

# Smart Metering Implementation Programme

Government Response to the consultation on the draft DCC Licence

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This Consultation response can also be found on DECC's website

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## Executive Summary

1. The Government's vision is for every home in Great Britain to have smart energy meters. Smart meters are the next generation of gas and electricity meters and they can offer a range of intelligent functions. Consumers will have real time information on their energy consumption to help them control and manage their energy use, save money and reduce emissions. Smart meters will also provide consumers with more accurate information and bring an end to estimated billing. Businesses and public sector users should also have smart or advanced energy metering suited to their needs. The rollout of smart meters will play an important role in Great Britain's transition to a low-carbon economy, and help us meet some of the long-term challenges we face in ensuring an affordable, secure and sustainable energy supply.
2. The communications and data transfer required to support smart metering are to be organised by a new central communications body – the Data and Communications Company ('the DCC'). The DCC will be a new licensed entity regulated by the Gas and Electricity Markets Authority (otherwise referred to as "the Authority", or "Ofgem"). A single organisation will be granted a licence under each of the Electricity and Gas Acts (there will be two licences in a single document, referred to as the "DCC Licence") to provide these services throughout Great Britain. Gas and electricity suppliers will be required to use the DCC to communicate with smart meters at domestic premises and will be permitted to use the DCC for meters at non-domestic premises.
3. The DCC Licence will be granted for a fixed term following an open competitive licence application process which is now underway. In April 2012 the Government consulted on draft DCC Licence Conditions and on policy proposals and legal drafting for the Regulations governing that application process ('the April 2012 consultation'). That consultation further developed a number of areas previously consulted on in September 2011. Respondents were invited to comment on the general approach to the licence and on specific policy issues.
4. This document is the Government's response to the April 2012 consultation on the draft DCC licence. The Government's response to the consultation questions on the application Regulations was published in September 2012 and is available at [http://www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx#dcc](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx#dcc).
5. Following analysis of comments received in response to the consultation and further consideration, some revisions have been made to the DCC licence . Key developments include:
  - The DCC licence will be awarded for a fixed term of 12 years, with a possible extension of up to six years in specified circumstances; these now also allow the Authority to extend the licence to ensure the smooth handover to a successor licensee;
  - Revocation events remain unchanged; the Authority can revoke the licence using powers that are consistent with other licences in the energy sector. Certain DCC specific revocation events remain, such as the failure to comply with an enforcement notice served by the Information Commissioner, reflecting the special position of the DCC. Revocation is always at the Authority's discretion;

- The former *Condition 3*, enabling the Secretary of State to modify the licence until 2018, has been deleted as secondary legislation is now in place so that the Secretary of State can modify the DCC licence using powers conferred by Section 88 of the Energy Act 2008;
- So as to retain only the absolute necessary minimum of continuing Government power over the DCC licence, various powers previously proposed for the Secretary of State have been transferred to the Authority (for example, oversight of the internal control document and risk management strategy) or removed altogether (veto over changes to the first objective of the charging methodology or to SEC modifications);
- The protection previously applied to existing core communications services required that any new service did not materially impact upon the provision of the existing core services. This protection has now been extended to other aspects of the DCC's mandatory business (e.g. elective services);
- Before offering a value added service the DCC is now required to notify any relevant regulatory authority (i.e. one that oversees the market, other than the energy market, in which the service will operate) of its intention to launch that service;
- The DCC's Internal Control Document must now cover the systems and procedures for the internal control of all of its Authorised Business, including its service providers, and not just its own activities;
- The SEC must now make provision for a Statement of Security Requirements to be designated by the Secretary of State;
- The Secretary of State can now direct the incorporation of registration services by the DCC at any time up to November 2018; previously this could only commence after April 2015;
- In procuring fundamental service capability (the communications and data service provider contracts) the DCC must now take account of any Public Interest Statement containing guidance on important energy policy matters issued by the Secretary of State;
- The DCC may now procure external services (but not fundamental service capability) from related undertakings subject to an efficiency or immateriality test. Previously the DCC could self-provide under the same circumstances but not procure from related undertakings;
- The DCC will be required to produce a Statement of Service Exemptions, for agreement by the Secretary of State and subsequently Ofgem, setting out those categories of properties at which it would be disproportionately costly or technically unfeasible for the DCC to service smart meters and what proportionate steps the DCC proposes to eventually incorporate those smart meters;
- The DCC is not now required to be a party to other core industry documents (excluding the SEC). Instead the SEC will contain provisions to ensure that the DCC is able to receive the information it requires via SEC obligations rather than as a party to other codes;
- A new General SEC Objective relating to the provision of information to facilitate energy consumers' management of their use of energy has been added. This will help ensure that modifications to the SEC that are intended to help consumers better manage their use of

- energy through e.g. modifications to the specification of the in-home display can be more straightforwardly proposed and considered by the SEC Panel (and ultimately the Authority).
- The licence now provides for the establishment of a joint venture company, SECCo Ltd, to act as the corporate vehicle for the provision of services required for the governance and administration of the SEC;
  - The DCC's price control conditions follow broadly the same approach set out in the April consultation. These conditions recognise the high proportion of the DCC costs that are likely to result from the activities of its service providers and that will therefore be passed through to the DCC's users. An additional requirement in the conditions is that the DCC must submit a report to the Authority on its cost performance with respect to external, predetermined internal and variable internal costs against those proposed in its licence application, with the potential for external and variable internal costs that have not been economically and efficiently incurred to be disallowed;
  - The management order condition now contains a sunset clause such that the condition will cease to have effect when an appropriate Special Administration Regime (SAR) is in place for the DCC. Subject to further consideration when the necessary legislative powers for an SAR are developed, the Government expects that the revised regulatory framework would need to cover the same range of risks as the management order condition;
  - To provide clarity and continuity to SEC Parties, the DCC's handover obligations in its licence now provide for the handover of rights and liabilities from an outgoing to an incoming DCC;
  - The former *Condition 44* (Survival of certain conditions of the licence) has been deleted in its entirety: the DCC's handover obligations will ensure it provides appropriate assistance to a successor whilst still the holder of its licence.
6. The revised draft DCC licence is at Annex 1 to this document. Published separately is the first legal draft of the Smart Energy Code ('SEC'), a key component of the DCC's regulatory regime that will form the contract between the DCC and its customers. The DCC licensing competition commenced on 12 October. The detail of the DCC licence is expected to evolve as a result of this competitive process, the consultation on the SEC (and subsequent SEC consultations), other smart metering consultations and further policy development.
7. As the draft licence evolves the Government will continue to engage with stakeholders on the relevant policy issues through these consultation processes and in stakeholder working groups. The first active (as opposed to draft) DCC licence will be published when the licence is awarded.

## 1. Introduction

- 1.1. The Government's vision is for every home in Great Britain to have smart meters, with businesses and public sector users also having smart or Advanced Meters suited to their needs. Smart meters are the next generation of gas and electricity meters and they can offer a range of intelligent functions. Consumers will have real time information on their energy consumption to help them control and manage their energy use, save money and reduce emissions. Smart meters will also provide consumers with more accurate information and bring an end to estimated billing. Smart metering will also play an important role in Britain's transition to a low-carbon economy and help to meet the long-term challenge of ensuring an affordable, secure and sustainable energy supply.
- 1.2. The Government's impact assessment estimates that the rollout of smart metering will involve a total present value cost estimated at around £11.5bn over the next twenty years, delivering total present value benefits of over £18.6bn, and resulting in an overall net benefit to Great Britain of around £7.2bn. These benefits derive in large part from reductions in energy consumption and from cost savings in industry processes.
- 1.3. Realising this policy goal will be a major undertaking. Regulatory obligations will help ensure gas and electricity suppliers deliver the rollout in a way that meets the Government's objectives. A comprehensive package of changes to the existing regulatory framework will be necessary.
- 1.4. The Energy Act 2008 modified the Electricity Act 1989 and Gas Act 1986 to give the Secretary of State powers to introduce a new smart metering related licensable activity that will underpin the introduction of a new central communications provider – the Data and Communications Company ('the DCC') – and allows for its regulation. This new licensable activity has now been introduced through a Statutory Instrument – the Electricity and Gas (Smart Meters Licensable Activity) Order 2012 (the 'Prohibition Order').
- 1.5. Conditions in gas and electricity supply licences will require suppliers to use the DCC for communication with domestic smart meters and optionally with the non-domestic sector.
- 1.6. The new activity undertaken by the DCC will be to provide a communication service for smart meters to energy suppliers, network companies and other parties for specified purposes and on defined terms. In March 2011, the Government concluded that the DCC should be created as a new licensed entity and that a single organisation would be granted a licence to carry out the licensable activity in both gas and electricity sectors. The licence will be granted for a fixed term following a competitive licence application process. The initial licence will be granted by the Secretary of State and, as the holder of a gas and electricity licence, the DCC will subsequently be regulated by the Gas and Electricity Markets Authority (otherwise referred to as "the Authority", or "Ofgem").
- 1.7. The DCC and its users will be established (in the case of the DCC) and subject to control through five regulatory interventions:
  1. the Prohibition Order – created through exercising powers in primary legislation establishing the requirement for DCC to be licensed;

2. the Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012 – which allow for the process for running the competition for the award of the DCC licences;
  3. the DCC Licence – to place obligations and restrictions on the DCC’s conduct;
  4. a range of new conditions in existing supplier and distribution/transporter licences and changes to existing codes, principally requiring suppliers to install smart meters and for them to use DCC for communication with such meters in the domestic sector; and
  5. the Smart Energy Code (SEC) – a new industry code introduced under the DCC licence setting out the day-to-day rules, rights and obligations of the different industry participants using smart metering equipment. Among other things it will detail the relationships between the DCC and the users of its services.
- 1.8. Initially the DCC’s activities and services will be limited to those functions that are necessary for the effective transfer of smart metering data, including secure communications, control of access to that data, scheduled retrieval of data from meters and the necessary data translation services. It is envisaged that meter point and supply point registration responsibilities will be transferred to the DCC in due course, and that the DCC may extend its activities into non-energy value added services. The draft licence provides for both of these. This staged approach is important to ensure that the services essential to the roll-out of smart metering are provided in the first instance, whilst maximising the benefits of smart metering in the longer-term.
  - 1.9. The Government has decided that, rather than the DCC itself providing services, best value for the consumer will be derived by separating its service and contract management roles from operational delivery. The DCC will not deliver communication services directly but will procure competitively the principal resources (specifically data and communication services) required to deliver its mandatory business services to users. To establish the DCC’s services early and bring forward the benefits, the Government decided to initiate procurement of the data and communication services on behalf of the future DCC licensee, in parallel with the process to select the first licensee. Once appointed the DCC will be required to enter into contracts with these data and communication service providers and will either provide directly or procure the other wider services it needs to operate its mandatory business.
  - 1.10. Following from previous consultations in March 2011 and September 2011, which established the Government approach to designing supplier obligations for Smart Metering and the policy design of the regulatory framework for the DCC, the April 2012 draft DCC licence consultation document (‘the April consultation’) presented a draft DCC licence and invited comments on a number of key areas. The draft licence has continued to evolve through dialogue with industry notably the Smart Metering Regulatory Group (SMRG) and its working groups - and with Ofgem.
  - 1.11. The same consultation paper also sought views on the proposed Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012 (‘the Regulations’) for the competitive process to award the DCC licence. The Government’s response to the Regulations section of the consultation was published separately in September and is available at

[http://www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx) . The Regulations are now in force.

- 1.12. Section 3 of this document (Next Steps) sets out in more detail the process leading up to the award of the first DCC licence.
- 1.13. It is important to note that this Government response is intended to set out the Government's current views with respect to the drafting of the DCC licence, however, the final licence text will take precedence over any comment here.

## 2. Response to April 2012 Consultation and Proposed Draft DCC Licence

- 2.1. The April consultation on the draft licence developed out of previous policy publications in March and September 2011. The consultation invited comment on the general approach to the draft licence, the conditions themselves and a number of specific policy issues.

### Structure of the DCC licence

- 2.2. The DCC licence comprises four parts: *Parts 1* and *2* contain terms that cannot be varied and which provide for the grant, expiry and revocation of the licence; whilst *Part 3* contains conditions to the licence that can be modified, as provided for by statute<sup>1</sup>, by the Authority or (for time-limited purposes related to smart metering) by the Secretary of State<sup>2</sup> as the case may be; and *Part 4* contains schedules to the conditions which can also be so modified. In this document specific references to the licence text are marked in italics, so for example references to *Parts 1* or *2* of the licence are in the following format '*Part 1, Paragraph 1*' whilst references to *Part 3* will, for brevity, refer to the condition rather than the *Part* of the licence e.g. '*Condition 17.3*'. Where relevant, it may also refer to the subsection within a condition, for example '*Condition 17 Part A*'.

- 2.3. The conditions in *Part 3* are divided for convenience into a number of chapters, each containing conditions addressing a particular aspect. These are:

Chapter 1: Interpretation, contact details and payments;

Chapter 2: Nature and conduct of the Licensee's business;

Chapter 3: Arrangements for the Licensee's independence;

Chapter 4: Start-up and development obligations;

Chapter 5: General arrangements for Services;

Chapter 6: Arrangements for Industry Codes;

Chapter 7: Financial and ring-fencing provisions;

Chapter 8: Provision of regulatory information;

Chapter 9: Price Control Conditions of this Licence;

Chapter 10: Arrangements for intervention and continuity.

Three schedules are also included in *Part 4*.

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<sup>1</sup> Sections 23 and 23A of the Gas Act 1986 and Sections 11A and 11B of the Electricity Act 1989.

<sup>2</sup> Energy Act 2008 Section 88

## Make-up of respondents

- 2.4. There were 28 responses from industry stakeholders including energy suppliers, network operators and others, Ofgem and representative bodies including Consumer Focus and the Federation of Small Businesses. 4 were confidential and none were received from individual members of the public.

## General comments

- 2.5. Ofgem, as a general point, noted the Government's ongoing interest in the DCC through certain licence conditions after the DCC had become licensed. It suggested further work between Ofgem and DECC to establish a clear boundary between the Authority and the Secretary of State so as to provide regulatory certainty to the DCC (and potential DCC applicants).
- 2.6. Three respondents were concerned that the benefits smart metering would bring to domestic customers, in particular around switching suppliers, should also be made available, with similar obligations, to small businesses. One respondent also suggested that the cost savings for suppliers resulting from smart meters must be passed on to consumers and that the better information the system will provide for suppliers ought to result in simpler and clearer tariffs.
- 2.7. One respondent commented that gender-neutral drafting would be more preferable in the draft licence.

## Government response to general comments

- 2.8. The Government agrees that clarity on the roles of the Secretary of State and the Authority in regulating the DCC is desirable to increase regulatory certainty. The Government has a key role in establishing the smart metering arrangements and has enhanced powers up until 2018 under the Energy Act 2008. Regulation of the system once it is operational is for the Authority. The Government wishes to keep its continuing powers over the licence, even before 2018, to the necessary minimum.
- 2.9. To this end, the Government has reviewed those parts of the draft DCC licence where the Secretary of State had an ongoing power, and generally sought to remove or limit these (including those in what were *Conditions 7, 18 and 23*, discussed separately below).
- 2.10. The Government agrees that the benefits of smart meters should accrue to small businesses as well as residential consumers. Energy suppliers will be obliged to provide smart meters to their smaller non-domestic customers. However, unlike the domestic market, there is already a degree of competitive provision of comparable services in the non-domestic market. Therefore, as set out in previous documents, energy suppliers will not be obliged (but can choose) to use the DCC for non-domestic meters.
- 2.11. The Government also notes that the use of 'he' to refer to the Secretary of State is consistent both with existing energy licences and with the Interpretation Act 1978 (the rules of which apply to the DCC licence).

## Structure of the following sections of this chapter

- 2.12. The remainder of this chapter, following a discussion of Parts 1 and 2, goes through the DCC licence chapter by chapter. It introduces the key points made in the April consultation paper, summarises comments received and the Government's response – explaining any further drafting developments. It indicates where the Government anticipates subsequent policy developments.
- 2.13. There have been some changes to the numbering of conditions. Note that discussion of the April licence draft uses the numbering from that draft, whilst discussion on the current draft will use the numbering as published (this principally<sup>3</sup> affects *Conditions 37-44*).

## Parts 1 and 2 of the DCC licence (terms in respect of grant and of revocation)

### April Consultation Paper

- 2.14. *Part 1* of the licence set out the proposed terms in respect of licence grant. The Government envisaged a single document that would constitute a licence to carry out both the gas and electricity related DCC activities, with a single set of terms and conditions. Thus the licence has effect under both the Gas Act 1986 and the Electricity Act 1989.
- 2.15. The Government proposed a fixed term licence to provide DCC applicants with certainty as to the duration of the regulatory obligations and to obtain the benefits of future competitive licence application processes. However, the April consultation recognised that there were arguments for a licence granted in perpetuity with provision for periodic re-running of the licence application process, and a fixed-term revenue stream. The consultation sought views on whether the fixed term or perpetual model was more appropriate.
- 2.16. It was proposed that, to minimise disruption to DCC service delivery, the licence duration should be linked to the duration of the initial service provider contracts. A licence duration of 12 years would allow the initial DCC to remain in place throughout the expected period of mass rollout. It would mean that the DCC would itself operate the next set of external service provider contracts, which it would put in place, for a minimum of 2 years prior to handover to a successor DCC. It also meant that no incoming DCC would be required to finalise a replacement contract without having been in post for at least 2 years. This was designed to ensure that any DCC would be both experienced and have a future stake in the operation and performance of those contracts.
- 2.17. The licence could be extended more than once, subject a maximum of 6 years. An extension of more than 1 year could be exercised only once unless the DCC consented to more. This protects the DCC from the uncertainty of multiple, long-duration extensions. Reasons for extension are to facilitate an efficient competition for a new licence, to ensure an appropriate length of time (as set out above) between procuring new service provider contracts and the

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<sup>3</sup> Condition 3 has been replaced in its entirety with a new condition, but this has not affected the numbering of later conditions (see paragraph 2.59)

award of a new DCC licence and to avoid the replacement of the DCC occurring simultaneously with, and adversely interacting with, any other major industry development that might be taking place.

