no comments in relation to the proposed changes to legislation in the consultation document.



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In addition we believe the interaction with the Climate Change and Sustainability Act 2006 should be considered further. This Act imposes energy efficiency obligations on suppliers and distributors e.g. obligations regarding carbon reduction. If DECC intends to impose energy efficiency obligations on DCC then the Gas and Electricity Acts may require amendment to include DCC in the list of those obliged to comply with the Climate Change and Sustainability Act 2006.

licence Conditions - General

Question 5: Do you agree with the proposal to have a single document with a single set of licence conditions that apply to both licences?

Yes we believe that establishing a single set of licence conditions in a single document is the right approach. Doing this will ensure that the requirements on the DCC in relation to gas and electricity are the same and thereby contribute to the harmonising of gas and electricity processes which will ultimately benefit the consumer, particularly during the change of supplier process.

Question 6: Do you agree with, and have any comments on, the proposed approach to establish all of the DCC licence conditions as "special" conditions?

We support the proposed approach as appropriate for a single licensed body and recognising the draft regulation currently before parliament.

Question 7: Do you have any comments on the scope and nature of the consequential licence changes that we propose to make?

The proposed changes to condition 26 of the Electricity Supply licence and condition 10 of the Electricity Distribution licence state that the DCC licensee may be able to interrupt supply and therefore they may need to be provided with information regarding customers who require advance notice. We believe that the decision on whether to interrupt supply should sit with the supplier (or distributor in limited cases) and therefore responsibility for ensuring customers are provided with advance notice should also sit with the supplier. We agree that providing this information to the DCC could provide an additional safety check to prevent vulnerable customers losing their supply without sufficient notice. However we feel that if this information is provided to the DCC, it should be clear that this does not mean that the overall responsibility is shifted from the supplier.

From a settlement perspective, we have processes in place to ensure that changes to energisation status and disconnection activities are notified to the Supplier Meter Registration Service (SMRS) so that the consumption can be accurately reflected into settlement. Again it is important that the supplier or



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distributor is aware if supply is likely to be interrupted for any significant length of time so they can make the required updates to the appropriate SMRS.

Question 8: Are there any other consequential licence changes that you consider might be necessary as a result of the creation of the new licensable activity?

No

Other Provisions to the Prohibition Order: Geographic Scope and Duration

Question 9: Please provide any comments on the proposed approach in relation to geographic scope of the DCC licence and provisions relating to its duration.

We agree that that the DCC licence should cover Great Britain as both the electricity and gas trading arrangements relate to Great Britain. Any misalignment between this or the coverage of the individual Supply and aggregate Distribution licences would necessitate dual arrangements and increase costs.

We agree that the duration of the licence should be specified in the licence itself and that any changes to the duration should be notified.

Chapter 3: DCC licence conditions

General Objectives of the DCC

Question 10: Do you agree with the proposed general objectives of DCC set out above?

Yes but see answers to Questions 13 and 14 below.

Question 11: Do you think it is necessary to include any statutory duties on DCC in the Gas and Electricity Acts or is it appropriate to address these issues in the DCC licence alone?

Yes, we believe it is appropriate to include appropriate statutory duties within the relevant Acts. Reference is made in chapter 2 (of the consultation) to a Prohibition Order and we assume that the requirements of such Order will be reflected in amendments to the Electricity Act 1989 and the Gas Act 1986. From a transparency and consistency perspective, we believe it would be helpful to include references to appropriate statutory duties in the respective Acts. The Electricity Act 1989 requires network licensees to develop and maintain an efficient, co-ordinated and economical system and to facilitate competition in the supply and generation of electricity and there are equivalent provisions in the Gas Act. The licences themselves reflect these duties as do the commercial and network codes associated with the licensed activities. The respective Acts also include provisions for modification of



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licences and references to the Authority in the event of disputes. Since the DCC will provide comparable network services with similar objectives both in its licence and in the SEC licence then we can see no compelling reason why the DCC obligations and duties should not be given statutory force.

Question 12: Do you agree than any obligation to facilitate competition in the area of distribution should be considered as part of the implementation of any future smart grids related arrangements?

We believe it would be sensible to include an obligation to facilitate competition in the area of distribution for two reasons. First, the DCC's operation will directly or indirectly affect both distributors and consumers and the obligation should be explicitly referenced.

Second, work on the development of smart grids is progressing rapidly and by the time the DCC arrangements are in place the interactions between smart grids and smart metering will be further defined. Incorporating an obligation now will obviate the need to introduce the requirement in parallel with, or soon after DCC implementation and will enable the DCC to take account of smart grid related arrangements from the outset.

Question 13: Do you agree with the approach proposed in relation to the protection of consumers?

No, whilst we entirely agree that the DCC should be required to protect the interests of consumers, experience dictates that a more explicit reference within the objectives would be helpful in assisting the DCC, users of the DCC's systems and the SEC panel to operate effectively. Failing that a guidance note (similar to that DECC provides to Ofgem with regard to consumers and the environment http://www.decc.gov.uk/assets/decc/what%20we%20do/uk%20energy%20supply/energy%20markets/regulation/1_20100121172046_e_@@_guidancegaselecmarkets.pdf) should be provided.

Question 14: Do you think DCC should have a separate objective to promote (or facilitate) energy efficiency?

It is difficult to envisage what an explicit objective on the DCC to promote energy efficiency might achieve over and above the obligations to develop, maintain and operate [and procure] an efficient communications system and to promote or facilitate competition, particularly if the latter obligation is expanded to include energy efficiency services, metering services and other energy related services.

If DECC does conclude that energy efficiency should be explicitly referenced then we would suggest the obligation on the DCC should be to facilitate this rather than promote it since promoting energy



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efficiency seems a more appropriate obligation for a regulator or supplier actively engaged in providing such services to consumers.

The Smart Energy Code licence Condition: The Scope of the SEC set out in the DCC licence

Question 15: Do you agree that SEC licence condition should be drafted so as to provide flexibility over the future scope of SEC, i.e. that the scope of the SEC in the DCC licence condition should be drafted in a permissive manner?

Yes. From our experience of managing the BSC we believe that licence conditions should be permissive. A robust change management process when coupled with appropriate and proportionate regulatory oversight can ensure that appropriate enhancements to the SEC and any consequential obligations on the DCC and others are properly evaluated without the need for redress to time-consuming and potentially costly legislative and licence changes.

Under all models consideration will also need to be given to how this is reflected in the commercial contracts that support delivery of the regulatory framework.

The Smart Energy Code licence Condition: SEC Applicable Objectives

Question 16: What are your views on the SEC Applicable Objectives set out above?

These seem appropriate as far as they go but please see the response to Questions 12 and 13 above – in our view a more specific reference to consumers and to distribution is required (the latter particularly if facilitating the implementation of smart grids is included in the DCC's responsibilities).

Generally, except where the objectives relate explicitly to obligations or services under the DCC's control, our strong preference would be for the objectives to refer to facilitation rather than promotion of a principle or service.

Question 17: Do you agree that the SEC should be designed to take into account consumers' interests by meeting its applicable objectives, rather than having an explicit objective related to the protection of the interests of consumers?

Please see our response to Question 13; an explicit reference to consumers would be desirable in our view.

Question 18: Should there be a SEC objective related to promoting (or facilitating) efficiency of energy networks?



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Please see our response to Question 12. There will be interactions between the DCC's services and those of energy network operators who will have certain rights and obligations within SEC; where appropriate it seems sensible that the SEC and DCC services facilitate enhancement of these services. We would suggest that the objective should be to facilitate rather than promote since the primary obligation on providing efficient energy networks rests with network operators.

Question 19: Do you think the SEC should have a separate objective of promoting (or facilitating) energy efficiency?

No. Please see our response to Question 14 i.e. we do not believe a separate objective on promoting energy efficiency is appropriate; objective (f) (related to promoting or facilitating competition in energy efficiency, metering services etc) should suffice. In our view, where relevant, obligations on the DCC should also be reflected in the SEC's obligations.

The Smart Energy Code licence Condition: SEC Modification Arrangements:

Whilst there is no question on this section, we note that DECC intends to progress the SEC Modification Procedures as part of detailed drafting of the DCC licence conditions and in light of the parallel development of the DCC. We would remind DECC of the findings of Ofgem's Code Governance Review and, given that this recommended the broader adoption of the BSC model, that the BSC provides a good starting point for developing these arrangements.

Service Provision

Question 20: Do you agree with the definitions of the services that DCC should be required or permitted to provide?

Yes we agree the definitions are reasonable however we believe that one key element that must be stressed is the importance of ensuring the integrity of the DCC. Therefore the 'appropriate authorisation' and the compliance definitions must ensure that the DCC is not required to deliver services to smart meters and service users that might compromise the DCC, particularly as a result of having to support 'non-compliant' metering systems

In keeping with this it is also important to ensure that where the DCC is 'required' to deliver services it can levy appropriate charging. Where it is unable to exercise discretion it is inappropriate for it to bear the risk of delivering the service.

With regards to 'other wholly unrelated services' we believe that provided robust financial ring-fencing and accounting arrangements are in place, the extent of services should not, in our view, be limited to a



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de-minimis level (instead services should be assessed to ensure that the delivery and integrity of the DCC is not compromised and that the competitive market is not adversely affected).

We recognise that the Authority's approval may be needed before additional services could be undertaken but in line with other provisions in the DCC licence and SEC, provisions should be permissive rather than restrictive; our own experience with the limitations in the BSC concerning what ELEXON, as BSCCo, is permitted to do bear this out. There will be circumstances where it is technically and commercially the right thing for the DCC to deliver a service itself. Such situations should be subject to an appropriate consents process rather than requiring expensive and time consuming removal of restrictions.

Question 21: In relation to which non-compliant metering systems should DCC be required to offer services?

The DCC should only be required to offer services to non compliant meters where it does not endanger the service and it does not carry an unreasonable cost to the industry. We suggest non compliant metering systems are subject to a dispensation authorised by the appropriate body (e.g. SEC Panel).

Question 22: In relation to which non-compliant metering systems associated with energy supply at consumer premises should DCC be permitted to offer services?

The DCC should only be required to offer services to non compliant meters where it does not endanger the service and it does not carry an unreasonable cost to the DCC (and therefore industry).

We need to ensure that metering systems meet the requirements for Settlement purposes under the BSC. As reliance may be placed on metering being compliant with the SEC for BSC purposes it is imperative that non compliant metering systems are not permitted where they do not meet Settlement requirements.

Question 23: What information should be made available to all users about:

- **elective services;**
- **value-added services?**

Should information be restricted to that required to assess the impact on other users of DCC services or should there be full transparency? Should DCC be required to make available the detailed commercial terms and conditions of such services?

There are several regulatory models which require service providers to set out a methodology which



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allows those wishing to use those services to calculate the cost of doing so; such arrangements typically include non-discrimination provisions and the right of referral in case of a dispute. There are other models which require the purchaser to indicate the range of services required and then the provider can establish indicative prices around which contracts for providing those services can be struck.

We would note that the BSC and its subsidiary documents contain tables of charges for the provision of some services.

Any one of these models would work for elective services but for value added services we consider that these should be subject to a bilateral agreement between the DCC and the purchaser; whilst indicative pricing might be appropriate the DCC should not be required to make publicly available the commercial terms and conditions of such services which purchasers might see as being commercially sensitive (see Q24).

Question 24: Do you think the detailed terms and conditions for elective and value-added services should be set out in the SEC or included in bilateral agreements between DCC and persons to whom it is providing services?

We would suggest that there are three key elements to this:

1. The principles underpinning elective and value added services should be established and documented within the SEC, including the charging methodology;
2. The detailed terms and conditions should be within bilateral agreements thereby allowing for flexibility around such areas as named contacts, charges updates, etc.
 - For these services we would propose the use of standard Terms and Conditions reviewed by the SEC Panel but with commercial and contract administration variables as a 'template Schedule' to the contract thus giving appropriate certainty to service users and the Authority but avoiding an expensive and inefficient change process.
3. In addition we would suggest that the SEC has a disputes mechanism to ensure that service users are able to challenge and that criteria are established against which such disputes can be raised.

Question 25: Are there any other matters that we have not addressed related to the nature of services provided by DCC? (Note that provisions addressing independence and non-discrimination in the provision of DCC services are covered in paragraphs 3.119 to 3.120).

One element which has not been addressed as part of this suite is any credit arrangements for service



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users. Within the energy industry it has been common to ask for credit (in letter or cash form) in advance of any provision of services to ensure that the service user can cover any accrued charges. Either payments will need to be made in advance or some arrangement of this nature will be necessary to protect the industry and DCC from the default of SEC signatories and should form part of the SEC.

Procurement: Resources to be Procured

Question 26: Do you agree that DCC should be required to externally procure specific services and have principles that determine what other services it should externally procure?

We agree that clarifying what must be procured, and principles around what other services should be procured, within the Legal Framework would be beneficial. However where it is possible for a service to be externally procured or delivered by the DCC itself, then subject to suitable permissions the latter should be permitted.

We therefore recommend that while the Data, Communications and compliance audit elements of the services must be designated for external procurement, all other services should be left to the discretion of the DCC with its overall mandate to deliver services economically and effectively. The SEC should ensure that DCC has this flexibility, with suitable controls in place.

Procurement: Procurement Objectives and Approach to Procurement

Question 27: Do you agree with the procurement objectives for DCC identified above?

Yes

Question 28: Do you agree that DCC should be required to produce a procurement and contract management approach document?

We believe that as part of the DCC Award process applicants should outline their procurement and contract management approach and identify how it fulfils the principles outlined in the licence.

We recognise that subsequently publishing a high level procurement and contract management document could promote transparency in how the DCC contracts and thereby encourage confidence and competition in its procurements. However it is important that this document is aimed at the principles and approach and does not expand into a manual on how each individual contract is to be or has been procured or managed - indeed timing issues mean that the bulk of the first set of principal procurements will have been undertaken by DECC.



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We believe that there is a useful parallel with the Contract Principles and Tender Framework Statement that the BSCCo is required to produce under the BSC. These models have worked well and could be applied to the DCC.

Question 29: We seek your views as to whether the procurement and contract management approach document should be required to be submitted for approval by the Authority and/or the Secretary of State.

We believe that the submission of a Procurement and Contract Management Approach should form part of the DCC licence Award process. This should then translate into a published document.

The successful DCC applicant will have a contract and a licence and be bound by the provisions of the SEC which will be designated by the Secretary of State with subsequent changes subject to regulatory approval. Unless there are significant changes to the smart metering arrangements in future which have a substantive impact on the provision of DCC services we see no merit in resubmitting the procurement and contract management approach for regular regulatory approval. Instead we believe that once the DCC is appointed the SEC Panel should be the focus for any future review and amendment to the approach document. Where a change is suggested to the SEC, from whatever source, then the DCC should confirm that the change does not impact its approach document. If it does, the DCC should seek agreement to the changes as part of overall change assessment process. This could be complemented by a requirement to review the approach from time to time, but again this activity should be focused by the SEC Panel.

We note that under the BSC the BSCCo (ELEXON) is required to produce and the BSC Panel consult on a Contract Principles (E 2.3) and, prior to commencing procurement, must prepare a Tender Framework Statement (E 2.7) for the BSC Panel. These models have worked well and use the Panel to provide an appropriate level of scrutiny. We therefore do not support the suggestion that the DCC's procurement and contract management approach document be subject to approval by the Authority or Secretary of State (other than as part of the initial DCC award process).

Independence

Question 30: Is the scope of the proposed prohibition on discrimination, which is limited to undue discrimination between uses or classes of users, adequate?

Yes

Question 31: Are any specific provisions needed which require DCC not to discriminate



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between service providers? Or is it sufficient to rely on obligations on DCC to maintain and develop an economic system and, in the procurement of DCC services, to promote competition in the provision of such services?

The latter. The DCC should provide an experienced procurement delivery function following a best practice approach.