- 2.18. The Terms also provided for modification of the licence by the Secretary of State up to 31 October 2018 as discussed below under *Condition 3* in Chapter 1 (see paragraph 2.59).
- 2.19. It was also proposed that when the licence expired certain obligations could continue to apply for a further two years without the principal obligations on the DCC remaining active (see below under Chapter 10).
- 2.20. *Part 2* set out the Terms for licence revocation. The majority of these reflected standard Terms in gas and electricity licences. There were also a number of DCC specific revocation events.
- 2.21. First, to reflect the importance of protection of data by the DCC, a failure by the DCC to comply with an enforcement noticed served by the Information Commissioner under Section 40 of the Data Protection Act was included. Revocation was not automatic, as the Authority would always have to consider whether the circumstances justified revocation.
- 2.22. “Other Revocation Event 5” allowed for revocation where the DCC failed to perform appropriately (e.g. there was a serious breach of its licence). This would arise where the licensee contravened the licence in a manner or extent that was so serious as to make it clearly inappropriate for it to continue to hold the licence. This provision was based on similar arrangements in Section 24 of the Water Industry Act 1991.
- 2.23. “Other Revocation Event 6” aimed to ensure the independence of the DCC and is discussed further with respect to Chapter 3.
- 2.24. “Other Revocation Event 7” applies if the Authority is satisfied that the DCC licensee no longer is, or never was, a fit and proper person to carry on the Authorised Activity. This test is new in energy licences but is a feature of Broadcasting Act licences and other regulatory regimes, such as that for the National Lottery. Given the importance and sensitivity of the DCC’s activity in smart metering, involving the transmission of individual energy consumption data, the Government proposed this test for the DCC.
- 2.25. “Other Revocation Event 8” would apply if the DCC ceased to carry out any part of the Authorised Activity.

## Views of respondents

### *Part one – Terms in respect of Grant*

- 2.26. Two respondents suggested that the ability of the Secretary of State (and later the Authority) to modify the licence at any time up until 2018 placed significant risk on the licensee and might increase risk premiums or even deter bids (see paragraph 2.59 below).
- 2.27. Two respondents were concerned at the ability to extend the licence very early (2018) in the 12 year licence term. Another suggested that, to ensure an incumbent DCC remained in post until a successor was found, there should be no power of veto by the DCC over any Authority instigated extension. Conversely, two respondents suggested that any extension should either

be a joint decision between the licensee and the Authority or should at least trigger a reopener of negotiations, recognising the commercial implications.

### *Part 2 – Terms in respect of revocation*

- 2.28. A number of respondents stressed the need for proportionality, and the importance of allowing the DCC to rectify less serious failings before any licence revocation.
- 2.29. Three respondents commented that the notice period for revocation needed to be better linked to the seriousness of the breach, with particular focus on the risk of damage to consumers or users during that notice period and on the DCC’s ability to continue to function until a replacement could be found. One respondent suggested that the Authority, if aware of any DPA risks, ought to intervene much earlier.
- 2.30. One placed particular emphasis on the DCC’s Data Protection responsibilities suggesting that the licensee should be considered a data controller in respect of DPA matters and that failure to meet these responsibilities (including contractual failure by DSPs or CSPs) should also be grounds for revocation. It also suggested a new revocation event be included for failure to develop DCC systems appropriately to take on new responsibilities, such as registration services.
- 2.31. One respondent felt that failure to facilitate effective competition in the industry ought to be a revocation event. Two respondents commented that if it in fact transpired that the DCC “never was” fit and proper to hold the licence then this would call into question the initial application and selection process.

### *Duration of licence*

- 2.32. Most respondents either firmly supported, or expressed a preference for, a fixed term licence. One of these suggested a shorter licence period (8-10 years). Ofgem and one other respondent preferred a licence granted in perpetuity whilst another, though content with the fixed-term approach, supported further consideration of a perpetual licence.
- 2.33. Those in favour were of the opinion that a fixed term licence provided greater clarity and certainty to the industry whilst avoiding the risk of inertia at the end of the licence period.
- 2.34. Those against a fixed term licence were concerned mainly with the arrangements at handover of the licence and the risk of no licensee being in place, or of the incoming licensee taking advantage of time pressure when negotiating terms.

## Response and Proposed Licence Drafting

### *Part one – Terms in respect of Grant*

- 2.35. Following consideration of the consultation responses and recognising the impact on the DCC of any licence extension, the Authority will now be required to consult the DCC before it can determine that a licence extension should take place (*Part 1, paragraph 6*). Ofgem has the discretion to consult more widely in any case. In response to one concern raised, the

Government notes that this requirement to consult would not constitute a veto by the DCC over any licence extension.

- 2.36. The Government also notes that while the potential for a contract extension could have commercial implications for the DCC, the limitation to a six year maximum provides certainty about the ultimate end date for its regulatory obligations. This approach also protects industry and ultimately consumers by giving the Authority the flexibility to extend the licence in the carefully defined circumstances set out in the draft licence (*Part 1, paragraph 7*).
- 2.37. An additional reason for extending the licence has also been identified. This is, to facilitate the efficient handover of the (outgoing) DCC's business to a new DCC (*Part 1, paragraph 7(b)*). The other reasons (to facilitate an efficient licence competition; to avoid an overlap of the renewal of service provider contracts and a new DCC licence being awarded; and to avoid an overlap with any major energy industry activity) remain the same.
- 2.38. The Government recognises that the Authority's power to extend the licence from April 2018 is relatively early. However, it does not see serious disadvantages to this. If any of the specified reasons for licence extension arose sufficiently early (for example a major structural change to the energy industry) then giving the DCC and its users as much advanced notice as reasonably practical could be beneficial. Introducing this power from 2018 is also consistent with the general shift towards complete Authority oversight over smart metering by 2018.
- 2.39. Following further discussion with Ofgem, the required notice period for an extension of more than one year has been reduced from two years to one. Significant issues creating the need to extend the DCC licence could appear at relatively short notice; therefore a two year notice period may be insufficient time to ensure that an operational and effective DCC is always in place. The notice period for an extension of less than one year remains at six months.

#### *Part 2 – Terms in respect of revocation*

- 2.40. The Government has considered the comments made with respect to revocation but does not believe further material modification is necessary. There is clearly a need for a proportionate response to each of the three classes of revocation events. Class A (emergency events related to insolvency) or Class B (material misstatement of facts during the application process) are standard Terms in other energy licences and are equally relevant for the DCC.
- 2.41. In the case of Class A (emergency revocation events) an allowance for remedial action would not be appropriate as they will only stem from situations of insolvency or other financial failure.
- 2.42. Similarly, revocation under Class B is only likely to result from the emergence of a misstatement of fact (on the part of the DCC at the point of application) which leads the Authority (or Secretary of State) to conclude that the DCC should never have been granted the licence.
- 2.43. The majority of the revocation events listed under Class C already allow for remedial action to be taken as they are prompted only by the DCC's failure to comply with certain orders having been made against it (events 1-4) or for failures with respect to its licence obligations (events 5, 6 and 8). The Government does not agree that were the licensee to be considered never to have been a fit and proper person (other revocation event 7) this would call into question the competence of the licence award process. Evidence that a person was not fit and proper could later come to light which was not available during the licence competition, despite all due

diligence, similarly the status of a person might change over time and they might cease to be fit and proper.

- 2.44. In all cases the revocation of the DCC licence would be at the discretion of the Authority. The Government is satisfied that the notice periods (a minimum of 24 hours for Class A events, 7 days for Class B and 30 days for Class C) are appropriate, consistent with other licences and allow sufficient flexibility for consideration by the Authority of the seriousness of the breach.
- 2.45. With regard to the DCC's duties under the Data Protection Act, it is the legal responsibility of all industry participants to ensure that they comply with the Data Protection Act (and any other relevant legislation) to the extent that it applies to them. Under the Data Protection Act, data controllers must ensure that any processing of personal data for which they are responsible complies with the Act. Generally speaking, suppliers, network operators and third parties accessing energy consumption data are likely to be data controllers, with the DCC potentially acting as a data processor on their behalf, although this will depend on the exact nature of the activity being undertaken and the contractual basis for it. The DCC's duties may change over time as and when it takes on responsibility for registration services, for example.
- 2.46. In any event the Government is satisfied that the proposed Data Protection requirements for the DCC, together with the revocation events that triggered by failure to meet these, are appropriate. For example, revocation on the grounds of Revocation Event 4 (e) can only follow a failure to comply with an enforcement notice served by the Information Commissioner. This means the DCC will have an opportunity to remedy a minor breach before any revocation action is considered and revocation itself would not be automatic.
- 2.47. Conversely, in response to the comment that it would not be desirable to have to wait 30 days (the notice period for a Class C Revocation Event) for the Authority to revoke a licence in the event of serious failings such as a major data protection breach, there are other protections in place. In particular, whilst it may take 30 days to formally revoke the licence, the Authority can take action to halt a serious licence failure much more quickly using the management order provisions (or potentially in future a Special Administration Regime (SAR)) (see paragraph 2.316).
- 2.48. If such a serious event did occur the Authority could introduce a management order as soon as it became aware of the abuse, directing a particular course of action and also, if appropriate, starting revocation proceedings. In practice, given the need to ensure that an appropriate replacement DCC could be put in place, the use of management orders or (if / when available) an SAR would be a likely additional and earlier step, rather than a reliance on revocation only. Other significant pressures for the DCC to avoid such a situation would include the possibility of fine for breach of its licence and a breach of its obligations under the SEC.
- 2.49. The Government does not consider that the failure to facilitate competition should be a distinct revocation event. One of the DCC's general objectives is to facilitate competition (though this must be weighed in the round against its other objectives) so any significant failure in this regard could constitute a licence breach. A serious breach of this kind could trigger Other Revocation Event 5.

*Licence duration*

2.50. The Government remains of the view that a fixed, non-rolling term licence is the most appropriate model for the DCC. The alternative model of a licence granted in perpetuity could provide some benefit in avoiding the risk of there being no DCC at any point. However, this risk can also be mitigated by the ability of the Authority to extend the DCC’s licence in clearly defined circumstances, coupled with careful design of the expiry and handover periods. The competitive process to identify a successor DCC should be completed during the incumbent DCC’s licence term. A fixed length licence has the significant benefits of providing pressure on the incumbent DCC to perform well as well as providing certainty for applicants that they will have a clearly defined exit point.

Summary of significant changes between April and November draft DCC licence	
Parts 1 and 2	<ul style="list-style-type: none"> <li>The Authority has an additional reason to extend the DCC licence. This is to facilitate the efficient handover of the DCC’s business to a new licence holder (paragraph 2.37 above and <i>Part 1, paragraph 7 (b)</i> of the draft DCC licence).</li> </ul>

**Chapter 1 of the DCC licence: Interpretation, contact details, and payments**

April Consultation Paper

- 2.51. The April consultation explained that *Condition 1* (definitions) and *Condition 2* (rules of interpretation) were conventional conditions for any energy sector licence. *Condition 4* made provision for the DCC to pay fees to the Authority and to cover the Authority’s (and potentially the Secretary of State’s and Competition Commission’s) costs, The scale of the fees payable is set out in the Authority’s licence fee cost recovery principles.
- 2.52. With respect to what was then *Condition 3* (Modification of Licence by Secretary of State), the April consultation set out the Government’s long held view that there were advantages in the Secretary of State having the ability to amend the DCC licence until 2018, in line with the powers in Section 88 of the Energy Act. Such powers would need to be exercised with caution and only following discussion with the licensee and Ofgem, to ensure the implications were understood and appropriately managed, for example by examining any impact on the DCC’s financial position.

**Views of respondents**

2.53. There were few comments on the definitions. One respondent suggested that the definition of “Commercial Activities” may need revisiting in the context of the SEC objectives (see discussion and response below at paragraph 2.232). Another was concerned that the definition of price control conditions made reference to Chapter 9 only and that this could cause problems if a later change meant that a condition outside of Chapter 9 had the character of a price control condition. It also argued that the definition of “Smart Meter” was generic and a wider definition than “Smart Metering System” as it included non-SMETS meters. Its final comment was that the definition of “Licence” did not reflect the fact that there are two licences.

- 2.54. Three respondents reiterated concerns around the ability of the Secretary of State to modify licence conditions and sought reassurance on protection for the licensee.
- 2.55. One respondent commented on *Condition 4* (providing for the DCC to pay Authority costs), suggesting more information is required prior to licence grant and that this payment is considered when procuring service provider contracts.

### Response and Proposed Licence Drafting

- 2.56. Some drafting changes have been made to Chapter 1 as a consequence of consultation responses and further internal review.
- 2.57. The Government believes it is quite clear that the DCC licence is granted under two pieces of legislation and is two separate licences with equal obligations. This is set out in *Part 1* of the licence in the opening two paragraphs. The definition of “Smart Meter” is taken from the Prohibition Order and is used to define the licensable activity within the licence, rather than to place obligations on the DCC, which are instead linked to the definition of “Smart Metering System”. The reference to price control conditions as being those in Chapter 9 provides a helpful reference for the purposes of interpreting Sections 23E and 11F of the Gas and Electricity Acts respectively, without legally constraining such interpretation. Should a later licence modification process mean that another condition took on the characteristic of a price control condition (which is defined in the Acts by reference to purpose) then the text could be modified accordingly.
- 2.58. With respect to licence fees charged by the Authority, the DCC’s price control conditions now include an explicit allowable element for such fees (see paragraph 2.295).
- 2.59. *Condition 3* was included in the April draft licence because there were then no powers to modify the DCC licence under Section 88 of the 2008 Energy Act (unlike other energy licences where such a power did exist). However, the Prohibition Order<sup>4</sup> has now added the DCC licence to the list of those covered by these powers. *Condition 3* (Modification of the Licence by Secretary of State) is therefore no longer required and has been deleted. The Authority’s powers to modify the DCC licence are not affected by the removal of *Condition 3*.

Summary of significant changes between April and November draft DCC licence	
Chapter 1 Interpretation, contact details, and payments	<ul style="list-style-type: none"> <li>• The former <i>Condition 3</i> (Modification of Licence by Secretary of State) has been deleted; the Secretary of State is now able to modify the DCC licence using powers under Section 88 of the Energy Act 2008 (see paragraph 2.59). A new <i>Condition 3</i> provides contact details for the licensee and other persons.</li> </ul>

<sup>4</sup> See the also the Government response to the Prohibition Order consultation at [http://www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx)

## Chapter 2: Nature and conduct of the Licensee's business

### April Consultation Paper

- 2.60. The April consultation explained the Government view that, in order to ensure consistency of DCC objectives across gas and electricity legislation, and in order to avoid disparity between DCC and other objectives in either Act, it was appropriate to set out the general objectives of the DCC in its licence rather than in legislation. *Condition 5* contained these objectives.
- 2.61. Two general objectives were proposed for the DCC: the first relates to the development, operation and management of an efficient, economic and co-ordinated system for the provision of Mandatory Business Services; whilst the second, to be balanced in the round with the first, required the DCC to carry on the Mandatory Business in a manner most likely to facilitate:
- effective competition in Supply and in Commercial Activities connected with Supply;
  - such innovation in the design and operation of Energy Networks as will contribute to the delivery of a secure and sustainable Supply of energy; and
  - the reduction (by virtue of the benefits arising from the provision of value added services) in the price payable by those receiving Mandatory Business Services.
- 2.62. The first of these objectives reflects the general duties placed on network licensees in the Gas and Electricity Acts. The second also reflects such general duties in relation to facilitating competition in supply, but, because the DCC is expected to provide services not just to suppliers but potentially to a wide range of other persons, the objective extends to the broad scope of persons engaged in commercial activities connected with supply. This was intended to cover the kinds of activities undertaken by energy services companies.
- 2.63. In recognition of the enabling role that smart meters are expected to play in the evolution of smart grids, sub-paragraph (b) of the second objective was intended to reflect the DCC's potential role in facilitating the development and operation of smart grids.
- 2.64. Finally, sub-paragraph (c) reflects the fact that where the DCC provides value-added services and it reduces its charges for mandatory business services as a result, such arrangements are considered to be consistent with the DCC's objectives.
- 2.65. *Condition 5 Part C* placed a duty on the DCC to carry out the mandatory business at all times in accordance with the General Objectives and to balance the objectives in the round when doing so. *Condition 5 Part D* required the DCC to not do anything that would prejudice or impair its ability to carry on the mandatory business in accordance with the General Objectives.
- 2.66. In drafting the objectives the Government was mindful of the need to differentiate between the purpose of the DCC (its objectives) and the rules governing its behaviour in meeting these objectives (its licence conditions and the SEC). As a consequence rules around data protection, security and transition appeared logically as obligations rather than objectives. By making them specific licence obligations they would not be expected to be balanced in the round against other potentially competing objectives.

- 2.67. The Government had further considered the need for a reference to consumers in the DCC's objectives and remained of the view that it would not be appropriate to include an explicit objective in relation to this. In line with similar objectives on network licensees, the DCC should provide services efficiently and facilitate competition in services provided to consumers, rather than seeking itself to determine what constitutes the consumer interest. It was also noted that the SEC Objectives did include a reference to consumers' interests.
- 2.68. On energy efficiency, the DCC will provide services to third parties offering energy efficiency related services, but it is not the DCC's role to take a view on energy efficiency matters. Consequently, the DCC should not have a specific energy efficiency objective. This would not prevent the DCC from offering new services to its users that support energy efficiency / better energy demand management.
- 2.69. *Condition 6* set out the scope of the Authorised Business of the licensee. The April consultation noted that further work to define the detail of the DCC's services was in progress.
- 2.70. In the draft licence, the DCC business authorised by its licence was split into two categories: 'Mandatory Business' and 'Permitted Business'. The mandatory business included core and elective communication services and any other enabling services (including, crucially, enrolment) specified under or pursuant to the SEC in each case, in addition to the procurement of the resources necessary to provide them.
- 2.71. These are discussed further in the context of Chapter 5 of the licence. Should the DCC take on responsibility for the provision of the communications hub (the equipment to be installed in consumer premises that will provide the connection to the DCC's wide area network (WAN) and to the home area network (HAN) which connects devices in the home), this would be treated as an enabling service within the mandatory business. (See also paragraph 2.152.)
- 2.72. The permitted business comprises the provision of value added services and minimal services. Value added services would need the consent of the Authority who would take into account proposals from the DCC to offset mandatory business service costs from revenues of the value added service under *Condition 11.5*. Under *Condition 6* the Authority could issue guidance on the criteria it will apply in considering whether to approve a value added service. The April consultation also made it clear that the Government and Ofgem were continuing to discuss the regulatory framework for value added services (see paragraph 2.97).
- 2.73. Minimal services are those which do not exceed a turnover of £500,000 per annum and which are not provided to any material extent from the capability or resources the DCC uses to carry out the mandatory business. This service category sets a de minimis threshold for regulatory intervention, to avoid unnecessary burdens on the Authority and the DCC.
- 2.74. *Condition 7* provided for a number of general controls on the DCC's business, taking account of the nature of its activities and its particular position as an asset-light entity with relatively large external contracts, occupying a crucial role in the GB energy infrastructure. The condition applied constraints relating to:
- corporate governance (for example compliance with the UK Corporate Governance Code);

- internal controls (including the need for an Internal Control Document demonstrating its maintenance of an appropriate organisational structure, audit trails and monitoring processes etc.); and
  - risk management including the establishment of a Risk Management Strategy setting out a robust framework for identification, evaluation and management of risk.
- 2.75. *Condition 8* required the DCC to install, operate and maintain adequate and proportionate security controls which are designed to protect the physical, organisational and information assets of the Authorised Business. The condition made reference to an “Authorised Security Standard”. The April consultation said that this document would stipulate the levels that needed to be achieved by the DCC in relation to security, taking into account the costs and benefits of the required controls. In doing so, the document would set the risk appetite for the DCC with respect to security and provide clarity for it, the Authority and other stakeholders on the appropriate level of security. However, it was noted that the Government was considering further the arrangements for this document.
- 2.76. *Condition 8* set more detailed obligations in relation to physical, organisational and information security and required the DCC to maintain a register of security incidents. It also prevented the DCC from entering into any contractual arrangements not containing provisions to ensure that the security arrangements can be met. It was noted that these high-level obligations on the DCC in relation to security were to be supplemented by obligations in the SEC.

## Views of respondents

### *DCC General Objectives*

- 2.77. In general, respondents were content with the proposed drafting. Two requested clarification of the roles of the DCC and its service providers with respect to liabilities and responsibilities.
- 2.78. Ofgem suggested that the objective in *Condition 5.4(c)* (the reduction in price payable for mandatory services as a result of payments for value added services) was unnecessary, raising concerns that it might be interpreted to mean that offering value added services was a general objective of DCC which, especially in its early years, should not be the case.
- 2.79. Two respondents wanted firmer emphasis on the need for the DCC to facilitate Smart Grids development, one suggesting that the second general objective did not go far enough. Another suggested that the smart grids objective in *Condition 5.4(b)* should refer to reducing energy demand.

### *Mandatory and Permitted Business*

- 2.80. Ofgem suggested that the Authority may not be best placed to consider non-energy related matters concerning value added services given its statutory role. Another respondent concurred, stressing that if the Authority were to take this on it would differ greatly from their current role and require adequate resourcing.
- 2.81. Two respondents sought reassurance that any new elective services or minimal services must only be provided so long as there was no possibility of a degradation to existing core services, one expressing concern that there was no licence condition to this effect.

- 2.82. Regarding *Condition 11.4(a)* (barring cross subsidy between mandatory and permitted business) one respondent suggested that using mandatory service infrastructure or expertise to develop value added services should not be classed as cross subsidy. Another saw a need to recognise that some value added services that did not reduce the costs of mandatory services might have some other benefit to users or to consumers.
- 2.83. One respondent suggested that the limit on minimal services should be £1m but did not provide a rationale. Another asked for confirmation that the limit was a total for all such services, not for each individual service.

### *General Controls*

- 2.84. One respondent questioned why it fell to the Secretary of State, rather than the Authority, to approve revisions to documents such as the Internal Control Document and the Risk Management Strategy (*Conditions 7.7* and *7.12*). One suggested there should be reference to the SEC Panel in *Condition 7 Part A* (Requirement for corporate governance arrangements) as well as to the UK Corporate Governance Code.

### *Security*

- 2.85. A substantial number of respondents felt too little was known about the security standards that would be applicable and that there would be a need for further consultation as policy developed. One asked that *Condition 8.1* be amended to oblige the DCC to take all reasonable steps to ensure their activities did not compromise the security of the end to end system.
- 2.86. One respondent was concerned that the DCC model potentially represented a significant security risk. To improve transparency, they suggested the establishment of a consumer advisory group and security working group to include security experts and consumer representatives, to focus on issues such as responsibility for monitoring security and ensuring continuing compliance. Another respondent urged that security requirements remain proportionate to risk and not be allowed to stifle innovation in the energy industry. A further more respondent asked for “material impact” on the permitted business to be defined.

### Response and Proposed Licence Drafting

#### *DCC General Objectives*

- 2.87. The Government considers that the objective on facilitating smart grids (*Condition 5.4 (b)*) is necessarily high-level, reflecting uncertainty now on how smart meters and the DCC will, in future, support the development of smart grids. The objective as drafted obliges the DCC to carry out its mandatory business in a manner likely to facilitate such developments. The Government does not agree an additional requirement is needed to facilitate a reduction in demand for energy. The design of smart grids is unlikely to result in a reduction in demand for energy – it is expected they will reduce the use, or change the pattern of use, of energy.
- 2.88. In respect of *Condition 5.4 (c)* the Government agrees with Ofgem’s view that the DCC should not focus on the provision of value added services in its early years. It should focus on quickly establishing a stable operational environment for core and elective services. However, it sees

the DCC offering value added services as a positive future initiative, all other things being equal and within the protections in the licence for the mandatory business, because value added service users would make a contribution to the costs of the system used by energy users.

- 2.89. The Government is considering the transitional arrangements for the DCC in the context of *Condition 13* and it may be appropriate to limit activity on value added services during this period. Alternatively, the requirement for the DCC to consider its objectives in the round may be enough, considering the protection of the mandatory business in the First General Objective.
- 2.90. A further protection is that the Authority may take the impact on the mandatory business into account when assessing applications for value added services. *Condition 6.13* allows the Authority to publish guidance on the procedure it will follow and the criteria it will take into account before approving such a service.
- 2.91. On an enduring basis, the Government believes it is important to refer to value added services within the DCC's general objectives. For reference the objective (*Condition 5.4(c)*) reads:
- “The Second General Objective of the Licensee is to carry on the Mandatory Business in the manner that is most likely to facilitate:
- ... (c) the reduction (by virtue of benefits arising from the provision of Value Added Services) of the charges payable for Mandatory Business Services.”
- 2.92. The drafting intention was to ensure, by referring to the need to orientate its business so as to facilitate value added services (and consequently the value their provision would bring to the mandatory business), the DCC would not be constrained by the general objectives. This allows it to take account of the potential benefits of value added services, which may outweigh a minor impact on the mandatory business, when considered in the round.
- 2.93. The requirement to conduct the mandatory business in such a way that facilitates the provision of value added services (so as to ultimately reduce the charges payable for mandatory services) is also important in ensuring that the DCC makes the best available use of its resources. This is because the DCC must take account of the potential benefits to mandatory business users that the provision of value added services might bring – however, it does not impose an obligation on the DCC to promote value added services. In considering its objectives in the round, the DCC should assess whether the provision of value added services would be making the most efficient use of infrastructure that will ultimately be paid for by energy consumers. It is important to note that the DCC must not, under *Condition 5.7*, carry on any activity, or any combination of activities related to the permitted business (value added or minimal services) in a manner that prejudices or impairs, or would be likely to prejudice or impair, its ability to carry on the mandatory business at all times in accordance with its general objectives.
- 2.94. Following discussions with stakeholders, *Condition 5.6* has been amended (with a similar modification in *Condition 18.17*). Where it is necessary for the DCC to consider its objectives in the round, the draft licence now says “weighing them as appropriate in each particular case” rather than the previous drafting which required the “balancing” of objectives. Stakeholders have suggested that ‘balancing’ might imply that in all cases equal weight would be given to each objective, which may not be appropriate given the particular circumstances.

### *Mandatory and Permitted Business*

- 2.95. The Government agrees there is a need to protect core services when the DCC is considering new activities and has concluded that there is equally a requirement to protect existing elective services. *Condition 6.6* has been redrafted so that all mandatory services that the DCC is obliged to provide (whether already operational or not) must be protected from material impact from a new service.
- 2.96. Given the monetary limits already applied to minimal services and the fact that they must not be provided to any material extent from within capability or resources available to the mandatory business, the Government is satisfied that any such services will not have the capacity to impinge on the DCC's ability to provide existing mandatory services. It would not be practical to define "material" with respect to the resources drawn from the mandatory business and instead considers that this should be assessed on a case by case basis by the DCC (and ultimately by the Authority in its regulatory oversight role). The Government considers that a limit of £500k in total is appropriate for all minimal services provided in one year (rather than the £1m suggested by one respondent). It is important to note that services above this £500k limit may still be permitted but would require active approval from the Authority as value added services or, if related solely to the supply of energy, supplied under the SEC.
- 2.97. The Government has considered further the regulation of value added services. The Authority's legal powers and regulatory expertise are almost entirely limited to the gas and electricity markets. Since value added services will, by definition, operate in markets that the Authority does not regulate, an additional protection has been built into the DCC licence. The DCC will have to identify any regulatory regime covering the proposed service and notify any relevant regulatory body (although many sectors do not have sector specific regulatory bodies). The DCC will have to demonstrate that this notification (where appropriate) has taken place. Should the DCC have any responsibilities arising from operating in certain sectors (for example water) it will, with its counterpart to whom it is offering the service, be treated like any other organisation operating in that field. Such compliance is not in the purview of the Authority's oversight of value-added services. In approving any value-added services, the Authority would be expected to consider the impact of providing the service on the mandatory business and any other relevant impacts on energy consumers, but not the impact of the provision of the service in areas outside of its specific expertise and regulatory remit.
- 2.98. On the question of whether there is potential for some value added services to secure benefits that are non-financial, it remains the Government's view that where a service makes use of infrastructure in place to facilitate DCC mandatory business services (and so funded by DCC users), then income generated from that new service should contribute to the cost of that infrastructure. Ultimately it will be for the Authority to decide whether to approve a value added service and the appropriate share of the value generated by the service that should accrue to energy consumers.

### *General Controls*

- 2.99. The Government agrees with respondents that the approval of material changes to key documents such as the DCC's Internal Control Document and Risk Management Strategy should rest with the Authority. The first such documents will be approved by the Secretary of State, since the Government will appoint the first DCC and will have an intimate understanding of the successful applicant's approach to risk at licence award.

- 2.100. In recognition of the need for the DCC to maintain appropriate oversight of all aspects of its business, including the crucial services delivered by external service providers, *Condition 7.6* expands the remit of the DCC’s Internal Control Document to cover its ‘Authorised Business Activities’ (the previous draft licence referred to covering the DCC’s activities only).
- 2.101. On the demarcation between the DCC and its service providers, it is clear that the DCC licence obligations will apply to the DCC and not its service providers. The contracts between the DCC and its service providers will establish the rights and responsibilities between those parties, including the obligations on service providers to ensure that the DCC can meet its licence obligations.
- 2.102. The Government does not believe it necessary or appropriate to refer to the SEC Panel in *Condition 7 Part A* (requirement for corporate governance arrangements) as this part of the licence deals with the DCC’s corporate governance arrangements. The SEC Panel has a different relationship with the DCC as its role is to govern and administer the SEC, representing user interests with respect to the SEC, not to regulate the DCC’s corporate controls.

### Security Controls

- 2.103. The security arrangements for the DCC continue to evolve through dialogue between Government and stakeholders. The Government’s intention is that a Statement of Security Requirements (formerly called the Authorised Security Standard) will be initially designated by the Secretary of State and form part of the SEC. Any material changes to this statement will be subject to governance arrangements as specified in the SEC. The Government plans to consult on the SEC drafting on security in the SEC Stage 2 consultation.
- 2.104. DECC is continuing to work with the relevant Government security agencies and external stakeholders in developing the detailed security arrangements for the DCC and the entire end-to-end smart metering system. As part of this work, it may be that the DCC takes on new responsibilities as a result of the finalised security architecture to offer encryption services for certain messages for small suppliers. As a consequence, the DCC licence will need further development with respect to security and the Government will maintain a dialogue with stakeholders on this issue.
- 2.105. The Government believes that requiring the DCC to take “all reasonable steps” regarding security in *Condition 8.1* would weaken rather than strengthen the obligations, because the condition is already drafted as an absolute requirement, reflecting the paramount importance placed on security by the Government.

Summary of significant changes between April and November draft DCC licence	
Chapter 2 Nature and conduct of the Licensee’s business	<ul style="list-style-type: none"> <li><b><i>Condition 6.6</i> extends the protection previously applied to existing core communications services to other aspects of the DCC’s mandatory business (e.g. elective services). This protection means that any new service must not materially impact upon the DCC’s ability to provide existing services (see paragraph 2.95).</b></li> <li><b><i>Condition 6.9(b)</i> now requires the DCC to notify any relevant regulatory authority of its intention to launch a value added service (the relevant regulatory authority is any regulator that oversees the market in which an intended value added service would operate in). (See paragraph 2.97.)</b></li> </ul>

	<ul style="list-style-type: none"> <li>• <b>Ongoing regulatory oversight of the DCC’s Internal Control Document (<i>Condition 7.7</i>) and Risk Management Strategy (<i>Condition 7.12</i>) now rests with the Authority and not the Secretary of State (see paragraph 2.99).</b></li> <li>• <b>The DCC’s Internal Control Document must now cover the systems and procedures for the internal control of all of its Authorised Business, including its service providers, and not just its own activities (<i>Condition 7.6</i>, see paragraph 2.100).</b></li> <li>• <b><i>Condition 8.3</i> now refers to the Statement of Security Requirements, which will form a discrete part of the SEC (see paragraph 2.103).</b></li> </ul>
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### Chapter 3: Arrangements for the Licensee’s independence

#### April Consultation Paper

- 2.106. *Condition 9 Parts A and B* was based on standard provisions from existing energy licences. They prohibit the DCC from holding another licence granted under either the Gas Act or the Electricity Act, or, except for limited purposes and with the consent of the Authority, from holding investments in any activity that is not part of the Authorised Business. The DCC is also prevented from carrying out any activity other than the Authorised Business. It was therefore envisaged that the DCC would probably have to be a discrete corporate entity, operationally separate from any company or companies that own it.
- 2.107. *Condition 9 Part C* placed further restrictions intended to ensure that the DCC’s corporate structure does not unduly influence its behaviour. To this end it:
- (i) prohibited the DCC from holding any interest in either DCC Users or Service Providers or any Affiliate or Related Undertaking of such persons; and
  - (ii) prohibited any person that can influence the DCC from having any interest in DCC Users or Service Providers.
- 2.108. The test of influence is whether the person has a “participating interest” in the DCC or whether the person is or is entitled to appoint a director of the DCC. The concept of “participating interest” is already used in existing energy licences in the definition of “Related Undertaking”, and relies on the Financial Services and Markets Act 2000 (“FSMA 2000”) definition. A serious breach of these independence requirements could lead to the DCC’s licence being revoked.
- 2.109. The consultation also asked whether groups of users with similar interests, e.g. suppliers or network operators, should be prohibited from holding a participating interest in the DCC (that is, taken together, a situation where a group of users own more than 20% of the DCC).
- 2.110. An exclusion was proposed for persons influencing the DCC to have de-minimis interests or interests purely for investment purposes (such as through a pension fund that, amongst a wide range of other investments, invested in a DCC User or Service Provider) in DCC Users or Service Providers. This was to avoid inadvertent contraventions.

- 2.111. *Condition 9 Part E* required a number of independent directors drawing on the Authority's review of ring-fencing of network licensees<sup>5</sup>. This was to be reviewed in light of the Authority's conclusions.
- 2.112. Likewise, *Conditions 10* and *11* were similar to conditions in existing energy licences. *Condition 10* prohibited disclosure of confidential information, except as required by the licence or law. *Condition 11* prohibited abuse of the licensee's special position, including a prohibition on undue discrimination in any DCC activity between any persons or classes of persons.
- 2.113. *Condition 12* was also similar to conditions in existing energy licences, and required the DCC to appoint a compliance officer and to produce an annual report on its compliance with *Conditions 9, 10* and *11*. The role of the DCC's compliance officer involves specific obligations reflecting the needs of the DCC's users and external service providers.

## Views of respondents

### *Independence*

- 2.114. A number of respondents were concerned that the independence requirements were unduly restrictive in preventing the use of parent group assets and capabilities. The response to this issue is discussed in paragraph 2.175 as it also relates to procurement.
- 2.115. Another respondent was concerned that groups of users could unduly influence the DCC and suggested that the 20% ceiling on ownership should apply to user groups and not just individual users' aggregate interest.
- 2.116. One respondent argued that *Condition 9 Part D* (on alternative arrangements for independence) should include reference to risk assessment and transparency. Another respondent argued that, if the Authority exercises its discretion under *Conditions 9.12* and *9.13* to consent to alternative arrangements to secure independence, it should first engage with industry stakeholders, perhaps through a formal consultation process.

### *Confidential information*

- 2.117. There was widespread support for the obligations around treatment of confidential information although one respondent argued there should be specific reference to the Data Protection Act in *Condition 10 Part B* which concerns confidential information.

### *Compliance Officer*

- 2.118. One respondent raised a concern that compliance officer reports and independent audits authorised by the SEC panel might cover the same areas, so thought would be needed as to how these interact and which takes precedence. Another suggested compliance officer reports should be pre-approved by the SEC panel ahead of wider general release.

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<sup>5</sup> "Proposed Modifications to the Ring Fence" Conditions in Network Operator Licences", Appendix 13, Ofgem, 25th March 2011

## Response and Proposed Licence Drafting

### *Independence*

- 2.119. Following consideration of consultation responses and further dialogue with stakeholders the requirements on independent directors have been changed. As in other energy licences the DCC will now be required to have two, rather than a majority of, such directors. They are now referred to as “Sufficiently Independent Directors”, a defined term that is used elsewhere in energy licences rather than the more general “independent directors”. Such a DCC director may serve up to six years in this role, with a maximum of one reappointment for up to six more years. There is no restriction on such a director then remaining on the board but they would no longer be counted as a Sufficiently Independent Director.
- 2.120. The Government notes that Ofgem is consulting<sup>6</sup> (until November 2012) on updated proposals for changes to Ring Fence conditions in network operator licences . One proposal is to introduce a new defined term - the ‘Associate’ of a licensee. Associate in the context of the independence requirements has a wider scope than the term ‘Affiliate’ currently used both in network operators’ licences and the draft DCC licence. Should this proposal be confirmed, following Ofgem’s consultation, the Government will consider modifying the DCC licence to ensure consistency with the wider regulatory framework.
- 2.121. The Government remains of the view that there are sufficient protections in place to ensure that groups of users owning an interest in the DCC would not be able to exercise undue discrimination. As argued in the April consultation, the combination of other licence conditions, the requirements of operational governance and the range of divergent interests within any one group of DCC users should, coupled with the protections in *Condition 11* (No abuse of the Licensee’s special position) and its non-discrimination obligations provide sufficient protection against the DCC exercising favouritism.
- 2.122. With respect to the suggestion that *Condition 9 Part D* (on alternative arrangements for independence) should include reference to risk assessment, transparency and possibly consultation by the Authority with SEC Parties: the Government notes that this condition matches those in other licences which do not require formal consultation on individual decisions by the Authority (though it may choose to do so) as there may be confidential elements. However, the Authority may choose to conduct or consult on a risk assessment in appropriate cases.