Question 32: Do you agree that DCC should be independent of service providers? Do you agree that a de minimis level of affiliation between DCC and service providers should be permissible?

We do not believe that there should be any degree of affiliation between the DCC and its service providers as it jeopardises the perception of the independence of the DCC in its central activity. The definition of service provider and to which roles this applies should be clearly defined so as to avoid DCC being prohibited from managing its operational business most effectively (we refer you to our comments in Q26)

Question 33: What level of affiliation do you consider should be set for the maximum level of shareholding or control of any individual service provider may have in DCC?

See Q32

Question 34: Do you agree with the business separation between DCC and users that is proposed? More specifically, do you agree that no DCC user that operates in a competitive environment should be permitted to have more than a 20% shareholding or control in DCC, and that DCC and its subsidiaries should not be permitted to have any shareholdings in users or service providers?

It is our view that the composition of the business ownership is not as important as the degree of influence that service users have. For example a 2% shareholding that granted the ability to nominate a Director would potentially be more damaging than a 20% shareholding with restricted voting rights or appointment powers.

However in addition to this it is key that potential new market entrants have confidence that the DCC and its service providers support the market as a whole and are not unduly influenced by individual existing users. This may best be achieved through an explicitly independent DCC.

Question 35: Do you agree that it is not necessary to explicitly require business separation



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between DCC users and DCC service providers?

We believe it would be inappropriate for the suppliers to provide services to other users through the DCC where they might be able to gain competitive advantage. As with DCC independence, it is not simply a question of actual anti-competitive behaviour but also perception.

We would suggest that this should be covered within the procurement principles and be under the DCC's discretion.

Question 36: Should DCC be prohibited from using confidential information for any purpose other than the licensed DCC activity? Should DCC be obliged to impose this restriction on service providers contractually?

DCC will be constrained in its use of data/information by the definition of the services it provides. We are not sure if this is referring to 'confidential' data or 'personal data'. The DCC should only use confidential or personal data for purposes it is permitted to do so.

This must also be applied contractually to the service providers. It is essential that consumer data and hence confidence is not put at risk by the DCC or its service providers.

For service procurements and when discussing the possible leveraging of its assets, the DCC must be able to use data relating to its services – notably data relating to requirements and volumetrics. The definition of what is confidential must recognise this requirement.

Financial Viability of the DCC, Business Continuity and Special Administration

Question 37: To what extent do you believe that the existing financial ring fencing provisions (and those proposed by Ofgem in its recent consultation on this issue) should be included in DCC's licence?

The proposed constraints are largely appropriate however the holding of the financial year's resources is not appropriate for a pass through cost and thin asset business.

Financial ring fencing in network licences is an important tool but if applied to the DCC it should be structured in such a way that it does not prevent the DCC accessing services from within its own broader business where this is most efficient e.g. some corporate functions such as HR and Finance will best be shared with other business units to get the best value; financial ring fencing must not prohibit this.

Question 38: Do you agree that a flexible approach to financial security should be adopted and, if a financial security is required, what level of financial security should be provided?



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A flexible approach to financial security is appropriate in this case due to the nature of the businesses best placed to help deliver the DCC. The DCC bidders should be assessed on a case by case basis reflecting the variety of models and variety of assurance provisions within this field.

Question 39: What are your views on whether it would be appropriate to require DCC to pay for a proportion of the costs of appointing a new DCC in the event of an early licence revocation? Do you think that this potential liability should be reflected in the level of financial security required from DCC?

This would in effect form part of the liabilities of the contract and is common within our own contracts. However we do not believe it is necessary to hold security to cover this as this would have a high cost and limited additional benefits. As with question 38 we believe bidders should provide appropriate assurance to ensure consumers are protected from the risk of the DCC failing to fulfil its requirements.

Question 40: Are there any other conditions that you consider should be imposed in DCC's licence to ensure its continued financial viability?

No

Question 41: Would it be appropriate for a special administration scheme to apply to DCC?

Yes. Provisions exist (or are proposed) for special administration schemes in relation to other 'network' businesses, for example electricity distribution and for electricity supply businesses.

Question 42: Do you agree with that DCC should be required to ensure business continuity of service providers and should monitor the provisions that they have in place to deliver business continuity?

The proposals are in keeping with those we use within the BSC and we believe are appropriate. However, recognising the importance of these contracts, the DCC must also identify alternative providers and understand how these might best be introduced to minimise disruption to the services in the event of service provider failure.

Question 43: Do you believe that DCC needs to include in its service provider contracts any further protections which help to secure against, or mitigate the consequences of, a financial failure of a major service provider? Please provide examples of any additional protections you consider suitable.

In addition to those proposed we believe that due to the strategic importance of the contracts involved



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there should also be:

- Step-in rights – to enable an alternative provider to step-in and deliver all or part of the services;
- Parent Company Guarantee.

Further we believe that all protections should apply to key sub-contractors as well.

Initial DCC licence Duration and Appointment of DCC Successor

Question 44: Do you agree that it is appropriate to grant the initial DCC licence for a ten year period?

Yes. However we believe that the final contract terms agreed for the Service Provider contracts will be a crucial driver in determining the right length for the licence.

Reprocurement of the DCC licence will lead to a significant portion of the incumbent's time being dedicated to supporting the process even if it chooses not to bid (due diligence etc) thus it is critical that the licence does not fall due during the licence holders critical deliverable of service reprocurement.

Reprocurement of the licence should not cause any reduction in service for the users or incur significant additional costs for the services.

We propose that the DCC licence term should not fall for renewal 12 months before or 6 months after the reprocurement of the key contracts:

- The 18 months in the lead up to a procurement is important for market development (with these contracts reflecting some of the largest let in the UK in any one year), service review and procurement design. With the duration of these contracts being relatively lengthy, coupled with rapidly evolving business needs, it is probable that the services procured in 2012 will no longer be fit for purpose in 2024. This is particularly pertinent with the development of the smart grid environment and the crucial role that the DCC will play in this;
- The 6 months referenced above is the minimum that will allow for the new contract to bed in and ensure that the incumbent DCC is not able to procure cheaply and place a poor service on the incoming DCC.

We therefore believe that the flexibility proposed in para 3.165 is vital but that the terms of the DCC and its Service Provider contracts must be deliberately mis-aligned to allow for effective and low risk reprocurement.



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Question 45: Do you agree that flexibility for the Authority to decide to extend the initial DCC's licence by up to 5 years would be desirable?

See Q44

Question 46: Do you agree with the approach described for the treatment of DCC internal costs for any extension period?

Yes this is a similar model to the standard price control process and. We agree with DECC's observation that internal costs provided for any extension period, made as part of the initial bid, should be reviewed over time, as the assumptions upon which they are based are likely to change.

Question 47: Do you agree that DCC should be required to ensure that any critical services can be transferred to a successor?

Yes. This is an essential requirement.

Question 48: What scope of matters governing the handover to a successor do you think need to be included in DCC's licence?

The matters covered in paragraph 3.167 are adequate. However we note that the incumbent DCC should either be able to charge for supporting any transfer in the event the licence was granted to someone else following procurement or that this should be an explicit cost item in the initial procurement of the licence.

Question 49: Do you agree that DCC's licence should be capable of being revoked in the event of a repeated or material failure to meet service levels?

Yes. This extreme right should be included.

Foundation and Subsequent Roll Out Obligations

Question 50: Do you agree that the DCC licence should contain a condition which gives it a high-level obligation in relation to foundation and subsequent rollout, activities and that the detailed obligations can be dealt with as part of the development of the SEC?

Yes this approach seems sensible. It is going to be important for the Programme to define who has responsibility for managing the roll out – not simply as part of the proposed annual reporting to Ofgem but at the weekly granularity to assure costs are apportioned appropriately and charges balanced – it



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will also form a crucial 'feedback mechanism' for the Users.

Here we see the role of the Authority in policing the annual plans but it will be for the DCC to monitor the day-to-day roll out and ensure the charges are set appropriately.

It is critical that the roles of DECC, Ofgem, the SEC and DCC are clearly defined in all areas of the Delivery. It is of particular importance with regards to roll out with the potential financial implications of failure to roll out in accordance with an agreed plan and thus dispute.

Requirement to provide additional services in the future

Question 51: Do you agree that DCC should have a high-level obligation, albeit initially "switched off", relating to the provision of meter point/supplier registration services?

Yes. The inclusion of a high level obligation relating to meter point / supplier registration services provides certainty to the market and DCC bidders about future delivery of these services. Combining the obligation with a timescale and matching obligations on existing market participants to facilitate the change would add further certainty and momentum.

Adding such obligations does not of themselves allow for such an activity to be planned or accurate costs developed, it merely confirms a future task to be undertaken. Nevertheless assessing the ability of potential DCCs to work with the industry to deliver this change and the attendant benefits should form part of the DCC Award process.

Question 52: Do you agree that conditions should be introduced in other licences providing the ability to release other licensees from the requirement to provide meter point/supplier registration services at some point in the future?

Yes, establishing matching conditions will increase the likelihood of this change being delivered.

Question 53: Do you agree that DCC and other relevant licensees should be subject to an obligation requiring the licensee to take steps to facilitate the transfer of meter point/supplier registration activities to DCC?

Yes. We see this as providing a clear message to the market and confidence to potential DCCs.

Determination of Disputes

Question 54: What dispute mechanism would be appropriate to apply to disputes involving DCC and who should be enabled to determine such disputes?



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If the context for the issue is set out in the SEC it should be adjudicated by the SEC Panel however where the issue is set out in the licence it should be adjudicated by the Authority as the arbiter of the licence.

However where there are commercial terms with an exchange of goods or services under a legal contract, UK Law would have ultimate jurisdiction. We would propose however that exercising some dispute resolution mechanism is incumbent on the parties before legal proceedings were initiated (similar to the Xoserve model). We would suggest that:

- Core services pricing will sit within the SEC and should be managed there.
- Where there is a question as to the elective and value added services charging principles set out within the SEC the dispute could be adjudicated by the SEC panel. The SEC would also allow for changes to be proposed to any charging principles contained in the SEC via the SEC change process.
- Where the issue in question is not defined by the SEC such as a dispute between the incumbent DCC and its successor it would have to be adjudicated by the Authority as they are responsible for the DCC licence.

Establishing criteria against which a dispute could be raised would help to reduce the number of 'opportune' dispute claims. It may also be necessary to guard against vexatious and frivolous disputes being raised by parties simply trying to use this mechanism as an extension of a negotiation process.

Other licence Conditions

Question 55: Do you believe that DCC should be required to operate its business in a way that ensures it does not restrict, prevent or distort competition in gas shipping, the generation of electricity and participation in the operation of an interconnector?

Yes, although we perceive that this should have been covered in the applicable objectives and would suggest avoiding any unnecessary duplication.

Question 56: Do you have views on the additional conditions discussed above?

No

Question 57: Are there any additional conditions that you would wish to see included?

No



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Modification of DCC licence Conditions

Question 58: Is it appropriate to consider extending the Secretary of State's powers to provide equivalent powers to modify DCC's licence conditions as it does for other energy licences for the purposes of implementing smart metering?

Yes the proposed approach is appropriate. However such changes may have commercial consequences which will need to be addressed.

Chapter 4: Revenue requirements

Adjustments to DCC's revenue stream for its internal costs

Question 59: Do you consider that it is practicable for DCC licence applicants to provide costs for undertaking meter point/supplier registration? Or is it more appropriate to include a specific reopener for DCC's costs of undertaking meter point/supplier registration?

DCC licence applicants could provide rough estimates of their internal costs given some background data and clarifications. These include:

- Current contract value (indicative size);
- Whether it is to be a procured as new outsourced service or delivered by the DCC's Data Service Provider;
- How the service costs are to be delivered e.g. passed through or whether it will form part of the DCCs revenue;
- Whether there is scope to suggest alternatives to the model either to generate savings in the near term or to drive greater efficiency in the longer term.

However these variables are significant and given the caveats that are likely to accompany any estimate, a reopener is almost inevitable. It is our view therefore that the licence application process should take into account proposals for assimilating registration but that costs should be excluded.

Question 60: Do you have views on the relative benefits of the two options (cost pass through and volume drivers) for recovery of DCC internal costs associated with SEC modifications?

A key issue is that a 'thin' DCC and SEC Secretariat cannot just ramp up and down staff instantly to deal with a variable level of change. As with the post NETA world, we would expect a high rate of change in the early years of the new arrangements which would gradually reduce over time. NETA experience also



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shows that the initial tranche of changes are likely to challenge fundamental aspects of the arrangements, impact more stakeholders and generally have a wide ranging effect. In addition some may need to be progressed urgently as they are seeking to remedy the defects that inevitably arise as a complex Programme goes live. Once the arrangements start to settle down, the impact of changes will be less critical, the changes become more predictable and the profile of change can be better managed. In any of the options a small, thin DCC and separate SEC Secretariat would find it hard to predict and respond quickly to a highly variable rate of change.

It is our experience that there is likely to be significant value driven by DCC dealing effectively with service providers in relation to Modifications, it is therefore important not to give DCC an incentive that might limit its efforts in this area. This leads us to suggest that cost pass through would be appropriate with an agreed standing charge being established to ensure that a core level of resource was always available. This might be moved to a fixed cost or volume driver basis thereafter.

Question 61: Do you have a view on the appropriate materiality threshold (trigger) for the revenue reopener?

Making the DCC absorb some cost variations is appropriate and avoids frequent changes. However if the level is set too high this will translate into high margins being proposed by applicants. 10% would therefore seem a reasonable compromise.

We believe revenue reopeners could equally be triggered by an accumulation of small events as much as by any single large event. Thus records should be kept of all effort expended and each time the cumulative costs vary by more than 10% there should be a reopener.

Where there are changes to the overall scope of work that the DCC has bid against (either increasing or decreasing workload) there must be a review of charges.

Whatever threshold is adopted, it is also important that the process works swiftly to ensure the DCC's liquidity was not put at risk.

Question 62: Do you consider that any other cost areas may require mechanisms to deal with uncertainty?

Another area of expected uncertainty that will best be served with a pass through/reopener mechanism is the number of contracts due for reprocurement during the DCC licence term. As a significant source of costs it should be recovered but the activity should be rewarded only where success has been achieved (against criteria agreed in advance). Incentivising the activity itself i.e. input (through inclusion in the



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cost plus model) may incentivise the perverse behaviour of early and uneconomic reprocurement.

We continue to assert that the incentive regime must be focused on supporting the objectives not simply achieving inputs.

Revenue Recovery during rollout

Question 63: Do you agree that market share should be based on MPANs and MPRNs that are mandated to receive smart metering systems, rather than all MPANs and MPRNs?

Basing these charges on the numbers of meters mandated to use the service appears to be equitable prior to the inclusion of registration. Once registration is included then services will be provided to all mandated and elective MPANs and MPRNs.

In all events we believe the costs should be modelled to ensure that the costs are equitable and do not fall disproportionately on any one organisation or sector of the market.

Question 64: Do you have a view on whether suppliers of only larger non-domestic customers should be charged a proportion of DCC internal costs?

See response to Q63.

Question 65: We welcome views from stakeholders in regards to charges on network operators for DCC internal costs pre-“go-live” and whether they should charge DCC for services provided to DCC.

There are two separate issues here.

1) Should DNO's be charged for internal costs pre-go-live?

Assuming the full costs are recovered from the service users at the time the costs are incurred we do not have a view as to who should pay the costs.

2) Should the DNO's charge for services to the DCC?

Yes where there is a cost to the DNO's for supporting the DCC this should be charged for and passed through to users ensuring maximum transparency.

Speed of Cost Recovery

Question 66: Do you agree that DCC should only begin to charge users for communication service providers' costs from “go-live”? Please provide reasons as to why this is or is not



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appropriate.

It is consistent with normal commercial practice to only charge for the live service. Whilst charging for set up as it occurs could reduce the overall cost there is a delicate balance to be struck if funding is to be provided by the users. Adopting such a model also invariably transfers risk to the users. We therefore support the charge from go-live model.