### *Confidential Information*

- 2.123. The Government does not consider it necessary to refer to the Data Protection Act in *Condition 10 Part B* as legislation applies regardless. The DCC will be expected to take full responsibility for ensuring it meets its responsibilities under a wide range of legislation and it would be impractical and inconsistent with the drafting in other licences to list all legislation that would or could apply to the DCC’s operations.

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<sup>6</sup> See <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=403&refer=Networks/Policy>

Compliance Officer

- 2.124. The Government concurs with respondents saying that the SEC panel, as well as the Authority, should receive reports from the Compliance Officer and has amended the licence accordingly.

Summary of significant changes between April and November draft DCC licence	
Chapter 3 Arrangements for the Licensee's independence	<ul style="list-style-type: none"> <li>The DCC is now required to have at least two, rather than a majority of, Sufficiently Independent Directors (<i>Condition 9.14</i> and paragraph 2.119).</li> </ul>

## Chapter 4: Start-up and future development obligations

### April Consultation Paper

- 2.125. The April consultation said that the Government was continuing to consider the overarching approach to transition in the various stages of the smart metering programme. It noted a range of options for managing the period between the award of the DCC licence through “go-live” (i.e. when its systems are ready to be used) and the subsequent mass rollout period. It further noted that it was likely that when the Government has decided on its overall transition strategy, it will need some form of regulatory underpinning.
- 2.126. One possible mechanism was provided for in *Condition 13* allowing a Smart Metering Transition Scheme to be designated by the Secretary of State. It was anticipated that any scheme would be effected using powers under Section 88 of the 2008 Energy Act and affecting a number of licensees. The scheme might provide for matters required in the period between licence grant and commencement of DCC service provision; those in the subsequent mass rollout period, including the adoption of communications contracts put in place by suppliers for smart meters installed prior to the commencement of the DCC’s services. Other potential options included using the SEC as the appropriate vehicle for transitional arrangements.
- 2.127. *Condition 14* required the DCC to establish and from time to time review and revise its business development objectives and to set them out in a Development Plan covering trends and factors likely to affect its business development. This plan would be approved by the Authority and made generally available. The April consultation anticipated that the DCC would use this requirement to proactively set out ways in which the smart meter market could develop, including “advertising” potential elective services on a multi-lateral basis to its users.
- 2.128. The April consultation noted that the Government remained of the view that moving responsibility for registration services to the DCC from gas transporters and distribution network operators at some future date was appropriate, and *Condition 15* signalled the Government’s intention of this. However, the policy on the transfer of registration needed further work, and the drafting of the condition was therefore necessarily high-level. In transferring this responsibility to the DCC it would be necessary to amend other existing licences and the condition reflected this.

## Views of respondents

### *Transitional Obligations*

- 2.129. Respondents were generally content with the example transition scheme outlined in the consultation and the draft licence. Specific comments raised include a concern around the timing as some elements of policy may still be unclear at the start of the bidding process, an observation that the transition scheme will incur costs for licensee so clarity on this issue throughout the *award process* will be vital to ensure accurate costing and a request that Condition 13.7(d) should include a requirement that any requests for information from the Secretary of State and the Authority should be consistent with Data Protection legislation.

### *Business Development Plan*

- 2.130. There were relatively few comments on the requirement for a development plan. One respondent thought it important some aspects of the plan could be kept confidential and only made available to the Authority, another that the DCC should consult SEC parties.

### *Registration Services*

- 2.131. There was widespread support for the DCC taking on responsibility for registration services although a substantial number of respondents stressed that the time this would take, the complexity involved and the need to amend existing licences to facilitate the change must not be underestimated. There was a suggestion that a change of this nature should be triggered only by market readiness rather than an arbitrary specified target date. It was also stressed that this additional activity must not be allowed to detract from the DCC's primary function.
- 2.132. Two respondents raised concerns about the timeframe for such a change, arguing that there should be appropriate timescales within which industry should implement the changes.
- 2.133. Some respondents suggested that industry now had an opportunity to arrange for the migration of electricity and gas data processing and data aggregation services to DCC at the same time, with necessary improvements in the change of supplier process. One respondent noted the reference to the SEC in *Condition 15*, commenting that the SEC may eventually be the home for governance of registration services but that a more pragmatic approach would be to allow the industry to determine this.

## **Response and Proposed Licence Drafting**

### *Transition*

- 2.134. The Government continues to develop its thinking with respect to transition arrangements. The obligations to be placed on the DCC may be sufficiently limited in number and scope such that they can be captured within licence conditions, or may be more appropriately dealt with in the SEC.
- 2.135. Whatever the most appropriate final mechanism, the DCC is highly likely to have transitional obligations and these are likely to be within the timeframe(s) and scope envisaged in *Condition 13*. Matters it may provide for in the transitional period include switching off and on, or

modifying, various licence and code obligations; making appropriate provision for testing, trialling and adoption of communications contracts; and the resolution of certain transitional disputes. For example, as set out in the SEC Stage 1 consultation published alongside this document, it is likely that the DCC will not be permitted to offer terms for elective services for the period between the award of its licence and its “go-live” date.

- 2.136. The Government does not believe it appropriate to refer to data protection legislation in relation to information requests from Government or the Authority as part of a transition scheme. Obligations on the DCC (and on the Government and Authority) to comply with data protection requirements exist regardless of the licence drafting.

#### *Business Development Plan*

- 2.137. In response to comments from one respondent about the potentially confidential nature of some aspects of the business development plan, the Government notes that the drafting already allows – following consultation with the Authority – the DCC not to publish confidential material (Condition 14.13-14.14). This applies to information about both the DCC and other parties. The Government also notes that the draft licence already has a requirement on the DCC to consult with SEC Parties (in particular) at Condition 14.6.

#### *Registration Services*

- 2.138. The Government welcomes industry support for the proposed shift to the DCC of responsibility for energy registration services and acknowledges the points made about the level of cross-industry effort required. The April draft DCC licence allowed for the Secretary of State to issue a direction to secure the incorporation of registration services between April 2015 and November 2018. Recognising the potential need for the DCC to undertake work prior to April 2015, the Government has removed the reference to a start date, that is the Secretary of State can now issue such a direction anytime before November 2018.
- 2.139. The Government agrees that it will be necessary to plan carefully the interactions between transfer of registration and the ongoing rollout of smart meters. It is highly likely that the introduction of registration services will require changes to the regulatory framework.
- 2.140. The Government agrees that the incorporation of registration services by the DCC offers an opportunity for the industry to undertake a fundamental review of those systems and processes in place and it will work with Ofgem and the industry to develop options and principles for registration services. Preliminary analysis suggests they would become services offered under or pursuant to the SEC. Therefore the revised draft DCC licence retains the reference to the SEC. However, it is almost certain that work to incorporate registration services within the DCC would require changes to many industry licences; if for some reason it transpires that the SEC is not the appropriate contractual vehicle, this point could be modified as part of the likely package of licence changes.

#### **Summary of significant changes between April and November draft DCC licence**

##### **Chapter 4 Start up and future development obligations**

- **The Secretary of State can now direct the incorporation of registration services at any time up to November 2018 (following consultation), previously this could only commence after April 2015 (*Condition 15.2* and see paragraph 2.138).**

## Chapter 5 of the DCC licence: General arrangements for services

### April Consultation Paper

- 2.141. The April consultation paper set out in *Condition 16* the obligations that would apply to the DCC with respect to its procurement activities.
- 2.142. The DCC would be required to procure services known as ‘Fundamental Services Capability’ as defined in *Schedule 1* to the licence. These Fundamental Services would be restricted to the principal data and communication service provider contracts and must always be procured externally. The Government is currently procuring these on behalf of the future DCC licensee. *Condition 16* also required the DCC to procure other services externally except where it would be more economical to provide the service in-house or where the resources involved in providing the service are insignificant. These, together with the ‘Fundamental Services Capability’ are referred to as ‘Relevant Service Capability’
- 2.143. *Condition 16 Part B* established a number of principles that will apply to external procurement. These largely reflect existing statutory requirements for the procurement of utility services, including with respect to *the need* to ensure that the DCC can properly exercise the full range of its functions; the need to take account of the quality, financial standing, and corporate reliability of service providers; the importance of securing value for money; and the need to ensure that appropriate arrangements are in place to secure business continuity.
- 2.144. *Condition 16 Part C* required the DCC to prepare a ‘Procurement Strategy’ document, in a form designated by the Secretary of State, and to take all appropriate steps to comply with it. The remaining parts of the Condition required the DCC to keep its Procurement Strategy under review and to maintain records of all its procurement transactions and arrangements.
- 2.145. Procuring the fundamental services will be a critical activity for the DCC when the initial service provider contracts (negotiated by Government) come to an end. The decisions it takes can be expected to have an impact on the evolution of smart metering and the energy market more generally. It was therefore important to consider how to assess and represent the wider public interest in these procurement exercises.
- 2.146. The decision to procure a particular communications solution could have a significant impact on the reach or quality of service offered by the DCC. In some cases, it may be that the cost of serving the most difficult to reach consumers (for example, those in geographically remote locations) is considered disproportionate and in these circumstances the DCC is likely to have to consider the trade-off between the desire to serve the maximum number of end-users and the total cost incurred by all users.
- 2.147. Different regulated sectors, such as railways and telecommunications, have different approaches to weighing various public policy demands such as the desire for universal coverage balanced against the general need to be mindful of overall costs to be borne by the public. The consultation sought views reflecting experience elsewhere on the inclusion of an appropriate mechanism for balancing various competing public interests when the DCC undertakes these procurement exercises.
- 2.148. The definition of the various services that the DCC will provide continues to be developed as part of the SEC arrangements. The scope of metering equipment with which the DCC will be

required to communicate continues to be considered in parallel through the development of the SMETS.

- 2.149. Under its mandatory business, the DCC will be required to provide core communications services, elective communications services and enabling services. The precise specification of core communication services will be a matter for the SEC, although it was envisaged that these (*Condition 17 Part A*) will be the minimum made available for all compliant smart metering systems in order to achieve the Government's objectives. Elective communication services (*Condition 17 Part B*) would be bespoke services taken by individual users or groups of users.
- 2.150. It was proposed that, to qualify as a core or elective service, the relevant communication should be related solely to the supply or use of energy, reflecting the desire to ensure that smart metering is used primarily for energy/supply related purposes and that any other use would require explicit Authority approval. *Condition 17 Part C* also required the DCC to enrol eligible meters through an Enrolment Service as part of its mandatory business. Enrolment is important as it is envisaged that a meter would need to be enrolled with the DCC before the DCC was required to provide communications services in relation to it. The consultation noted that precisely which metering equipment the DCC will be required or permitted to enrol continues to be considered.
- 2.151. Where a metering system was enrolled with the DCC, the DCC would be required to provide core communication services in accordance with the SEC to any SEC party. It would also be required to respond to service requests for elective communication services and would be permitted to provide value added services (with the Authority's permission). The enabling services necessary to support the delivery of the core, elective and value added communication services (such as enrolment, first line helpdesk services, billing etc.) would also be provided under or pursuant to the SEC. The consultation explained that the scope of these would be defined in the SEC or other associated documents.
- 2.152. *Condition 17 Part D* concerned the provision of communications hubs. This would only apply if the Government concluded that the DCC, through its service providers, rather than suppliers, should be responsible for the provision of communications hubs. This issue was consulted upon in the August SMETS 2 consultation, where the Government sought views on its marginal preference for a DCC led procurement. The Government expects to publish a response to the SMETS 2 consultation by the end of the year.
- 2.153. The April consultation set out proposals for handling requests for different types of service. For core communication services the draft licence (*Condition 17.5*) made it clear that time would be of the essence in making such services available following a valid request. However, it was proposed that for elective communication services (*Condition 17.7*) the DCC must respond to service requests following a two-stage approach.
- 2.154. *Condition 17 Part F* permitted the DCC also to offer value added services to SEC Parties or others, subject to approval by the Authority. The provision of value added services is discretionary but the terms on which they are offered will have to comply with certain provisions of the SEC, which may cover, for example, potential liabilities to other users of the DCC systems. More generally however, value added services were expected to be provided outside the SEC in bilateral contracts between the DCC and relevant users.

- 2.155. The remaining parts of *Condition 17*: required the charges set out in any offer to be consistent with the DCC’s charging methodology and statement of charges; relieved the DCC of the obligation to offer services where the provision of those services could put it in breach of legislation, the licence and/or the SEC; and provided for disputes regarding Core and Elective Communication Services to be determinable by the Authority (permitted under *Condition 20*).
- 2.156. The April consultation set out the Government’s proposed approach to charging for core services, and in particular the requirement for uniform charging for domestic energy consumers but not for non-domestic ones. This was because there is an existing market for such services to non-domestic consumers. Uniform charging for these meters could result in non-domestic customers only in more expensive to serve locations using the DCC’s services. This is because, as an averaged price, the DCC’s charges would be less than that charged by the market in such areas. Non-domestic consumers in less expensive to serve locations would remain with their existing service provider as these would charge less than the DCC’s uniform prices. The net effect would be a cross-subsidy by domestic consumers to the more expensive to serve non-domestic consumers.
- 2.157. *Condition 18* (“Charging Methodology for Services Charges”) required the DCC to have in force a charging methodology which, initially, would be designated by the Secretary of State and incorporated into the Smart Energy Code. *Condition 18 Part C* set out the objectives of the charging methodology, being, in summary:
- Objective 1: that charges in respect of Mandatory Business Services (other than Elective Communication Services) do not distinguish between domestic energy consumers in different parts of GB, i.e. are like “postage stamp” charges;
- Objective 2: that, subject to Objective 1, the charging methodology must: result in effective competition in Supply; not restrict, distort or prevent competition in Energy Efficiency Services, Energy Management Services, Energy Metering Services and Energy Price Comparison Services; not hamper a full and efficient Smart Meter rollout; and reflect costs, including the costs of implementation.
- 2.158. *Condition 19* (“Charging Statement for Service Charges”) required the DCC to have a charging statement for services in a form approved by the Authority. The condition also provided for the review, amendment and publication of the statement.
- 2.159. *Condition 20* (“Determination of disputes by the Authority”) following a similar approach to other energy licences, provided for the Authority to determine disputes between the DCC and SEC Parties concerning the terms on which services are provided or offered to be provided.

## Views of respondents

### *Procurement Obligations*

- 2.160. As noted in the discussion on independence above, some respondents felt it particularly important that the DCC should have the right both to procure services and provide them itself as this would encourage synergies and attract bidders. One respondent also argued that the DCC should be able to self-provide the Data Service Provider functionality.

- 2.161. One respondent felt that taking on government procured contracts would be unattractive to potential bidders and suggested that Government consider making the DCC a managing agent rather than a prime contractor with CSPs and DSPs. In contrast, another respondent wanted greater clarity that Fundamental Services Capability cannot be self-provided in future.
- 2.162. One respondent asked why the procurement strategy, once agreed with the Authority, should be shared with SEC parties, voicing concern that it might contain commercially sensitive information. Another asked for clarity over whether public procurement rules would apply to the DCC.
- 2.163. One respondent said that the DCC should retain records of its procurement for the full length of the licence term rather than the five years set out in the draft licence. The same respondent suggested that a further objective should be to ensure Service Provider obligations with respect to data protection legislation are 'thoroughly drafted within the bi-lateral contracts'.

#### *Role for the Authority in influencing DCC's balancing of competing public interests*

- 2.164. The majority of respondents who commented on this felt the Authority should have little or no role in influencing the DCC on balancing of public interest issues. One was concerned that, having exerted such influence, the Authority might later be in a position of determining related disputes among SEC parties. One respondent thought the Authority's role should be limited to setting out "the overarching strategy of the Government of the day" at the beginning of any major procurement.
- 2.165. Another respondent was in favour of Authority involvement especially as the DCC will procure contracts that may outlast its own licence and which will need to be novated to a new licensee.
- 2.166. Very few stakeholders provided evidence or examples from other sectors. One noted that the NHS, when engaging in public procurements, has the public interest defined by the procuring body at an early stage. Should public interest have an impact during procurement, these changes are applied to all parties entered into the competition. Another noted the Network Rail consultation process model but suggested that clarity would be needed as to who the stakeholders are before a consultation process that is acceptable to all could be developed.

#### *DCC obligations on the provision of services*

- 2.167. One respondent suggested there should be flexibility for the DCC with regard to timescales depending on the nature of the service that was being requested. Two other respondents were concerned that the obligations with respect to enrolment suggested that the DCC may have a duty to offer to make a meter compliant, stressing that this had never been the intended role for the DCC. There was also a suggestion that the reference to "Principal Energy Legislation" in what was *Condition 17.23(a)* should in fact refer to "any" legislation.

#### *Charging Methodology*

- 2.168. One respondent expressed concern that non-domestic services could be charged on a geographic basis, explaining that in existing market conditions most non-domestic services are in fact charged on a uniform basis.

- 2.169. Whilst most stakeholders seemed content with the charging methodology, one noted the importance of an early sight of the DSP and CSP contracts to evaluate the impact of their costs and in turn the effect they will have on the overall methodology.
- 2.170. There was a suggestion from some respondents that SEC parties (as well as the Authority and the Licensee) should be consulted by the Secretary of State prior to the designation of a Charging Methodology.
- 2.171. One respondent argued that there should be a further charging methodology objective, to facilitate “efficient uptake and use of communications services”. Another argued for an objective on transparency to ensure charges can be accurately forecast in a timely manner.