Question 67: Do you have a view on whether the data service provider(s) should be treated differently from communication service providers and be allowed to recover its fixed costs evenly over the length of its contract from "go-live"? Please provide reasons why this is or is not appropriate.

The payment profile for the Service Providers should be designed to ensure the most economic and effective service provision across the life of the contract and this is best established during the procurement.

For the DCC Licensee it is essential that whatever profile is adopted it is matched with the charging methodology and does not leave the DCC exposed to unrecovered costs or a weak cash flow profile.

Allocation of fixed costs between users

Question 68: Is it appropriate that the allocation of costs on suppliers during rollout be based on the suppliers' rollout plan for the year plus actual smart meters installed in preceding years? If so, how can this option for allocating costs during rollout be improved? If not, what is your preferred option and why?

Yes it is broadly appropriate. However we would like to make a number of additional remarks with regards this approach:

The DCC's cashflow will be dependent on the variable rates of rollout achieved by suppliers; in the proposed thin model the DCC will not be able to hold sufficient cash to protect against this. It is therefore necessary for either the Service Providers to charge in arrears for variable elements; or for service users to provide sufficient credit to cover their 'worst case' exposure to charges or pay in advance.

This system using, as it does, reflective charges will require a body that is able to enforce the payment of overruns and assess disputes should they arise. We would suggest that the SEC Panel would initially be well placed for this role but escalation to the Authority might be necessary.

This system will also require that suppliers will have seen the spread of communications coverage and



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understand any communications supply chain issues ahead of submission of their roll out plans. Where coverage is not as published and the metering system installation is deferred or an additional further visit is required the communications Service Provider should potentially be liable for the additional costs – it is not clear how this will be managed.

Question 69: Do you have a view on how any additional costs resulting from suppliers exceeding their rollout plans should be allocated? Should DCC be able to pass through to the relevant supplier any higher costs resulting from this (or should such costs be averaged across all users)?

Incentives must ensure that the suppliers behave in a way that does not drive excess costs while maintaining the roll out. The danger of smearing additional costs across the whole industry is to incentivise submission of low estimate roll-out plans with the industry bearing the risk of the costs incurred when these are over achieved. As the Service Provider is likely to incur greater costs themselves from unexpected additional connections this must be borne by the party that caused the increase and can manage it.

We propose that the DCC should be able to pass the costs directly to the relevant supplier.

Question 70: Do you agree that network operators should be charged in line with their market share?

Yes, with market share being calculated consistent with that determined in response to questions 63 and 64.

Chapter 5: Charging methodology

Core services structure of charges

Question 71: Do you agree that a standing charge should cover the service providers' fixed costs for providing core services, DCC's internal costs and the SEC management funding requirements?

Yes. The key to this proposal is establishing the coverage and level of the fixed costs. However the Programme still needs to determine how these costs are allocated across suppliers and Network Operators.

Question 72: Do you agree that a proportion of service providers' fixed operating expenditure should be converted to volumetric charges?



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Yes, as this reflects the usage and from where the costs are ultimately driven.

Cost service charges per premise

Question 73: Do you agree that the proposal for postage stamp charging is consistent with the objectives of the smart metering programme?

Yes, this is suitable for the provision of core services from a mandated solution.

Question 74: Should postage stamp charging apply to all users including network operators?

The essential principle to be applied here is that of equity for the consumers and thus we support the postage stamp charge however we believe there will be challenges with establishing the charge and varying it where necessary. This concern arises from the cost structures of the possible communications technologies and the impact of variations in the roll-out plans.

In our experience no market participant likes frequent changes to charges. Instead they value stability coupled with early notice of changes as a basis of establishing the tariffs that they offer to their customers. It is therefore important to allow for variable charges but to avoid varying them too frequently. We accordingly suggest that charges to DCC users should not vary more often than every 6 months to avoid significant additional risks and costs on suppliers.

Faced with costs that are likely to vary more frequently than 6 months it will be necessary to include an arrangement within the user charging arrangements to allow for the recovery of accrued Service Provider costs when setting subsequent user charges or transfer the risk to the Service Providers and acknowledge that they will price accordingly.

Charging objectives and principles

Question 75: Do you agree with the proposed charging principles?

Principle (E) could be viewed as superfluous, because delivering principle (A) will inevitably require that charges are predictable. We therefore suggest is that a clearer expression of (E) is that users can validate their charges and can determine how changes in use will drive their charges.

Question 76: Do you consider that an objective for the charging methodology should be to promote innovation in the supply of energy, provision of energy related services and energy distribution?



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The DCC must have responsibility for delivering innovation within its own services and where possible *facilitating* innovation elsewhere in the industry. Where this will have a cost implication it should be possible for this to be reflected in the charging.

We would generally support the inclusion of a charging principle supporting innovation. The inclusion of incentives to deliver innovation which drives the LCNF and the introduction of the RIIO would suggest that there's merit in incentivising innovation and that the absence of that principle previously in the simple RPI-X approach needed to be remedied.

Question 77: Do stakeholders have views on whether DCC's internal costs should be allocated across the different types to users on the same basis as service provider fixed costs?

We believe they should be allocated using the same methodology.

Other service charges

Question 78: Do you agree with the proposals to charge users for extensive assessment and design work in relation to AMRs? Should a similar approach be adopted for other elective services offered by DCC, regardless of the user accepting the service?

We do believe that any substantive upfront costs incurred should be paid for by the requestor irrespective of their use of the service and that a similar approach should be adopted for other elective services especially when allied to the 'second comer principle' outlined in paragraph 5.48.

However it is important that the principles of transparency do not affect the DCC's ability to utilise its resources to the benefit of the users. As we note in questions 23 and 24 this is particularly important with regards to 'value add' services. Where the DCC delivers competitive services to other industries the publishing of the costs of delivering these services may compromise negotiations and commercial confidentiality.

In the case of 'value add' services we would propose that disclosure be limited to the costs recovered for the DCC users and then only at aggregate to protect competitive advantage.

Question 79: Do you agree that a 'second comer' principle can be applied

This approach should be applied for the first year after a new service has been implemented or be subject to a De Minimis rule.

We propose a de minimis level to cater for the circumstances where administration of the second comer



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principle outweighs the costs recovered, i.e. where development costs are minimal for a new service and the administration of the second comer principle outweighs the benefits of reallocation. This should be avoided if the service is to remain economic.

Chapter 6: WAN Requirements

Questions 80 to 82:

We have not provided a response to Section 6; we believe that these technical questions are better answered by providers of communication services.

Chapter 7: Performance incentives

Question 83: Please provide comments on the incentive regime proposed for DCC.

We have previously shared thinking with DECC with regards to principles of the regulatory and incentive regime. We have attached a separate set of slides on Performance Incentives, which comprises our response to this question. [See attachment.](#)



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Question 84: Do you consider it appropriate and feasible for the SEC panel and DCC to negotiate KPI targets?

No. We are uncertain why the SEC Panel would be given this responsibility. The role of the SEC Panel has yet to be fully defined. However you would expect its responsibilities would include overseeing that the services and processes that have been agreed are delivered to the standards agreed. To achieve this, the Panel would rely on appropriate reporting being provided for within the DCC's obligations or the SEC.

We agree with the observation that "the scope for negotiation will be limited" as it may change costs and require a modification to the licence. Furthermore we would question whether the SEC Panel will be in any position to negotiate contractual matters with DCC or be resourced to do so. If it were to undertake this there could only be limited support from the SEC secretariat as it is funded via the DCC. We assume that such activity would require a mechanism for the licensing Authority to have some final approval or veto.

Since the licence holder is overseen by the licensing Authority, who will have the powers to revoke that licence or amend that licence as appropriate, it would make more sense for discussions (which will have a commercial impact) to be held between licensee and licence holder. Under such a mechanism we would expect the Authority to have consulted with and considered any comments from DCC users and the SEC Panel as part of its process for amending the licence or adjusting KPIs.

Question 85: Do you have views on the use of an independent audit of DCC performance? Should this be on a regular and/or ad hoc basis?

We support the use of independent audits as a means of impartially assessing performance. However there are two aspects to be addressed prior to embarking on this route:

- 1) What would the scope of the Audit be?
- 2) The burden and the cost of the audit should always be appropriate to the issue it is seeking to address.

If a robust set of KPIs (associated with contract management or procurement) are defined these can be reported upon by the DCC itself to the SEC Panel and Authority. The role of the Auditor could be to simply confirm that reporting is accurate and evidence based. If this were the case then an Ad Hoc audit would seem sufficient to verify the DCC reporting. If thereafter DCC is found to be consistently accurate in its reporting, an independent Audit may rarely need to be exercised and the 'threat' of the right to call an audit should be sufficient deterrent.



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Alternatively if the KPIs or tools for measuring how DCC is meeting its obligations are not easily measurable and interpreted (e.g. are highly subjective) an audit may be a useful mechanism for providing an independent view of performance. However an audit opinion in isolation would not be a suitable tool to determine if DCC should/should not be entitled to its reward.

The audit should be clearly defined and linked, as suggested, to relevant evidence gathering related to the DCC obligations/licence conditions. Over time the costs of the audit could be reduced by varying the scope to focus on any perceived areas for improvement: this approach has been successfully applied under the BSC. This audit should be distinct from any technical audits of the performance of service provider systems which may comprise part of a wider SEC assurance regime. Alternatively if the KPIs or tools for measuring how DCC is meeting its obligations are not easily measurable and interpreted (e.g. relate to development of a procurement policy and adherence to that policy) an audit may be a useful mechanism for providing an independent view of performance.

Question 86: Do you consider that a sharing mechanism should be in place for DCC internal costs? Should a sharing mechanism be included in the contracts with the service providers?

From our experience of using gain share we believe there are some key elements to bear in mind:

Gain share is an incentive aimed at reducing costs for service users where the SP income is not directly affected by the volume of transactions. It can be assumed that over the life of a substantial contract the incumbent SP's should be able to drive down costs not least as operational synergies are realised and the uncertainties reduce.

DCC Internal costs:

- Open book accounting is essential in agreeing the gain to be shared
- Gain share will require active management by the DCC if results are to be achieved. Agreeing the gains should fall under the remit of the Authority.
- Cost plus and gainshare are counterproductive incentives i.e. where the profit is tied to the size of the contract. The margin must be delivered pre gain share or protected from its effect if the DCC is not to be doubly charged for making savings for the industry.
- On a contract the size of the DCC gain share may be applied but to ensure it remains an effective incentive (driving out savings often requires expenditure) the DCC must be allowed to keep enough of the savings it realises to keep looking for opportunities.
- It is worth considering a threshold below which Gainshare would not apply.



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The Service provider contracts

The opportunities for gain share are more significant within the much larger SP contracts.

- Gain share will not be achieved without proactive management of the SP. Thus the DCC should also be incentivised to achieve this either directly through a percentage of the saving or indirectly
- While we agree that savings should be shared by the DCC users this should not be to the extent that savings are not realised as the incentive has become too weak.
- One of the key benefits of gain share is that it provides an incentive on the incumbent to identify savings, these savings are valuable not only in the shared cash in the initial contract but become even more so as the contract is re-specified recognising these savings.

In summary it is a powerful tool but it has a high degree of management cost associated with it. This may be appropriate for the SP's but not for the DCC with its smaller revenue and indirect management.

Question 87: Do you consider that it is appropriate to invite DCC licence applicants to propose KPIs?

Yes. However, there is a question over how the KPI's as submitted by bidders would be compared and evaluated under the procurement process. What criteria would be applied and what weighting given? This information would need to be known by bidders in advance of the start of the award process to ensure that appropriate KPIs are bid in.

Chapter 8: Adoption of Foundation Stage communication contracts

Question 88: Are the criteria for adoption of contracts discussed in paragraphs 8.8 and 8.9 appropriate? Are there any additional criteria that should be included? Can quantitative thresholds for any or all of criterion be defined and, if so, how?

The criteria in paragraph 8.8 bullet point 3 describes that the contract should be accompanied by a positive service provider relationship. This is a highly subjective and unpredictable criterion. More applicable criterion would be that the contract must not have any outstanding legal conflicts pertaining to it.

In paragraph 8.9 it is unclear of the meaning of bullet point 4. A clarification of the wording is important to establish if the criteria refers to contracts not adopted but 'bought out' by the DCC. Therefore if a contract is not adopted, the DCC should have no concerns as to its termination or duration.



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In paragraph 8.10 the discussion references the hurdle rate for adoption is the difference between the existing opex and novation costs vs the installation of a new WAN, connection charges and the opex on the DCC contract. It would seem that this hurdle rate is unlikely to be met in year one of any contract. It would seem likely that the most cost effective solution would be the adoption of the existing contract and technical integration of the solution. (From the discussions with potential data providers we believe that the solutions within the marketplace will be able to integrate all existing technologies with relative ease)

Another aspect that we believe may affect the importance of this discussion is that from conversations with potential communications providers it is likely that as part of their bids they will be able to offer to adopt the contracts themselves recognising the low numbers and their strong incentive to offer this simplification as part of their solution. Where possible we believe this should be encouraged by the Programme.

If this does prove to be the case it will be an important cost driver for the DCC bids and must therefore be made available by at least the ITA submission.

Question 89: Do you agree with our approach to identifying the guaranteed adoption volume of Foundation Stage smart metering systems? Are the factors we have identified the appropriate ones? What are your views as to the appropriate values of the various parameters identified in Table 8.1?

The minimum adoption criteria will be driven to a high degree by the commercial positions of the communications service providers. While the methodology appears correct we agree that, at best, an initial minimum adoption level should be set.

In paragraph 8.41 views are sought on how the adoption volume might be allocated. While we have no view on the policy aspect of this decision we note that complexity is unlikely to enhance the benefits realised.

Question 90: Do you agree that DCC should be able to decide to adopt communication contracts associated with Foundation Stage smart metering systems in excess of the guaranteed adoption volume providing there is a net benefit to doing so? If so, does DCC need to be provided with additional obligations and incentives to encourage DCC to actively pursue such contracts and what factors should DCC take into account in making its assessments? Should we specifically provide for suppliers to compensate directly DCC for any costs incurred by DCC or its service providers in the adoption of additional contracts?



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The DCC should be obliged to adopt any contracts for which there is a net benefit and the methodology for this calculation must be published and should include internal DCC costs. However it would not be appropriate to incentivise this as this may distort the benefits case.

In the interests of simplicity and assuming this is likely to have a fairly low number of instances (if not meters) the cost administering a pass through mechanism as opposed to rolling it up as part of the general DCC charges may make it uneconomic.

However should there be any delay in the establishment of DCC services and the number of contracts increases it would be prudent to revisit the approach and any obligations associated with adopting contracts.

Question 91: What in your view is the most appropriate option for allocating the guaranteed adoption volume across energy suppliers and on the mechanism, including timing and frequency, by which any allocation unused by one supplier should be redistributed to other suppliers?

We are unclear of the benefits of reallocation particularly as the volume of unused guaranteed adoption contracts will not become clear until the DCC goes live and suppliers will be unwilling to return them before this time. A solution based on annual figures is likely to lead to disagreements over intended roll out profiles and may be uneconomic and counterproductive.

Question 92: Do you have views as to when Foundation Stage communication contracts should be adopted?

A timeband set at 18 months would ensure that legacy contracts did not damage the benefits case or inhibit service development thereafter. The DCC should have discretion as to when and in what sequence it adopts the foundation contracts to avoid a bottle neck at the end of the timeband.

A timeband of 12 months may be restrictive given the uncertainty of the live performance of the new services. The extra 6 months should alleviate this while still maximising the benefits.

Chapter 9: Competitive licence application process

Design of Process

Question 93: Do you agree that a four stage process as outlined in paragraph 9.10 is appropriate for appointment of DCC?

The four stage process proposed is a standard procurement approach (and one which we have used to



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good effect in our own procurement process). However unless all risk associated with design of the Service Provider contracts is eliminated from the DCC, due diligence on these contracts will have to take place before the DCC is able to submit a binding bid.