#### *Dispute resolution*

- 2.172. One respondent asked that all dispute resolution be moved into the SEC, as opposed to the provision in *Condition 20* for the Authority to determine disputes between the DCC and SEC Parties on terms offered for services.

#### Response and Proposed Licence Drafting

##### *Procurement*

- 2.173. The Government has further considered how best to ensure that major energy policy issues are, where appropriate, taken into account by the DCC when undertaking its procurement activities. *Condition 16 (16.13-16.18)* of the revised draft DCC licence now contains a new Part C “Public Interest Statement relating to procurement activities”. This obliges the DCC to take account of guidance issued by the Secretary of State in such a statement. The guidance would only apply to the DCC’s procurement of Fundamental Services Capability (i.e. the communications and data service provider contracts) in recognition of the size and potential impact of these procurement exercises on the development of Great Britain’s energy market. The Secretary of State is not under an obligation to always issue such statements but must consult both the DCC and the Authority before doing so.
- 2.174. Notwithstanding the Secretary of State’s ability to issue such a statement, the Authority retains regulatory oversight of the DCC’s procurement through its approval of changes to the DCC’s procurement strategy and power to direct the DCC to revise its procurement strategy.
- 2.175. The draft licence has been amended to allow the DCC to procure services from parent companies or related undertakings where this would be the most economic and efficient option and would be immaterial in terms of its value or resources within the context of its mandatory business. The DCC remains barred from procuring Fundamental Services Capability (i.e. the data and communications service providers) from either itself or related undertakings. This includes future contracts; *Condition 16.5* explicitly states that Fundamental Service Capability must be procured externally, whilst *Schedule 1* of the draft licence defines Fundamental Service Capability as that capability that is delivered via the contracts that are to be listed in Schedule 1. Therefore any future service provision that delivered the capabilities covered by the contracts listed in Schedule 1 would fall within the definition of Fundamental Service Capability and so must be procured externally.

- 2.176. The Government agrees with the comment raised by one respondent that it would be appropriate for the DCC to retain records of procurement activities for the full duration of its licence term rather than just five years and has redrafted the licence accordingly.
- 2.177. As to whether public procurement rules (for example the Utilities Contracts Regulations 2006) would apply to the DCC, although the Government has drafted the procurement obligations with best practice in mind, the DCC's legal obligations extend beyond its licence conditions and it is important that it takes its own legal advice on this and other issues.
- 2.178. On the concern about sharing potentially confidential information in the procurement strategy with SEC parties, the existing drafting provides for the Authority to restrict publication of certain parts of the document if it appears to the Authority "to be necessary for the purpose of protecting the legitimate commercial interests of any person" (*Condition 16.29*).
- 2.179. With respect to one respondent's suggestion that the DCC should be a managing agent for contracts, the Government policy remains the same as set out in the March 2011 Prospectus Response, the September 2011 policy consultation on the DCC and the April draft DCC licence consultation. This is, that the best value for consumers will be delivered by the DCC's having the responsibility for the procurement of service provider contracts and then delivering specified services under the SEC to SEC Parties.
- 2.180. As set out in the April consultation, the Government continues to believe there are clear advantages in allowing energy suppliers to rollout smart meters ahead of the launch of the DCC and, consequently, in making provision for the DCC to enrol those meters and adopt the underlying communications contracts at a later date. Adoption of these contracts will contribute towards the DCC's procurement of fundamental services capability and, as set out in the April draft, will be added to *Schedule 1* of the DCC licence. A new *Condition 16 Part I* 'Adoption of Energy Supplier Communications Contracts' makes provision for the resolution of any dispute between the DCC and energy supplier over the adoption of these contracts. The Government is consulting separately on adoption and enrolment criteria (see [http://www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx)).

#### *Requirements for the provision of services*

- 2.181. Following further development of the SEC a new *Condition 17.2* has been drafted to reflect that contract formation for the provision of most DCC services will occur as a consequence of a party's entry into the Framework Agreement for the SEC (signing the Framework Agreement is a prerequisite to acceding to the SEC). That is, the terms on which most services are provided will be the relevant terms of the SEC itself. As a consequence, Part B 'Terms in respect of Core Communication Services' has been substantially shortened.
- 2.182. The April draft licence allowed the DCC to batch requests – that is, to consider separate requests for service together - for elective services where it would be more economical, efficient and effective to do so. The Government believes this approach might equally apply to other services and has amended the drafting accordingly (*Condition 17.3*). It has also modified the drafting to allow the DCC to batch requests if just one of the tests (economical, efficient or effective) is met as it believes there would be correspondingly greater benefit to the DCC and its users in the efficiency gains realised. The DCC can also now extend the time required to deliver the service if the applicant agrees and not just with the Authority's permission.

- 2.183. A new *Condition 17.4* has been added to the draft licence providing for the reimbursement of earlier customers for particular DCC services by later users, where appropriate. This ensures that so called 'first comers' are not materially disadvantaged by second comers' free-riding on services for which they have paid the development costs. For example, if an elective service request required major software development, the user requesting the service would reasonably expect to pay for that work. If a later user requested a similar service and it would be inefficient for the DCC to repeat the work, the DCC will be able to charge the second (or latter) comer for a proportion of the costs incurred and reimburse the first user. Such an approach already exists in the energy industry, with respect to network connections<sup>7</sup> for example. The SEC Stage 1 consultation, incorporating the draft charging methodology (both published alongside this document), proposes a threshold of £20k to which this condition applies. This means that where a service cost a first comer more than £20k, a later user of that service would reimburse a proportion of that cost to the first comer via the DCC. For services costing less than £20k the DCC would not seek to reimburse the first comer and later users would only be charged the marginal cost that their use of that service entailed.
- 2.184. With respect to elective services, following comments received and for consistency with other licences, the timeframes in which the DCC must respond to requests have been changed to calendar days. The Government now considers it likely that many elective services requests can be dealt with within the initial evaluation period envisioned in *Condition 17.7*. It is still unclear how long more detailed evaluation of more complex requests for service will take; the Government considers that it would be unrealistic at this stage to impose a 28 day deadline upon the DCC and instead proposes that the DCC must conduct more detailed technical evaluations as soon as reasonably practical (*Condition 17.9*).
- 2.185. The Government believes the DCC will have a clear commercial incentive to process these requests as soon as possible. However, if the DCC was consistently slow to act the licence could be modified to impose a stricter timeframe. The DCC will continue to have 28 days in which to prepare the terms for the agreement for services whether following a simple evaluation or the more detailed evaluation discussed above.
- 2.186. Regarding *Condition 17 Part C* (a duty to offer terms for enrolment) the Government agrees that the original drafting was unclear and that the DCC ought not to have a duty to make non-compliant metering systems compliant or to offer terms for such work. This condition has been re-drafted to clarify that the DCC's duty will be part advisory in that it will be expected to inform users of the steps to take to make their meter compliant. If the DCC is able to amend its systems to accommodate a non-compliant metering then it can offer terms for that.
- 2.187. Separately, the Government is consulting on appropriate criteria for the enrolment and adoption of existing smart meters and communications contracts in the Foundation Smart Market consultation available at [http://www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx). As a consequence of this consultation it is possible that further development of the regulatory framework will be required, including the DCC licence, in particular with respect to the adoption of existing communications contracts and on any dispute resolution procedures needed to support the adoption process.

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<sup>7</sup> see the Electricity (Connection Charges) Regulations 2002 (SI 2002/93).

- 2.188. On the suggestion that what is now *Condition 17.32(a)* should include reference to all relevant legislation, the reference to “principal energy legislation” is retained, for consistency with other network licences. The formulation is deliberately narrow as the licensee is unlikely to have any functions (in the usual statutory meaning of that word) outside the ambit of the parent legislation. This does not alter the fact that the DCC will remain bound by provisions of all general legislation that applies.
- 2.189. The obligations on the DCC with respect to Communications Hubs (*Condition 17 Part E*) are likely to be finalised as a result of the August SMETS 2 consultation. The current licence drafting reflects the Government’s current marginal preference as set out in that consultation for DCC-led procurement of these. However, even if this approach is confirmed it is likely there will be further development of the licence condition, for example to include more detail on the technical specification.

#### *Enrolment services – the Statement of Service Exemptions*

- 2.190. The Government has given further consideration to the trade-offs between coverage and cost that the DCC is likely to face once it starts providing services. There may be circumstances in which the DCC will be unable to achieve wide area communication with a small proportion of premises because of either geographical location (that is, areas where the DCC’s communications service providers are unable to provide coverage) or site-specific difficulties (for example buildings with particular features of design or materials that seriously impede the available communications solutions).
- 2.191. In order to ensure that the DCC is not required to spend a disproportionate sum on communicating with these meters, or to reach properties where this is not technically feasible, the draft DCC licence introduces a new concept into *Condition 17 Part C* (Enrolment): the ‘Statement of Service Exemptions’. (Further detail is at *Condition 17 Appendix 1*.)
- 2.192. The statement will set out those categories of premises that the DCC proposes should be covered by the exemption, and the steps it proposes (if any are practicable) which would allow it to provide an enrolment service to such premises without incurring disproportionate costs.
- 2.193. The DCC will be required to publish, maintain, and keep under review this statement following initial approval by the Secretary of State. In assessing whether to approve the statement, the Secretary of State will consider his or her general duties and have particular regard to the national policy objective of securing the widespread take up of smart meters across Great Britain at a reasonable overall cost to energy consumers. Subsequent approvals or amendments to the initial approval must be agreed by the Authority.
- 2.194. The DCC would not then be required to provide services to the premises identified in the approved statement subject to it following any steps set out in the statement and/or taking any other actions that may otherwise rectify the position with the aim of achieving full geographic coverage. The Government would expect that as communications services evolve and as the industry gains further experience from installing smart meters, the number of meters covered by this statement would decrease and would approach zero over time. The Government is considering the potential implications of this for suppliers’ new smart metering obligations.

### *Charging methodology*

- 2.195. The Government is mindful of the point raised by one respondent that, in practice, charges for non-domestic customers in the existing competitive (and non-DCC) market are uniform and therefore not cost reflective with respect to the cost of communicating in different parts of the UK. Nonetheless, the Government still believes it would be inappropriate to impose, by regulation, uniform charges in a market with existing competition. In practice, there is likely to be differential charging to non-domestic properties for each of the three communications service provider regions. The Government does not expect postcode to postcode variations in prices to be an outcome in the service provider procurement process, so there should not be differential prices to non-domestic customers within regions.
- 2.196. In considering its charges, the DCC will need to balance the various applicable objectives: for minor differences in cost it may be more pragmatic for the DCC to apply uniform charges (taking account of the requirement for reflective costs 'as far as is reasonably practicable' (*Condition 18.16 (d)*); for more significant differences it will need to consider the objective to not 'restrict, distort or prevent competition' (*Condition 18.16(b)*).
- 2.197. The government recognises the importance of the charging methodology to potential SEC parties and agrees that they should be included as mandatory consultees prior to its designation by the Secretary of State. *Condition 18.9* has been amended accordingly.
- 2.198. As noted above, in the April draft licence, the first relevant policy objective of the charging methodology (which requires uniform charges for services other than elective services and non-compliant enrolment services to domestic meters) could not be modified without the Secretary of State's consent. Following further consideration of the extent to which Government should retain ongoing power over the DCC licence, the Government has decided to remove this ongoing requirement for consent although the underlying policy remains the same. The Secretary of State retains a power of veto over licence modifications under the Gas and Electricity Acts. The Government agrees with the respondent who suggested that there should be efficient uptake and use of communications services. However, the existing Charging Methodology Policy Objectives include an objective to be cost reflective (*Condition 18.16(d)*), which should help drive the efficient uptake and use of the DCC's communications services.
- 2.199. With respect to the suggestion that the Charging Methodology Relevant Policy Objectives should include reference to transparency, the Government notes that *Condition 18.3* demands that the Charging Methodology is: 'a complete and documented explanation, presented in a coherent and consistent manner, of the methods, principles, and assumptions that apply..' and believes that this will ensure transparency.

### *Charging Statement*

- 2.200. In line with the Government's objective of avoiding continuing powers over the DCC licence beyond the minimum necessary, ongoing approval of the form of the Charging Statement now rests with the Authority (*Condition 19.5*). The initial Charging Statement will be approved by the Secretary of State.

### *Dispute resolution*

- 2.201. In response to the comment from one respondent that *Condition 20* should be removed and all dispute resolution moved into the SEC: the Government does not believe it would be

appropriate to remove this condition. *Condition 20* provides for the determination by the Authority of disputes about terms for services – required under the licence – rather than the more detailed types of disputes that may arise around provisions in the SEC which would be dealt with by the dispute resolution procedures set out in the SEC. To remove this condition would also be inconsistent with equivalent provisions in other energy licences.

Summary of significant changes between April and November draft DCC licence	
<p><b>Chapter 5 General arrangements for services</b></p>	<ul style="list-style-type: none"> <li>• In procuring fundamental service capability (i.e. the communications and data service provider contracts) the DCC must take account of any Public Interest Statement containing guidance on important energy policy matters issued by the Secretary of State (<i>Condition 16.13</i> and see paragraph 2.173).</li> <li>• The DCC may now procure external services (but not fundamental service capability) from related undertakings subject to an efficiency or immateriality test. Previously the DCC could self-provide in these circumstances but not procure from related undertakings. (<i>Condition 16.6</i> and see paragraph 2.175).</li> <li>• <i>Condition 17.4</i> now makes explicit the requirement for the DCC to provide for the allocation and reimbursement of charges between service users, for example where a ‘second comer’ makes use of a service developed on behalf of a ‘first comer’ (see paragraph 2.183).</li> <li>• The DCC will be required to produce a Statement of Service Exemptions (<i>Condition 17.19</i>) setting out those categories of properties at which it would be disproportionately costly or technically impractical for the DCC to service smart meters and what proportionate steps the DCC proposes undertaking to eventually incorporate those smart meters (see paragraph 2.190).</li> <li>• The Secretary of State’s veto over any changes to the First Relevant Policy Objective of the Charging Methodology (<i>Condition 18.15</i>) has been removed (see paragraph 2.198).</li> </ul>

## Chapter 6 of the DCC licence: Arrangements for Core Industry Documents

### April Consultation Paper

- 2.202. Chapter 6 of the April consultation set out the DCC’s arrangements with respect to core industry documents, including both the SEC and other relevant documents.
- 2.203. *Condition 21* (“Compliance with Core Industry Documents”) obliged the DCC to become a party to and comply with a number of gas and electricity industry codes. It was noted that more detailed consideration of the relevant codes would follow. The licence condition also required the DCC to comply with the Fuel Security Code.
- 2.204. In *Conditions 21* and *22* (“The Smart Energy Code”) the DCC was required to be a party to and comply with the SEC but was also required to maintain and have in force the SEC. The purpose of this latter requirement was to ensure that the SEC is always up to date and contained the necessary components and procedures set out in *Condition 22* and *Condition 23* (“Change Control for the Smart Energy Code”).

- 2.205. *Condition 22* set out requirements with respect to the ongoing governance arrangements, secretariat and administration of the SEC. The Government proposed that the DCC should not have voting rights on the SEC Panel and so could not vote on modification proposals, though its views would be sought on their impact. It also defined the objectives of the SEC; as set out in the April consultation these were:
- to facilitate the efficient provision, installation, and operation of Smart Metering Systems at Energy Consumers' premises within Great Britain;
  - to enable the Licensee to comply at all times with the General Objectives of the Licensee, and to efficiently discharge the other obligations imposed upon it by this Licence;
  - to facilitate effective competition between persons engaged in, or in Commercial Activities connected with, the Supply of Energy under the Principal Energy Legislation;
  - to facilitate such innovation in the design and operation of Energy Networks as will best contribute to the delivery of a secure and sustainable Supply of Energy under the Principal Energy Legislation;
  - to ensure the protection of data and the security of data and systems in the operation of the SEC; and
  - to facilitate the efficient and transparent administration and implementation of the SEC.
- 2.206. Recognising that these objectives could conflict, the draft condition specified that the SEC achieves the "Relevant SEC Objectives" if it achieves them in the round, balancing them as appropriate in each particular case and with due regard for energy consumers' interests.
- 2.207. The reference to energy consumers' interests was in recognition of the fact that the SEC arrangements could have a more significant direct impact on consumers than other energy industry Codes. This explicit recognition of the need to have regard for consumer interests would be unique to the SEC. The April consultation also recognised that the inclusion of SMETS as a subsidiary document in the SEC meant that any modifications to the specification to improve outcomes for consumers (for example, changes to the IHD specifications) would have to be justifiable on the basis of the SEC Objectives. Such modifications could not be raised without such justification.
- 2.208. The April consultation discussed adding a general objective related to protecting consumer interests. This looked straightforward in principle and potentially attractive in that it could capture any unforeseen consumer interests not already addressed by the other objectives. However, this risked opening up the scope of the code so widely that modifications could be raised and justified on almost any matter. It also risked diluting the importance of protecting consumer interests because these would have to be balanced in the round against other objectives. The proposal was therefore not to include such an objective.
- 2.209. An objective relating to innovation in Energy Networks was included to reflect the importance of interaction with smart grid arrangements, for which smart metering is intended to be an enabling technology.
- 2.210. The licence conditions also set out the principal contents of the SEC. It was noted that these, along with the governance and administration of the SEC, would be kept under review as the

detail is developed. Draft *Condition 22.23(b)* provided for the Authority to appoint an appropriate Chairperson of the Panel although it noted that this might be subject to later review. *Condition 23* (“Change Control for the Smart Energy Code”) set out arrangements for establishing an effective and transparent compliance and change control framework for the SEC. Particular proposals noted included the ability of the Secretary of State to veto SEC modifications in the period up to 31 October 2018 and the ability of the Authority to put forward modification proposals following a Significant Code Review process. The condition as drafted provided the Authority with relatively broad powers to bring forward modifications; the intention was that the power would be limited to specific, defined areas that will be set out in the SEC. The Government recognised this was unusual for industry codes and was interested in views from potential SEC parties and others on the implications of the condition.

## Views of respondents

### *Compliance with core industry documents*

- 2.211. One respondent questioned whether the need for the DCC to be subject to the listed codes in *Condition 21* had been adequately demonstrated. Another highlighted the need for the DCC to sign up to these codes and sought clarity on the DCC's likely role, the extent of participation, voting rights and funding obligations, suggesting that this be clarified via SMRG Working Group 4. Conversely, one respondent suggested that the IGT Uniform Network Code should be added to the list of codes. This respondent also opposed the idea that the Authority be allowed to appoint a SEC panel chair, commenting that this appointment ought to be the responsibility of the SEC panel itself.
- 2.212. Another asked for examples of an appropriate use of the Authority's derogation powers in *Condition 21 Part E*, to relieve the DCC of industry code obligations. .
- 2.213. A number of respondents agreed that the DCC should be obliged to maintain and keep in force the SEC. One emphasised that this must be enduring and apply to fall future DCCs. One respondent felt this requirement was unnecessary and that a condition to comply with the SEC was sufficient.

### *SEC Objectives*

- 2.214. Most industry respondents were content with the approach in the SEC Objectives to the consumer interest, but a number were concerned that it would not give sufficient certainty that consumer-related modifications, for example affecting the IHD specification, could be justified. Another questioned whether the objectives, as drafted, left the way open for improvements for consumers in affordability and health and safety.
- 2.215. One consumer group respondent raised a number of scenarios, focussing particularly on vulnerable consumers. These included suggestions of how the SEC could provide a means of targeting and supporting customers who self disconnect or who require remotely credited winter fuel payments. They also suggested that health and safety risks such as gas leaks could be tackled using smart data by identifying abnormal consumption patterns. It was argued that a specific consumer objective should be drafted, rejecting the view that this would open the way to spurious modifications being raised. It was asserted that the scrutiny processes of SEC governance would prevent abuse of this objective.

- 2.216. Conversely, Ofgem argued that the proposal (requiring due regard for consumer interests) was superfluous, given the Authority's primary objective. One respondent opposed this entirely, believing the Authority already had sufficient power to protect consumers.

#### *Interoperability*

- 2.217. Three respondents saw some merit in specifying interoperability in the SEC objectives; one said that this was unnecessary and more a function of the SMETS. Another respondent said a single party should have accountability to facilitate and govern system integration.
- 2.218. One respondent was concerned that what was then the third SEC objective, to facilitate effective competition in Commercial Activities, included, services such as energy efficiency and price comparison. This was seen as risking unintended consequences and blurring the key purpose of the SEC.

#### *Change Control*

- 2.219. A significant number of respondents felt that any modifications put forward by the Authority should only follow a significant Code Review process, or that there should at least be an obligation for the Authority to consult prior to raising modifications. One respondent suggested that Authority modifications be limited to those concerning security, consumer protection or stability of service.
- 2.220. One respondent expressed concern that unlicensed parties would have the ability to propose modifications, even though they might not be affected by them. Another argued that modification reports should cover quantifiable and unquantifiable impacts on consumers (e.g. on access for the vulnerable).
- 2.221. Most respondents commented on the Secretary of State's power to block modifications expressed some concern. Some suggested it should only be used as a last resort and follow consultation with SEC parties. One suggested it should not endure beyond 2018, and that any plans to block should be signalled early.

### Response and Proposed Licence Drafting

#### *Compliance with Core Industry Documents*

- 2.222. Following further discussions with stakeholders, the approach to ensuring the DCC works with other industry codes has been revised. Rather than the DCC being a party to them, participants in those codes will be obliged to be party to the SEC and in turn the SEC will oblige provision necessary information to the DCC. Cross code arrangements (the development of which is underway) will ensure that the DCC is consulted prior to any code modification with potential to affect the smart metering framework.
- 2.223. *Condition 21* has therefore been significantly redrafted and includes a reference to *Condition 22.26(b)* (the Smart Energy Code). This new *Condition 22.26(b)* requires inclusion of an additional matter in the SEC, namely provision for the arrangements described above. Similarly, as a consequence of the proposal to incorporate the Statement of Security Requirements within the SEC, *Condition 22.26(c)* includes this Statement as another such matter. The Government retains its view set out in the April consultation that the DCC should

have a licence obligation to maintain and have in force the SEC. Most respondents who addressed this issue agreed. This will ensure that there is always a SEC in place, with separate governance arrangements to ensure the SEC is developed in partnership with industry.

- 2.224. As a consequence of the shift away from direct DCC participation in other codes to a model where the DCC receives the information it requires as a consequence of obligations placed on other parties under the SEC, the derogation power in *Condition 21* has been removed in its entirety (see comment at paragraph 2.212). However, *Condition 22.27* retains a power of derogation against SEC Obligations. The Government now believes this power should rest with the Authority rather than the Secretary of State. It is not anticipated that such a power would be used, but its inclusion is precautionary.

### *SEC Objectives*

- 2.225. The extent to which consumer interests were adequately addressed in the SEC Objectives was the subject of considerable disagreement amongst stakeholders. The Government recognises that the relationship between the SEC Objectives and outcomes for consumers is opaque. It is important to note that the purpose of the SEC is to serve as a contract governing the relationship between industry participants in smart metering but not to govern the relationship between industry and consumers. Nonetheless, the SEC, like other energy industry codes, exists in a regulated framework whose fundamental goal is to protect the interests of (existing and future) consumers. Various interests of energy consumers are protected under the legislation, including price, sustainability and security of supply amongst other matters.

- 2.226. Following analysis of consultation responses the Government has looked in detail at those aspects of the inter-industry relationship that could have an impact on consumers, and identified a gap with respect to the provision of information to help consumers better manage their use of energy. The desire to improve such provision is a key driver behind the rollout of smart meters and it is entirely appropriate that the SEC should have this as an objective. However, on reflection, the Government recognises that the original objectives as drafted might not have allowed for a modification for this purpose unless it also achieved one of the other objectives. A new objective has therefore been drafted to address this gap (*Condition 22.11*) as follows:

“The third General SEC Objective is to facilitate Energy Consumers’ management of their use of Energy through the provision to them of appropriate information by means of Smart Metering Systems.”

- 2.227. The Government notes that stakeholders raised other potential examples where the existing objectives might not capture certain important consumer issues. However, having considered the examples raised, the Government believes that the objectives (including the new objective) are sufficient or that other regulatory tools would be more appropriate. For example, if it were agreed that suppliers should remotely credit winter fuel payments to eligible consumers, it is not obvious that the SEC would need to be modified to accommodate this (suppliers’ usual procedures for crediting customers would apply).
- 2.228. The Government has concluded that respondents were correct in arguing that the draft requirement to achieve SEC objectives with due regard to consumers interests could create

confusion, and has decided to remove this text. The purpose of the other objectives are all ultimately concerned with the consumer interest.

- 2.229. For similar reasons the Government does not consider that an all-encompassing consumer objective would be appropriate. Instead, when considering a modification proposal it will be the act of considering the impact of a proposed modification upon all the objectives that will determine whether the consumer interest as a whole is served in implementing that proposal.
- 2.230. Furthermore, it is important to note that the Authority will make the ultimate decision on whether to accept modifications (excluding non-material ones) and that it must at all times consider its principal objective to protect the interests of existing and future energy consumers.
- 2.231. Following consideration of consultation responses and in recognition of the importance of interoperability to the efficient rollout and evolution of the smart meters, an additional requirement has been added to the first general objective (the new text is in bold for emphasis):
- “The first General SEC Objective is to facilitate the efficient provision, installation, and operation, **as well as interoperability**, of Smart Metering Systems at Energy Consumers’ within Great Britain.”
- 2.232. The Government notes that the definition of Commercial Activities (with reference to the fourth objective in particular) does include e.g. energy price comparison services. However, the Government considers that this is entirely appropriate as such third parties may become parties to the SEC and are expected to play a dynamic role in the evolution of smart metering and the benefits that accrue to consumers.
- 2.233. The requirement in *Condition 22.23* for the SEC to include arrangements for novation to a successor DCC has been expanded upon to include reference to the transfer of rights and obligations to the successor; this is discussed in more detail at paragraph 2.320.
- 2.234. Following further consideration of SEC governance, a number of changes have been made. Provision is now made for the Authority to approve rather than appoint the Chair of SEC Panel (this is to maintain consistency with other codes), for the appointment of one, rather than two, members of the Panel to represent consumer interests and for the establishment of a SECCo Ltd – a simple legal entity capable of contracting for services in relation to the governance and administration of the SEC. These arrangements are discussed in more detail in the SEC consultation published alongside this response document<sup>8</sup>.
- 2.235. On the suggestion that the SEC Panel should report on impacts on consumers, similar to that for climate impacts, the Government believes this would be practically difficult and add little value. There is an established methodology for assessing greenhouse gas emissions; but not for the impact upon consumers, which may be qualitative rather than quantitative and the SEC Panel is unlikely to have the necessary skills and experience to conduct such a formal analysis. Ultimately it will be for the Authority, with its primary objective to protect the interests of consumers, to consider if the proposal will benefit consumers.

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<sup>8</sup> [http://www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx)

### Change control for the SEC

- 2.236. Following further consideration of the circumstances in which a modification may be required, an additional requirement has been added to the fourth requirement to allow urgent modifications.
- 2.237. A new requirement for change control has also been drafted (*Condition 23.13*) so that modification arrangements allow for the timely processing and determination of any modification proposal that arises as a result of a decision of the European Commission or the Agency for the Co-operation of Energy Regulators.
- 2.238. In light of the Secretary of State's powers under Section 88 of the Energy Act 2008 and following consideration of consultation responses, further dialogue with industry and a review of the Government's continuing powers within the DCC licence, the Government has decided to remove the Secretary of State's power to block SEC modifications (formerly *Condition 23.15*). However, in the SEC Stage 1 consultation published alongside this response document, the Government is seeking views on whether it would be appropriate for the Secretary of State to have such a veto contained in the SEC itself for a short, transitional period.
- 2.239. The Government notes the concern raised by one respondent that SEC parties may have the ability to raise a modification proposal without being materially affected by the proposal (whilst other parties may incur a negative impact). However, the Government considers that the need for any proposal to better meet the SEC objectives in the round and the Authority's ultimate power to reject or approve a modification will together ensure that only beneficial modifications will pass. Similar constraints do not typically apply to other codes.
- 2.240. The Government agrees with those respondents who suggested that the ability for the Authority to modify the Code should follow the Authority's Significant Code Review process. The draft DCC licence gives the Authority the power to bring forward a proposal by reference to policy considerations that are specified in the SEC. It is intended that these policy considerations would mirror the Significant Code Review process. The Authority is currently consulting on code governance<sup>9</sup> and the Government would expect that the outcomes of this consultation will inform the final licence drafting.
- 2.241. An additional paragraph has been added to the tenth modification requirement. This tenth requirement is that the modification process must provide for the Authority to have the power to direct the SEC Panel to make a modification of the SEC if:
- a) it has been processed in accordance with the applicable modification arrangements;
  - b) the modification would better facilitate the achievement of the SEC Objectives;
  - c) that directing the modification would be consistent with the Authority's principal objective and general duties under the Principal Energy legislation (i.e. the Gas Act 1986 and Electricity Act 1989).

This new part c) is partly explanatory in that it makes it clear that the Authority's statutory responsibilities will apply in all cases to its consideration of code modifications over and above the text of the licence, as is implicitly the case with other codes.

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<sup>9</sup> <http://www.ofgem.gov.uk/LICENSING/INDCODES/CGR/Pages/GCR.aspx>

Summary of significant changes between April and November draft DCC licence	
<p><b>Chapter 6 Arrangements for core industry documents</b></p>	<ul style="list-style-type: none"> <li>• The DCC is not now required to be a party to other core industry documents (excluding the SEC). Instead the SEC will contain provisions to ensure that the DCC is able to receive the information it requires via SEC obligations rather than as a party to other codes (<i>Conditions 21.6 and 22.26(b)</i>, see also paragraph 2.222).</li> <li>• A new General SEC Objective relating to the provision of information to facilitate consumers management of their use of energy has been added (<i>Condition 22.11</i> and see paragraph 2.225).</li> <li>• The licence now provides for the establishment of a joint venture company, SECCo Ltd to act as the corporate vehicle for the provision of services required for the governance and administration of the SEC (<i>Condition 22.25(c)</i>) and see paragraph 2.234).</li> <li>• A new requirement of the SEC modification process is that it must allow for timely processing of any modification arising from a binding decision of the European Commission or Agency for the Co-operation of Energy Regulators (<i>Condition 23.13</i> and see paragraph 2.237).</li> <li>• The Secretary of State’s power to veto a modification to the SEC has been removed (see paragraph 2.238).</li> </ul>

## Chapter 7 of the DCC licence: Financial and ring-fencing provisions

### April Consultation Paper

- 2.242. The April consultation explained that the conditions in Chapter 7 were drawn from network licences more generally and were intended to ensure that the DCC has at all times the necessary resources in place to effectively deliver the services it is required to offer. However, it was noted that the DCC, designed to be an asset-light organisation, with potential low levels of shareholder capital, requires further obligations on financial security (see *Condition 26* below). In drafting these conditions the Government was mindful of the need to strike a balance between obligations that are robust enough to ensure the ongoing operation of the DCC if it encounters financial difficulties but that are not so burdensome as to deter suitable applicants for the DCC licence or to generate unnecessary costs on service users.
- 2.243. *Condition 24* (“Availability of all necessary resources”) required the licensee to ensure that it has available, either itself or under contract, the financial and management resources, personnel and assets necessary to carry on the Authorised Business, and required the DCC’s directors to certify annually to the Authority whether or not they reasonably expect that this will be the case for the next 12 months. It further required the DCC to certify to the Authority before paying any dividend that the payment of such a dividend would not cause the DCC to be in material breach of conditions of its licence with respect to independence and the Chapter 7 conditions, and to notify the Authority if there is any change in circumstances that could undermine the basis on which certificates have been given.
- 2.244. *Condition 25* (“Undertakings from an Ultimate Controller”) required the DCC to obtain a legally enforceable undertaking from the DCC’s ultimate controllers that they will not take any action that might cause the DCC to breach any of its duties under the licence or legislation.

- 2.245. *Condition 26* (“Financial stability and financial security”) required the DCC to maintain an investment grade credit rating except where the Authority agrees to an alternative form of security. The purpose of this security is to provide assurance that the DCC is in a position to finance its licensed activities in an efficient manner through ready access to sources of liquidity and capital on reasonable terms. The consultation noted that, as the first DCC licence will be awarded by the Secretary of State, it is clearly important that the Authority and the Secretary of State are in regular dialogue during the licensing process in the event that an applicant wishes to propose an alternative form of security.
- 2.246. *Condition 26* also required the DCC to put in place financial security additional to that required to give assurance as to its financial standing. This is intended to ensure the DCC shareholders have a clear interest in the ongoing financial viability of the business, even in challenging circumstances. It was proposed that the amount of this additional financial security (the Relevant Sum) should be established as part of the licence application process.
- 2.247. *Condition 27* (“Indebtedness and transfer of funds”) placed restrictions on the DCC incurring debt or creating charges over its assets except on arms-length, normal commercial terms and for a Permitted Purpose. Given the key position of the DCC within the UK energy infrastructure, the condition was intended to avoid the DCC incurring debt (except in clearly defined circumstances related to its authorised business) that jeopardises its ongoing financial viability.
- 2.248. *Condition 28* (“Disposal of Relevant Business Assets”) prevented the licensee from disposing of, or relinquishing control of, assets that are essential to the mandatory business, including contracts with external service providers. To assist monitoring, the DCC was required to keep a register of such assets.
- 2.249. In addition, *Condition 9 Part A* and *Part B* prohibited the DCC from undertaking any activity other than the Authorised Business unless with the Authority’s consent (largely mirroring the Distributed Network Operator licences). With such consent, the DCC may hold shares in another company but only for the purpose of carrying on the licensed activities.

#### Views of respondents

- 2.250. Most respondents were content with the requirements relating to financial security and provision of a performance bond, with a number emphasising their importance while noting that initial financial stability alone may not be sufficient to ensure high performance.
- 2.251. One respondent suggested that it should be sufficient to offer a parent company guarantee as an alternative to a security bond. Another noted that DCC financial exposure may increase over time particularly as and when it takes on registration services. The same respondent suggested that examples should be provided of the factors that the licensee would draw to the Authority’s attention (in *Condition 24 Appendix 2*) which may cast doubt on the Licensee’s ability to carry on the Authorised Business. It also suggested *Condition 25* be redrafted to provide clarity and avoid the introduction of what it considered to be the confusingly defined roles of Ultimate Controller / Covenantor as these might imply duties with respect to data protection.
- 2.252. Only one respondent argued that a bond was unnecessary, suggesting that the risk of failure, or of a licensee walking away was minimal. It urged consideration of alternative assurance methods such as negative pledges in respect of balance sheet strength.

## Response and Proposed Licence Drafting

- 2.253. The Government recognises that, at least at the beginning of the DCC's licensed term, it is unlikely that it would be able to secure an Investment Grade Credit Rating as set out in the April consultation. Therefore the obligation to secure such a rating has been removed from the draft licence. The DCC will still need to secure an appropriate alternative to demonstrate its financial stability and this will require the consent of the Authority.
- 2.254. Following consideration of consultation responses the Government still remains of the view that a performance bond (or alternative form of additional financial security) is necessary as a result of the relatively asset-light structure of the DCC and its significant position within the GB energy market. Ofgem has also noted that the *Condition 26* requirements with respect to the additional arrangements in respect of financial security perform a similar role to the 'alternative arrangements'<sup>10</sup> for independent energy network operators but differ in terms of the triggers and role of the Authority.
- 2.255. The Government does not consider it necessary or helpful to include examples of the type of factors that the DCC might be required to bring to the attention of the Authority in *Condition 24 Appendix 2* (the certification of the availability of operational resources). This is because such an occurrence is likely to be so specific to a particular set of circumstances that theoretical events listed in the draft licence would offer no clarity. *Condition 24 Appendix 2* does in any case set out those operational resources that the DCC should have available to it. The DCC is now obliged at *Condition 24.4* to include, alongside its certificate, a statement of the main factors that the directors have taken into account in giving that certificate.
- 2.256. The Government disagrees with one respondent's suggestion that the terms Ultimate Controller / Covenantor are confusing and novel as it understands these are long-standing terms in the energy industry. The Government does not believe these conditions are an appropriate place to further expand upon the DCC's responsibilities with respect to data protection as this is more properly a matter for data protection legislation and regulation.
- 2.257. The Government agrees that the level of appropriate cover required by *Condition 26* may change as the DCC's responsibilities grow. However, it considers that the licence already allows for this. For example, if the DCC were to take on a value added service the Authority may require it to increase its arrangement in respect of financial stability and financial security (i.e. the performance bond) as a condition of the Authority's approval if it considered that the DCC might take on more risk as a consequence of providing the value added service. It is also accepted that it may be appropriate to review the level of cover that the DCC provides as part of any transfer of responsibility for registration to the DCC.
- 2.258. In response to the question from one respondent as to whether a parent company guarantee was sufficient as a form of financial security, the draft licence does not preclude this but sets out that any proposal must be approved by the Authority.