If due diligence is to take place and it is anticipated that this will take place during the 4 week ITA stage we believe this will not be long enough to carry out effective contract review. It also presupposes that the Service Provider contracts will be completed which we did not understand to be the intent. Servicing this requirement is likely to impose a high burden and costs on both the Programme and the DCC licence applicants. The alternative is to proceed with a series of reopening caveats which exposes the DCC service to subsequent variations and associated costs.

In terms of alternative processes, we could only identify one; however it would extend the DCC appointment process which is a distinct disadvantage. The alternative is identifying the leading DCC candidate on the basis of who is best positioned to deliver the principles of the DCC role and then allow them to support the Programme's procurement process from as early as possible. Conclusion of the licence negotiations could then take place after the Service providers are in place. This would provide support to the SMIP, and through earlier involvement, can build a stronger relationship between the DCC and its service providers. It would also allow for more appropriate KPIs relating more directly to the services to be put in place. To mitigate against the risk that the identified DCC candidate would be in too strong a negotiating position we, would suggest that the second place bidder not be ruled out until the final negotiations have taken place.

Financial Security

Question 94: Do you consider that applicants should commit to lodge a form of financial security at the invitation to apply stage that would take effect if the licence was granted to the applicant?

It is unclear what level this should be set at when there remains uncertainty about the final details of the roles, responsibilities, regulatory and commercial framework and details of the Service Provider contracts. As indicated in our response to questions 38 and 39 we believe that the appropriate assurance should be clear and defined from the ITA stage.

Changes to an applicant's consortium

Question 95: Do you agree with the proposals for dealing with changes to consortia including allowing changes up to but not beyond submission of responses to the ITA?

This seems a sensible approach given the need to conclude the tender process and deliver the service



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within the timescales the Government has committed to.

Confidentiality agreement

Question 96: Do you agree with the proposal for one overarching confidentiality agreement for each applicant group rather than individual confidentiality agreements for each member of the group?

Yes.

Clarifications

Question 97: Do you have any comments on the approach to clarifications and dialogue with prospective applicants?

The approach is sensible but given the timescales to which the programme is working and expects others to respond we would emphasise the need for the data room to provide a quick turn around on any points of clarification referred to it.

Pre-qualification Stage

Question 98: Do you agree with the proposed approach to the pre-qualification stage including the timescale, the information required and the assessment methodology and criteria?

The approach is fully consistent with what we would expect given the nature and size of the contract. In the spirit of transparency, we would expect that applicants have visibility of the weightings associated with Part 2 PQQ criteria within the PQQ.

ITA Documentation

Question 99: Do you have any comment on the documentation to be provided by applicants for the DCC licence? Is there any other information that you think should be made available to applicants?

The suite of documents proposed seems appropriate; the key will be the provision of sufficiently detailed information within those documents.

We would also expect to receive a proposed Pricing Template within the suite of documentation so all applicants understand how Prices should be presented.



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Applicant's Responses

Question 100: Do you agree with the proposed approach to the Invitation to Apply stage including the timescales, the assessment criteria and their weightings?

Whilst we recognise that the six to eight weeks envisaged to evaluate the ITA applicants will depend on the number of responses we would encourage DECC to complete this process as quickly as possible and to allow sufficient time for the BAFO process. We would also urge DECC to emphasise the need for those tendering for the licence and engaged in dialogue with DECC to have decision making authority; in our experience the need for employees to revert to Head Office (including reference to their lawyers) can prolong the application process.

The criteria include a reference to transition planning and in our experience a clear and comprehensive exit plan which adequately reflects the term of the contract (and the services procured) is vital.

The Consultation is silent on any Negotiation Stage within the procurement process; we have assumed that this would occur within the proposed BAFO stage, unless the process does not permit negotiation.

Question 101: Do you agree with the proposals for appointing one or more preferred applicants as well as one or more reserve applicants to ensure that there are alternatives in the event that a preferred applicant withdraws or is disqualified?

Yes, it would help reduce timescales and costs in appointing a final successful candidate.

Best and final offer (BAFO) stage

Question 102: Do you agree with the proposal for an optional best and final offer stage in the event that two or more applicants have similar positions?

Yes. This is consistent with our approach to managing the award of BSC Agent contracts and has worked well for maintaining competitive pressure.

Preferred applicants and licence grant

Question 103: Are there any other specific issues that you think should be considered before grant of the licence?

It would be helpful to have a definitive answer on whether the DCC and SEC Administrator could be one and the same company. We are aware that a number of organisations, including our own, not only have robust contract procurement and management expertise but also an excellent track record in providing



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governance services.

Fast track process

Question 104: Do you agree that in the event of DCC losing its licence the Authority should have the power to fast track the appointment of a temporary DCC? If so, is eighteen months an appropriate maximum time period for the temporary DCC to hold a licence before a new DCC can be appointed via a full competitive process? Which elements of the licence application process could be accelerated or eliminated to ensure rapid appointment of a temporary DCC?

Given the importance of the DCC service and the regulatory scrutiny to which it will be exposed we would expect that in all, bar the most catastrophic failures, poor performance would be identified promptly and remedial action taken, to allow the failing service to be rectified.

Nevertheless we recognise that catastrophic failures can occur and that in these circumstances expeditious replacement is essential. Irrespective of whether a successor is temporary or permanent, the ability to novate the service provider contracts will be fundamental to the successor's ability to perform. Recognising the severe problems that will be caused to all industry billing arrangements we support the need for the Government/the Authority to be able to rapidly appoint a 'temporary' DCC licence holder.

The shorter the temporary appointment the more expensive the solution is likely to be and any procurement is costly for both the procuring party and those who wish to tender; an 18 month appointment may not be sufficiently attractive to parties. In determining the length of any temporary appointment consideration would also need to be given to the term of the underpinning service provider contracts; if any re-procurements were in process or pending it may be necessary to extend the temporary appointments or the service provider contracts.

It is also probable that the 'temporary' DCC will be unable to identify and cost the full extent of the remedial actions it will need to take to restore the failed service during the course of a rapid process. In such circumstances a 'costs plus agreed margin' arrangement may prove most expeditious to execute and could provide necessary financial assurance for both the temporary licensee and its service users.

For more information on our response, please contact:

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Ref: URN 11D/868

Attachment to ELEXON's response to DECC's Smart Metering Implementation Programme: Question 83.

DCC Incentivisation

1. DCC incentives

An appropriate incentive regime, targeting the outputs of the services, that is simple to administer, and capable of delivering the behaviours desired is a common goal of all bidders, the Programme and the service users.

The DCC consultation outlines a number of tools and techniques that could be used to establish an effective regime. In this document ELEXON has outlined its suggestions for how this might work recognising the number of outstanding variables.

2. How Incentives should be applied

Outputs not inputs:

All incentive regimes must identify what they are looking to achieve before they address how they might achieve it. In the case of the DCC this has been stated as economically and efficiently delivering communications services to smart meters. The DCC Licensee as manager of these services plays a pivotal role in delivering this.

Incentives should ideally be placed on outputs as this is focused on ensuring that the service users receive the required service levels. Incentives placed elsewhere – such as the inputs may distort the service reducing the output quality or increasing its cost.

Simplicity:

Simplicity should be at the heart of any incentive regime if it is to be used as an effective and economic tool. Undue complexity will often result in a disproportionate burden that dilutes the incentive regime

Limit on risk:

Incentive regimes are designed to ensure that the most important aspects of a service are appropriately prioritised and that where services are not sufficiently prioritised there is a financial consequence. What the regime must not do is risk the viability of the service through the application of penalties greater than the margin on the service. This is particularly the case where the business in question is asset light. We have seen examples from with the



Attachment to ELEXON's response to DECC's Smart Metering Implementation Programme: Question 83

BSC services where exposed revenue has driven the Service provider to attempt to deliver the service for the reduced payment – thus reducing the service standard.

The best candidates for incentivisation

We believe that two important parameters in establishing any incentive regime are predictability and controllability. Where activities are both predictable and controllable then strong incentivisation can be applied with realistic targets.