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<sup>10</sup> Further information on the 'alternative arrangements' for network operators is available at <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/IDNOs/Pages/IDNOs.aspx>

Summary of significant changes between April and November draft DCC licence	
Chapter 7 Financial and ring-fencing provisions	<ul style="list-style-type: none"> <li>The DCC’s directors must include a statement setting out the factors that they have taken into account in issuing the DCC’s required certification of the availability of all the necessary resources to conduct its business (<i>Condition 24.4</i> and see paragraph 2.255).</li> </ul>

## Chapter 8 of the DCC licence: Provision of regulatory information

### April Consultation Paper

- 2.259. The April consultation explained that *Conditions 29 to 33* were largely standard conditions dealing with the provision of information by the licensee to the Authority and the Secretary of State. They also set out the requirement for the licensee to produce regulatory accounts, to report on quality of service and price control information and to set out the arrangements for any Regulatory Instructions and Guidance. The consultation noted that quality of service in particular will be an important issue for the DCC’s customers and it is through *Conditions 31 and 34* that such information will be made available.
- 2.260. Under *Condition 31* the Authority would – as is common in energy licences – issue detailed guidance on the type of information it required. *Condition 34* requires that the DCC provides an annual report to the Authority on its performance and that of its service providers, and make the report generally available to SEC parties and other interested persons. Under the procedure for preparing the report, the DCC will have to give its service providers an opportunity to comment on the report’s review of their performance before the DCC finalises the report. These conditions will give the Authority the information necessary to monitor the DCC’s performance as well as informing DCC users and other stakeholders.

### Response and Proposed Licence Drafting

- 2.261. The April consultation did not seek answers to specific questions on Chapter 8 and no comments were received. No substantial drafting changes have been made.

## Chapter 9 of the DCC licence: Price Control Conditions

### April Consultation Paper

- 2.262. The April consultation set out certain key issues that would shape the evolution of the price control conditions in the DCC licence:

- From the award of the licence, until DCC go-live, the DCC will need to concentrate on setting up, testing and trialling the services;
  - During this time, it is important that it concentrates on key milestones rather than having its attention diverted into making small improvements in its cost base;
  - Until the time when the DCC starts delivering services, and possibly for some time after that, it may be unclear how Key Performance Indicators (KPIs) for DCC internal costs should be calibrated; and
  - The DCC should be concerned with the overall costs of its data and communication service for smart meters and not be focussed solely on its internal costs. Consumers will be affected by the combination of DCC and service provider costs, so the price control framework must give incentives on the DCC to drive for efficiencies in the service provider contracts as well as internal efficiencies.
- 2.263. The Government was in discussion with Ofgem over the detail of its proposals. The Government recognised the importance of incentivising the DCC to control its costs, but was not proposing direct financial incentives on internal costs for an initial period. On balance, the Government took the view that there are significant risks that direct financial incentives on internal costs could generate unintended consequences and skew the DCC's focus in undesirable ways. Given this, an evolutionary approach was proposed, whereby the development of the price control conditions over time will be informed both by the requirements of users and by the Authority's experience in the development of price controls for other utilities.
- 2.264. Views were sought on the proposed model and possible alternatives for the price control framework. The question of the relationship between the competitive tender process for the DCC licence and the subsequent modification of the "price control" conditions was also recognised as a subject for further consideration.
- 2.265. The form of the "price control" proposed for DCC in the April consultation was that of a revenue restriction<sup>11</sup> – i.e. DCC's maximum allowable revenue would be restricted, rather than setting a limit on DCC's prices.
- 2.266. In view of the fact that the proposed arrangements allowed for pass-through in relation to the efficiently incurred costs, apart from the incentives targeted on the DCC margin, no revenue restriction reopener provision is required in advance. It was expected that after the initial stage of the price controls, the conditions would be revised to allow for the additional incentives to be imposed.
- 2.267. In using the term "initial" the Government took the view that such incentive licence conditions would apply from award of the licence at least until DCC go-live and probably beyond that time. It was recognised that the incentive to achieve a successful DCC go-live will, of course, fall away after that is achieved. The Government would expect that the price control licence conditions would be reviewed once sufficient information was available to enable the design of appropriate Key Performance Indicators (KPIs) and incentives for the

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<sup>11</sup> Hence the Price Control Conditions of the DCC licence will restrict DCC's maximum allowable revenue in any particular year.

- DCC internal costs and/or the DCC was able to propose changes to the service provider contracts which would elicit gains in which it would wish to share.
- 2.268. *Condition 35* set out the definitions used in the Price Control Conditions whilst *Condition 36* set out the Principal Formula by which the DCC's Allowable Revenue is determined. In *Condition 36 Part A* "Duty of Licensee not to exceed its Allowed Revenue", the DCC was expected to take 'reasonable steps', rather than the more common (in energy licences) 'all appropriate steps', to ensure that its revenue does not exceed its defined allowed revenue for the year. However, in recognition that the DCC will, initially, be unclear as to its likely income, and potentially its charging base, this greater level of obligation was not thought to be appropriate.
- 2.269. The remainder of the Condition showed how the allowable revenue is calculated at all stages and with respect to core and elective communication services. The components of that allowable revenue were shown as:
- The DCC's internal costs; in this case this means all of its costs except the costs of its Fundamental Service Capability contracts for data and communications; plus
  - The DCC's external costs; that is the costs of its prime contracts (the Fundamental Service Capability as set out in *Schedule 1* to the licence); plus
  - The Baseline Margin agreed with the DCC as part of the licence award process; plus
  - A sum described as the Baseline Margin Performance Adjustment (BMPA), constructed from a number of potential underlying incentive mechanisms and with a maximum or minimum that could be set as part of the licence award process; plus
  - The External Contracts Gain Share which is the amount of revenue adjustment in respect of gain sharing arrangements in respect of reductions in External Costs; less
  - The Value Added Services Contribution which is a sum being the agreed contribution to users' costs from approved value added services; plus
  - A correction (K) factor based upon the under- or over- recovery of costs in the previous year.
- 2.270. The DCC's Internal Costs were explained to be the costs of providing the DCC's Mandatory Business Services, less the costs of procurement of the Fundamental Service Capability, which are essentially the costs of the service provider contracts. Conversely, the DCC's External Costs were defined as the costs of services provided under the Fundamental Service Capability.
- 2.271. It was expected that the BMPA term would be set to zero initially with the exception of the Milestone Incentive, which was expected to be agreed as part of the licence application process. It was expected that the form of that incentive could be a payment for the achievement of the milestone(s) subject to conditions that other aspects of the DCC performance were satisfactory, to ensure that the DCC does not divert all its efforts into the achievement of the milestones. It was noted that the question of the relationship between the competitive tender process for the DCC licence and the subsequent modification of price control conditions also needs further consideration.

- 2.272. *Condition 38* set out how the external contract gain sharing amount in *Condition 35* would be determined. It was expected that this condition will be turned off initially and that the value, in respect of any proposal by the DCC for changes in the service providers' costs or performance will be negotiated at the time that the DCC makes such a proposal to the Authority. Such gain sharing would have to be based upon action taken by the DCC to reduce external costs but not just the operation of KPIs in the service provider contracts where reductions in cost would be passed through to the users. It would also be necessary to determine how the gain in reduction of service providers' costs is shared between the service provider(s), the DCC and users.
- 2.273. *Condition 39* set out how the value added service contribution in *Condition 35* would be determined. This adjustment would have no effect until such a time as the DCC has a value added service approved by the Authority.

#### *Interaction between Licence Application Regulations and DCC's Revenue Restriction*

- 2.274. The April consultation explained that the licence application process will determine a number of commercial parameters that will ultimately need to be reflected within the DCC's revenue restriction. For example, these may include the level of margin the DCC is allowed on internal costs, and the overall amount of revenues placed at risk through any incentive arrangements, which may be capped and floored.
- 2.275. The consultation also noted that whilst these parameters will be determined through the licence application process, the ongoing regulation of the DCC will be by the Authority. Furthermore, it explained that it is expected that, in light of operational experience, the DCC's price control would be reopened by the Authority at some point during the first licence period.
- 2.276. The April consultation said that the Government expected to make a clear distinction between those parameters that it is expected would be periodically set by the Authority, and those considered to be part of the package set as part of the licence application process. It also noted that any changes made by the Authority under its normal powers would be subject to the standard procedural protection of an appeal to the Competition Commission in the event of a dispute between the DCC and the Authority.
- 2.277. The April draft DCC licence therefore had a number of areas of interaction with the licence application and grant process. First, where the licence grant is contingent upon the DCC performing certain additional obligations related to the initial establishment of the organisation, it was expected that such obligations would be included in Schedule 3. Where financial parameters (e.g. DCC margins, caps and floors on incentive regimes etc.) are determined as part of the licence application process, these would be reflected in the principal price control conditions, with other parameters, such as the detail of specific performance incentives, potentially being set subsequently by the Authority within the scope of the parameters agreed as part of the application process. Finally, a number of documents required to be produced pursuant to licence conditions would need to be in place on grant, or shortly after grant. In either case, it was expected that the relevant documents would need to be developed as part of the licence application process, where appropriate also involving the Authority, such that they could be put in place in the requisite timescales. Examples include the initial DCC charging statement, its internal control

document (*Condition 7 Part B* referred) and any alternative and additional arrangements in respect of the licensee's financial stability (*Condition 26* referred).

#### Views of respondents

- 2.278. Many of the responses sought clarification rather than opposing or putting forward proposals. One suggested that the focus should be on DCC managing its external costs rather than internal costs, noting that the bulk of its costs as a contract management body will be external. Another suggested that DCC progress towards milestones should be shared with users on a regular basis. A third was concerned at the complexity of the revenue restrictions, the risk they posed to the licensee in terms of charging and the potential for fines. They repeated their earlier suggestion that DCC be a managing agent rather than a prime contractor with service providers.
- 2.279. Another respondent emphasised the importance of the Authority being adequately resourced to ensure compliance with DCC revenue restrictions. On this subject there was one suggestion that the Authority should retain the right to disallow DCC costs that are manifestly inefficient in the period prior to go live.
- 2.280. Regarding KPIs, one respondent suggested that those listed were sufficient for commencement but that more will need to be developed as DCC service is established. Another two respondents felt it would be a challenge to structure a KPI around areas like contract management as these were difficult to measure.
- 2.281. One respondent felt that the SEC was not the right place for DCC KPIs as these would be the responsibility of the Authority rather than the SEC panel. Furthermore, KPIs as part of the SEC would be subject to the SEC modification process which, the respondent felt, was intended for modifications to industry arrangements rather than commercial performance measures.

#### Response and Proposed Licence Drafting

- 2.282. The Government's thinking on the price control conditions has continued to evolve as a result of consideration of the consultation responses (which were broadly supportive of the evolutionary approach outlined in April) and further dialogue with Ofgem. The following section explains how it is envisaged that elements of the drafting of these conditions will be finalised as part of the licence application process, what the implications of this are for the DCC and how it is expected that the arrangements will change over time following licence grant. In summary, the key issues are:
- Upon licence grant, it is expected that the DCC will, with some important exceptions, operate on a cost pass through basis, i.e. that the majority of its internal and external costs will be simply passed through to its users, subject to the Authority being satisfied that the costs were efficiently and economically incurred;
  - Applicants for the DCC licence will be able to propose that revenues to cover certain costs be agreed for a fixed period of time as part of the licence application process (Predetermined Internal Costs);

- The cost-pass through arrangement will also initially be supplemented with one or more milestone incentives aimed at incentivising DCC to contribute to timely “go-live” of its services. The Government is continuing to develop the details of the milestone(s) and the structure of the incentives around them;
- The Government will, through the licence application process, seek to develop other incentive arrangements and it is envisaged by the Government that a more comprehensive incentive framework would be switched on some time after the initial services had been established and had bedded down;
- As is the case with other energy industry licences, the price control conditions, like all conditions in the licence, can be modified by the Authority following the appropriate process. However, in recognition of the need to provide a stable regulatory framework for the DCC, the Government has worked closely with Ofgem in developing the price control conditions to ensure close alignment over the optimum approach to the regulation of the DCC’s revenue. Furthermore, the Government retains the ability through its powers under Section 88 of the Energy Act 2008 (see paragraph 2.59) to make modifications to the DCC licence until 2018.

2.283. The DCC’s total allowed revenue for a given year is calculated through the ‘Principal Formula’ set out in *Condition 36.5*. This says that the Allowed Revenue (AR<sub>t</sub>) in year t, is:

$$AR_t = EC_t + PIC_t + PTC_t + VIC_t + BM_t + BMPA_t + ECGS_t - VASC_t + K_t$$

- EC<sub>t</sub> means the actual amount of the DCC’s External Costs, as calculated for Regulatory Year t by the Licensee (see paragraph 2.285);
- PIC<sub>t</sub> means the total amount of the DCC’s Predetermined Internal Costs agreed as part of the licence application process (see paragraph 2.287);
- PTC<sub>t</sub> means the total amount of Pass-Through Costs incurred by the DCC’s in Regulatory Year t (see paragraph 2.295);
- VIC<sub>t</sub> means the actual amount of the DCC’s Variable Internal Costs, as calculated for Regulatory Year t by the Licensee (see paragraph 2.285);
- BM<sub>t</sub> means the DCC’s Baseline Margin for Regulatory Year t (see paragraph 2.290);
- BMPA<sub>t</sub> means the Baseline Margin Performance Adjustment (see paragraph 2.291);
- ECGS<sub>t</sub> means the amount of revenue adjustment in respect of External Contract Gain Share, as calculated for Regulatory Year t (see paragraph 2.293);
- VASC<sub>t</sub> means the amount of the Value Added Services Contribution, as calculated for Regulatory Year t (see paragraph 2.294); and
- K<sub>t</sub> means the correction factor (see paragraph 2.296).

2.284. The underlying structure of this formula is designed to allow DCC to pass through the costs of carrying out the mandatory business, supplemented by a number of targeted incentives.

It is important to note that the Price Control Conditions are silent on the way in which DCC should set its charges in order to recover its allowed revenue. The structure of DCC charges is a separate issue and is dealt with elsewhere in the licence (primarily *Conditions 18 and 19*) and hence the discussion in this chapter focuses on DCC revenues and not DCC charges.

- 2.285. In the above formulation, subject to the exclusion of any costs that the Authority does not consider to be economically and efficiently incurred, the DCC is permitted to pass through its external costs (EC) and variable internal costs (VIC). As a consequence of this, prior to the introduction of a more comprehensive set of incentives on DCC to appropriately manage both internal and external costs, it is intended that regulatory scrutiny will be the principal mechanism through which assurance that DCC's costs are both economic and efficient will be delivered.
- 2.286. In undertaking its review of DCC costs, the Authority will have the discretion to make reference to the business plans submitted by DCC as part of the licence application process (and as subsequently amended thereafter as part of the ongoing business planning processes). Precisely how the Authority would undertake its review of DCC costs is a matter for the Authority itself. Ofgem has been engaged in the development of the price control conditions and is considering how best to communicate its approach to applicants for the DCC licence. *Condition 37* of the DCC licence also sets out additional provisions covering this process, i.e. whereby DCC is required to submit a report containing relevant information to the Authority, and the Authority may disallow costs that it considers were not economically and efficiently incurred; and that it may issue guidance in relation to such matters.
- 2.287. The Principal Formula also provides for DCC's revenues in relation to certain internal costs to be determined during the licence application process for a discrete period of time. These internal costs, known as Predetermined Internal Costs PIC may be determined by reference to a combination of parameters fixed as part of the licence application process (e.g. an interest rate), whilst others may be determined by reference to actual outturn values (and in which case this element of the cost determination would also be subject to an economic and efficient test by the Authority).
- 2.288. The purpose of the PIC is twofold. Firstly, it allows DCC licence applicants to directly bid in their expected underlying costs for those aspects of their business that they considered it reasonable to forecast, capitalising on the competitive pressure of the licence application process. In doing so the successful DCC would then bare the risk that it had underestimated that cost (and conversely would benefit if it over-performed) but would have much greater regulatory certainty that, for the period over which it was agreed that cost item would be determined, it would not be subject to further regulatory review. Such an approach also reduces the regulatory burden on Ofgem and will allow it to focus on the DCC's variable costs.
- 2.289. It will be important to ensure that DCC does not initially have a disproportionate incentive to minimise internal costs at the expense of managing external service provider cost and performance. As a consequence, the scope of DCC internal costs that it is appropriate initially to determine in this manner may be limited.

- 2.290. The Baseline Margin term ( $BM_t$ ) in the DCC licence reflects the intention that the DCC would be permitted to earn a margin on economically and efficiently incurred internal costs. Again this is something that it is intended to establish as part of the licence application process and write into the licence to have effect from licence grant.
- 2.291. The BMPA term ( $BMPA_t$ ) is the principal term through which the consequences of DCC's performance incentives affect DCC's allowable revenues. The April consultation set out a potential approach to the underlying construction of the BMPA that could include milestone incentives, sliding scale incentives based around the DCC's internal costs and potential system volume incentives associated with the total number of a successfully delivered system messages. The April consultation also proposed a potential cap and floor mechanism that place limits on the maximum increase or decrease in the DCC's allowable revenues.
- 2.292. Having considered consultation responses, the Government recognises that the exact mechanism for performance incentives within the DCC licence may be subject to further refinement. This may include, for example, further consideration over what aspects of the incentive regime and incorporated within a price cap or floor. Therefore the detail in *Conditions 36.8 and 38 (Part B onwards)* is considered to be prematurely specific and has been removed from the draft licence. The licence application process will allow the Government to test potential mechanisms with applicants before including the detail in the issued licence. The Government will continue working with the Authority and future DCC users as appropriate to consider other possible incentives to be included in the price control conditions that can be "turned on" at a later date.
- 2.293. Similarly, with respect to the ECGS term, the detail in *Condition 39 (on the determination of external contract gain share)* from Part B onwards has been removed. As with *Condition 38*, whilst the Government considers it important to include a mechanism for sharing benefits between the DCC, service providers and users, it recognises that the optimum formula for delivering that mechanism may arise out of the licence application process and that the inclusion of the level of detail in the April draft licence is premature ahead of that dialogue with applicants in the competitive process.
- 2.294. The value added services adjustment term  $VASC_t$  will be zero prior to the Authority granting consent for DCC to provide any value added services. From licence grant this term would be capable of being agreed with the Authority where such consent is given.
- 2.295. The pass through costs term  $PTC_t$  is the sum of the DCC's licence fees (under *Condition 4*) and the payments it must make to SECCo Ltd for purposes associated with the governance and administration of the SEC within the regulatory year (see paragraph 2.234). These are costs the DCC would expect to pass through and would not be subject to an economic and efficiently incurred test as they are not within the DCC's control.
- 2.296. Finally, as set out in the April consultation the correction factor  $K_t$  has been included to adjust the allowable revenues in a given year 'year t' for any over or under recovery against allowed revenue from the previous year ('t-1'). Also included within the  $K_t$  factor is an adjustment for any bad debt arising in the previous year through the  $BDC_{t-1}$  term (see *Condition 36.10*). In practice, because  $K_t$  is determined by reference to the difference between actual revenue and actual costs in the prior year, any bad debts would be capable of being passed through. The effect of the BDC term is to disallow bad debt where DCC

fails to fully comply with its obligations to manage SEC parties' credit cover or bad debt under the SEC, and in which case it takes the value determined by the Authority following the formula set out in the SEC for this purpose. This term therefore provides for DCC to be prevented from passing on certain bad debts where it has failed to act appropriately under the SEC, and in the event that such bad debts arise.