By contrast where there is limited controllability and predictability then imposing incentives is unlikely to affect outcomes. Indeed, in such circumstances not only does incentivisation carry little benefit, but the associated risks are likely to drive use of contingencies and other factors leading to higher charges.



The use of Caps and Collars

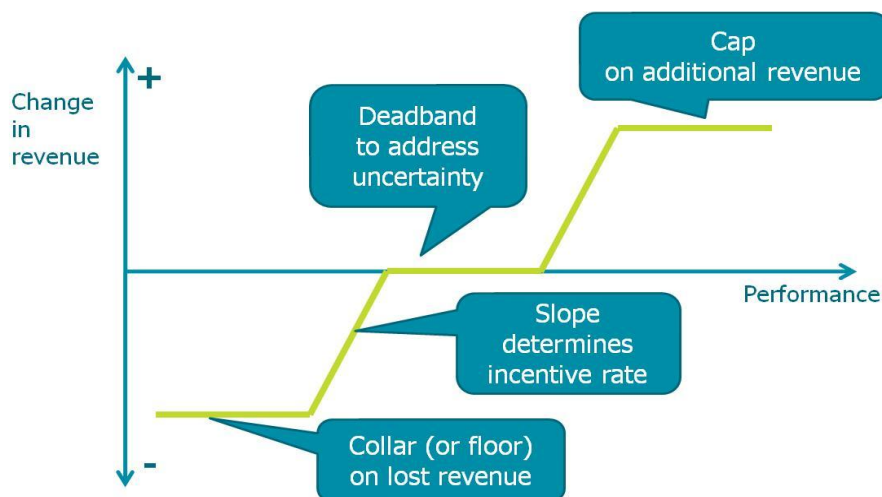
We see the use of caps and collars as tools to ensure a viable and appropriately incentivised DCC.

Caps and collars are an effective method of limiting exposure while ensuring that the party best able to manage a variable has the incentive to do so.

Any model adopted would need to help drive savings on internal costs while limiting the risks on significant variations that might inhibit the service. In such circumstances we believe that **a mechanism involving caps and collars on profit exposure and including a deadband will prove the most effective** (see below).



Attachment to ELEXON's response to DECC's Smart Metering Implementation Programme: Question 83



Whilst caps can be viewed as restricting performance enhancements and collars limiting the rectification for under performance, this is not borne out in our experience.

The aggregate levels of exposure under such mechanisms need not be the summation of all the individual regimes – as the probability of all occurring simultaneously is quite low – we would suggest that caps and collars should be based on reasonable best and worst case scenarios across all areas of incentivisation.

3. How might the incentives be structured

The DCC will have to address a series of unique challenges across its initial 10 year term. In particular it will have to manage 3 distinct phases of operation. Incentives should be targeted and they should vary across the three periods reflecting the activities being delivered.

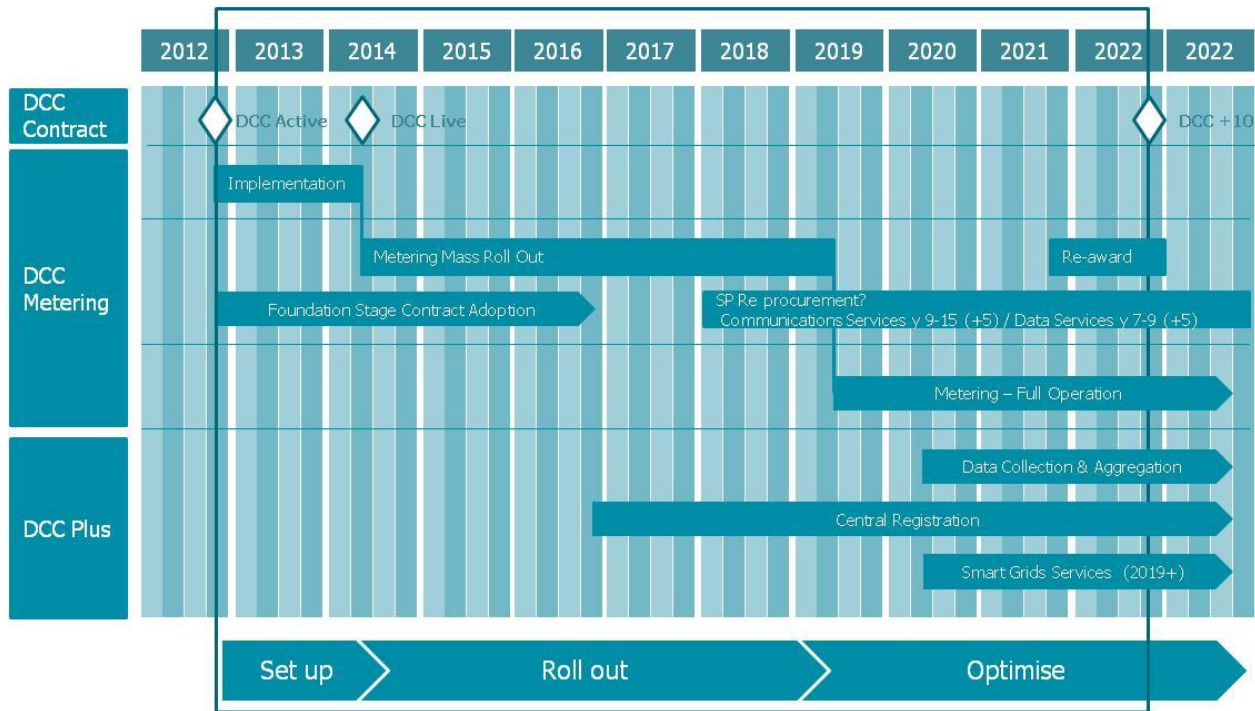
1. Set Up: establishing the right commercial model for the new services and ensuring that the DCC services are ready for the mass roll out of smart meters in Q2 2014.
2. Roll Out: adopting the foundation stage communications contracts and managing the data and communications services that underpin the supplier led roll out of smart meters through to 2019.
3. Optimisation: ensuring efficient and effective delivery of the services and pursuing enhanced economic delivery - including the procurement of the data (and possibly the communications) contracts.

In addition, the DCC will need to assimilate central registration and may need to assimilate Data Collection and Data Aggregation, plus Smart Grids functionality.

Attachment to ELEXON's response to DECC's Smart Metering Implementation Programme: Question 83



Attachment to ELEXON's response to DECC's Smart Metering Implementation Programme: Question 83



Similarly the underpinning KPI's should be reviewed periodically and redundant ones eliminated as the programme moves through each phase and greater learning and certainty is achieved.

4. What are the appropriate candidates for incentivisation

Having established the principles behind how the incentives should work it is important to describe what should be incentivised.

The DCC primary outputs, those elements that the customers will benefit from, will be governed by the Service Provider contracts. For example dial success rates or service latency will be prescribed and defined during the procurements.

The failure to deliver the service levels applied to these aspects will be the responsibility of the Service Providers but it is the DCC's primary function to prevent failures occurring through pre-emptive contract management and minimising the impact through effective incident management.

Once the DCC Licensee is familiar with the controls in place on the primary outputs within the Service provider contracts it should be in a position to articulate its own performance measures. However in the absence of



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understanding the Service provider contracts the only incentives a DCC Licensee should agree to are the less effective incentives on the inputs such as contract management processes.

Therefore we would suggest that the complete incentive regime can only really be usefully implemented after the Service Provider contracts are in place.

5. Conclusions

- Incentives must be linked wherever possible to the outputs not inputs;
- We agree that the aggregate exposure should not exceed the DCC's profit (as this risks damaging the service);
- The incentives regime should reflect the phases of the programme recognising the significant differences in activity;
- In the absence of information on the Service Provider incentives regime the DCC bidders should propose caps by programme phase with specific KPI's being negotiated when end-to-end contract information is available;
- We recognise the value in the Programme's suggestion that the DCC bidders should propose its own incentives caps as a part of the risk/reward regime – assuming it is clear how comparison will be made between bids.