#### *Future Changes and interaction with the Licence Application Process*

2.297. As is the case with other energy industry licences, once the initial licence is granted, the Authority has defined powers under the Gas and Electricity Acts to make changes to licence conditions. This means that the Authority will be responsible for regulation of the DCC's allowable revenues into the future. However, the Government and Ofgem recognise the importance of providing a stable regulatory framework for the DCC and have worked together to ensure alignment on the most appropriate approach to regulating the DCC. The Government will seek Ofgem's active engagement in the licence application process run by the Government, so that the DCC will have a reasonable understanding of the Authority's likely approach to the duration and levels of firmness over which various parameters are fixed, and that such matters are more widely communicated as appropriate.

#### *Schedule 3*

2.298. Another section of the licence that it is envisaged would be completed as part of the licence application process is Schedule 3. This provides for any commitments made by the DCC as part of the licence application process to be captured within the licence and to be made binding on the licensee. It is possible that no such matters arise out of this process, and in which case there will be no need to include any matters in this schedule. However the types of things that may be considered appropriate for inclusion may, for example, include undertakings on mobilisation etc. given by DCC as part of the application process.

#### *Liabilities*

2.299. As is explained in Section 4.2.14 of the SEC Stage 1 consultation document, it is possible that, depending upon the final position reached on the treatment of limitation of liability under the SEC and Service Provider contracts, the DCC might face a position whereby:

- i) there is a breach of the SEC by a SEC Party which results in a consequential breach by the DCC of one of its service provider contracts; or
- ii) there is a breach of a service provider contract by a service provider which results in a consequential breach of the SEC by the DCC,

and in either case where the DCC is liable for damages which exceed those that it can claim from the person causing the original breach, the net liabilities for the DCC will be recoverable from SEC Parties.

2.300. If this situation exists, the Government is of the view that it would be appropriate to allow the DCC to pass through any such costs to SEC parties (i.e. its users), subject to the DCC having taken any action to mitigate any losses to the extent that is within its control. So, for example, if the DCC's contractual liabilities to a service provider, incurred as a result of the action of a SEC party, exceeded the amount it could recover from that SEC party, it would be able to spread the remainder of the amount of damages across SEC parties generally.

Similarly if the actions of a service provider resulted in the DCC having liabilities under the SEC, and the damages due exceeded the amount the DCC could recover from the service provider, then the DCC could recover those costs from SEC parties generally. As a consequence, such costs should be considered to be economically and efficiently incurred by the Authority for the purposes of the price control conditions. In the event that liabilities arise as a consequence of a breach caused by the DCC which is not a consequence of the actions of a user or service provider, it will be for the Authority to consider in the circumstances of the case whether such costs should be permitted to be passed through.

Summary of significant changes between April and November draft DCC licence	
Chapter 9 Price Control Conditions	<ul style="list-style-type: none"> <li>A new <b>Condition 37 (Monitoring and assessment of the Licensee’s costs)</b> requires the DCC to submit a report to the Authority on its cost performance with respect to external, fixed internal and variable internal costs against those proposed in its licence application (see paragraph 2.286)</li> </ul>

## Chapter 10 of the DCC licence: Arrangements for intervention and continuity

### April Consultation Paper

- 2.301. Chapter 10 of the April draft licence included four conditions. The first, *Condition 41*, dealt with Management Orders for the Licensee. The purpose of this condition was to allow the Authority to intervene in the strategic management of the DCC to rectify actual or likely material failings in the way in which the DCC is being run. The overall objective was to ensure continuity of the DCC’s services to users, given its importance, in the same way that the special administration regimes for the electricity distribution networks aim to ensure continued secure and safe operation of the networks in the event of an insolvency.
- 2.302. The failings that might need to be rectified through a Management Order are matters of a serious nature, and the powers given to the Authority are correspondingly wide, although subject to a strict test of necessity and appropriateness. At the same time, the condition was drafted without prejudice to the Authority’s exercise of its more wide-ranging enforcement powers by means of statutory orders and financial penalties under the energy legislation.
- 2.303. The April Consultation explained that it is unlikely that *Condition 41* would be needed if and when legislative changes are made to put in place a Special Administration Scheme (SAR) for the DCC, so the Government would review its continued position in the licence if and when such a regime has been implemented.
- 2.304. There are two circumstances in which a Management Order might arise. The first is if the Authority considers that Other Revocation Event 5 has arisen, or is likely to arise, i.e. that the DCC has or is likely to contravene a condition of its licence or any statutory requirement in a manner or to an extent that is so serious as to make it clearly inappropriate for the DCC to continue to hold the licence, with the intervention designed to pre-empt these circumstances. The second is where there are significant financial or operational failings in the way DCC is carrying on the Authorised Business that are capable

- of redress but for which the DCC has not itself taken appropriate action. In either case, the Authority would have to be satisfied that it is appropriate to take action under *Condition 41* in all the circumstances.
- 2.305. The sorts of actions that it was proposed that the Authority might undertake included: requiring the removal or suspension of directors and their replacement with specified individuals; requiring the DCC to secure that an activity or function is performed as specified in a management order; providing for the Authority to appoint an adviser to the DCC whose recommendations must be followed; and requiring the DCC to release emergency funds from security that it has been required to put in place under *Condition 26*.
- 2.306. The consultation explained that the proposed powers for the Authority (which stop short of an actual hands-on operational management role) under *Condition 41* had been introduced to provide for a regime in which, in the unlikely event that they are needed, action can be taken to correct any material failings in the DCC which stops short of licence revocation. This would ensure the ongoing delivery of an important service relied upon by consumers. The April consultation stated the Government's view that, as an enduring alternative to these arrangements, it would be preferable to introduce primary legislation when possible to implement a Special Administration Regime for the DCC.
- 2.307. *Condition 42* placed obligations on the DCC in relation to the expiry and handover of the licence. These included a requirement on the DCC to prepare a draft handover plan that includes those matters necessary to ensure a smooth transfer of responsibilities from the DCC licensee to its successor. It was expected that this plan would include arrangements for the novation of service provider contracts and the transfer of Intellectual Property Rights.
- 2.308. The April consultation noted that the Government considered that whether or not TUPE arrangements would apply to the DCC is a matter of law, and that there is no need to include any further explicit drafting on these matters. Insofar as a "bond" is concerned, the April draft intended that the DCC will be required to put forward a degree of financial security under *Condition 26* which would provide assurance that it would comply with its licence obligations generally, including those relating to handover.
- 2.309. *Condition 43* dealt with Intellectual Property Rights (IPR). This condition was required so that the DCC takes into account the potential impact of IPR on existing and future integration of services, future competition in the provision of services and the needs of successor DCCs and successor Service Providers.
- 2.310. Finally, *Condition 44* set out the scope of the matters in the DCC licence that it was proposed should potentially survive for a period of two years after the end of the DCC's licence term for the purposes of ongoing handover to a DCC successor. These obligations would help ensure that the DCC's successor could operate effectively following some unforeseen event not sufficiently accounted for in the handover plan.

#### Views of Respondents

- 2.311. One respondent said management orders should be for a time limited period and challengeable, another said they should be dropped once an appropriate SAR came into

- being. Another argued that the Management Order condition should be dropped in its entirety and replaced by an SAR introduced in the 2013 legislative timetable.
- 2.312. Regarding IPR, three respondents wished to clarify that some pre-existing IPR which may have been used to deliver services may need to remain the property of the organisation who originally owned it and should not necessarily transfer with the licence.
- 2.313. Regarding business handover one respondent suggested inclusion of TUPE arrangements for transfer of staff upon handover of licence and urged that redundancy liability should not lie with the outgoing DCC in the event that no successor is in place to take over. They suggested also that the requirement to provide assistance following expiry must be clarified regarding staffing. For example, if a previous DCC's existing workforce have already transferred to the successor then the previous DCC should not be put to expense in meeting the *Condition 44* obligations. Another respondent questioned how licence conditions could survive revocation of the licence.
- 2.314. A number of respondents recognised that there will be a need for obligations which endure for a period post handover to allow for resolution of issues raised near the end of an outgoing licensee's period in post.
- 2.315. Another respondent asked for annual consultation on the handover plan, not just at the initial stage.

## Response and Proposed Licence Drafting

### *Management orders*

- 2.316. The Government continues to hold the view that a Special Administration Regime (SAR) would be preferable to a reliance on management orders for serious financial or operational failings on the part of the DCC. The Government remains committed to putting such a regime in place, subject to parliamentary time and, ultimately, approval. Nonetheless, in the absence of such an SAR it considers the management order condition is vital to provide some protection against a serious failing on the part of the DCC.
- 2.317. A number of drafting modifications have been made to the management order condition. *Condition 42.1* now says that the Authority may "make and keep in place a Management Order for as long as is necessary and appropriate (but no longer)" where previously it said "take action". The purpose of this change is to make clear that such an order would only be made in extreme circumstances and for no longer than was clearly necessary.

### *Interaction between the management order condition and a future Special Administration Regime*

- 2.318. An SAR is preferable to reliance on management orders because, if the DCC's problems were such that it could not avoid insolvency proceedings, then substantial consumer detriment might occur. To be successful, intervention by the Authority using a management order would have to take place early enough to avoid reaching that point. Thus a management order is not a direct substitute for an SAR, although it provides some degree of protection.

- 2.319. To provide certainty over the future regulatory framework, a sunset clause has been added at *Condition 42 Part D* (Duration of this condition) so that the condition would fall away if and when an SAR regime is in place. It is important to note that the Government will want to ensure that the replacement regime, including the SAR, addresses all the risks to consumers covered by the management order approach, including both financial failings and serious operational failings.

*Arrangements for the handover of business*

- 2.320. The Government agrees that it is important to ensure there is provision for the management of SEC compliance issues (and other matters) during the transition from one DCC to another. The revised draft licence requires the handover plan to provide for a legally enforceable arrangement between the incoming and outgoing DCCs such that the former takes on the latter's liabilities (or money owed) but allows the latter to represent its own interests in any dispute.
- 2.321. The purpose of this is to provide SEC parties with a single legal relationship (the active DCC) and so avoid potentially complex simultaneous arrangements between both an outgoing and incoming DCC and SEC parties. (The level of complexity is further increased if we consider the parallel contractual arrangements between the DCC and service providers: there could be a contractual link between monies owed by or to service providers via the DCC (the licensed entity) to SEC Parties. Again, having a single legal relationship for SEC Parties should minimise the uncertainty that such complex relationships can give rise to.)
- 2.322. Following further consideration, the Business Handover plan must now (at *Condition 43.18(d)*) also include the DCC's approach to dealing with all records, systems, documents, software, databases, information, and data held by it in connection with the carrying on of the Authorised Business (including the prevention of any third-party access to such things or, where the Authority so directs, the permanent deletion of any or all of them) prior to the expiry of its licence. This is to help ensure that any confidential data is not made available to unauthorised parties once the DCC licence has expired.
- 2.323. Also to facilitate the smooth handover between incoming and outgoing DCCs, *Condition 43.23* enables the Authority to direct that one or more licence conditions will cease to have effect during the Handover Period. The Handover Period will be notified by the Authority to the DCC and will cease on the Expiry Date (when the licence expires or is revoked).
- 2.324. The Government notes concerns raised by one respondent that, if the DCC model were to change such that there was no successor DCC, the incumbent DCC may face certain liabilities with respect to redundancies. The Government considers that there is a low risk of such a change of law or policy and that it is appropriate for this risk to lie with the DCC licensee.
- 2.325. The proposed approach to handover has not materially changed since the April consultation, but for clarity the approach is summarised below:
- The initial DCC licence has a nominal term of 12 years;

- As set out in paragraph 2.36 the licence term is capable of being extended at the Authority's discretion (and following consultation with the DCC) for up to an additional 6 years either:
  - (i) to facilitate a competitive tender process for the appointment of a successor DCC;
  - (ii) to support handover to a successor;
  - (iii) to ensure timing of DCC replacement does not clash with a major service provider re-procurement; or
  - (iv) if there are wider energy industry considerations that make extension appropriate.
- The Authority must give advance notice of any extension (6 months where the extension is up to 1 year, and 1 year for extensions of greater than a year). Only one extension of greater than one year is permitted;
- The outgoing (incumbent) DCC is required to produce a Business Handover Plan, approved by the Authority, setting out how it would hand over the Authorised Business to a successor, and to review and update the plan at least annually;
- The outgoing DCC's handover obligations, beyond the quite detailed work required in the preparation of a Handover Plan, will start at the beginning of the Handover Period as notified by the Authority. This period may start before a new DCC is awarded a licence. During the Handover Period the outgoing DCC will take steps to facilitate the handover of business (as set out in its Handover Plan);
- During the Handover Period the DCC may continue to provide services and to receive revenue for those services until the Authority directs that one or more licence conditions will cease to have effect (see paragraph 2.323 above);
- As a consequence of the contents of the Handover Plan, the outgoing DCC is likely to have run-off obligations for a period of time after handover of the principal business, requiring it to provide ongoing support for the successor and complete business termination (as mentioned above this may include destroying confidential data, for example). These obligations would be in effect during the nominal or an extended term of the initial licence, depending upon which approach the Authority considered most appropriate;
- Any obligations on the successor licensee to prepare for handover would be governed by the (as yet unwritten) conditions of the successor licence. It is important to note that it is highly likely that there would be two DCC licencees during the Handover Period. However, only one would have active licence obligations with respect to the provision of services. It will be for the Authority to determine when this obligation should switch between outgoing and incoming DCC (this is the Transfer Date in *Condition 43.7*);
- The Authority has broad powers relating to handover aimed at allowing arrangements to be tailored to the circumstances. These include being able to direct changes to the Handover Plan and requiring the two DCCs to enter into contractual arrangements covering handover;
- The performance bond from the outgoing DCC would be released after the Authority was satisfied that handover had been successfully completed;
- At the end of the Handover Period (the Expiry Date) the outgoing DCC's licence would ultimately expire and its obligations would fall away.

*Intellectual Property Rights*

- 2.326. In response to comments received during the consultation and further analysis, the Government recognises that pre-existing IPR, or that created by service providers, may not be transferable on a royalty free, payment free basis. Therefore the drafting has been modified to require that any IPR used by the DCC (other than that created by the DCC) be novatable to successor DCC's on terms that are not materially disadvantageous relative to those that had applied to the original DCC if so desired by the incoming DCC. Any IPR created by the DCC must still be novated to a successor DCC on a payment free, royalty free and non-exclusive basis.
- 2.327. Following further policy development around SEC governance, *Condition 43 Part D* (IPR arising under the SEC) has been modified such that IPR that arises under the SEC will now be owned by the SECCo Ltd upon its creation. This would not apply to IPR owned or created by the DCC or service providers in the provision of services but rather to the content of the SEC itself (as noted above this would still be available to future DCC's). This condition also allows the SEC Panel to licence such materials for any use that does not hinder, delay or frustrate the continuing achievement of the General SEC Objectives.

*Former Condition 44: Survival of certain conditions of the licence*

- 2.328. The Government continues to believe that the efficient and effective handover of responsibility from an outgoing DCC to an incoming DCC will require obligations to be placed on the outgoing DCC, even after it has ceased providing services. However, the Government no longer believes *Condition 44* (Survival of certain conditions of the licence) in the April consultation is necessary to achieve this end. Furthermore, there is some legal uncertainty over its enforceability after a licence was handed back or revoked. This condition has therefore been deleted.
- 2.329. As is explained above the outgoing DCC will still, in *Condition 43* (Expiry of Licence and Handover of Business), be required to assist the Authority, industry and an incoming DCC in the transition to a new DCC.

Summary of significant changes between April and November draft DCC licence	
<p><b>Chapter 10 Arrangements for intervention and continuity</b></p>	<ul style="list-style-type: none"> <li>• The management order condition now contains a sunset clause such that the condition will cease to have effect when an appropriate Special Administration Regime is in place for the DCC (<i>Condition 42.17</i> and see paragraph 2.318).</li> <li>• <i>Condition 43</i> now provides for the handover of rights and liabilities between an outgoing and incoming DCC (<i>Condition 43.15</i> and see paragraph 2.323).</li> <li>• The licence obligations in relation to IPR now require the outgoing DCC to ensure that IPR arising from external service provider contracts are transferred to an incoming on terms that are materially the same. The previous draft required that the incoming DCC had the rights to use this IPR for free (<i>Condition 44.5(b)</i> and see paragraph 2.326).</li> <li>• What was the former <i>Condition 44</i> (Survival of certain conditions of the licence) has been deleted in its entirety (see paragraph 2.328).</li> </ul>

## Part 4 of the DCC licence: Schedules to the Licence

- 2.330. The April draft DCC licence included three schedules. *Schedule 1* set out the Fundamental Service Capability. The consultation noted that the definition of Fundamental Service Capability would develop in the light of additional information on the detail of the initial service provider contracts. Essentially, it is intended to cover the underlying services that the DCC will always be required to procure externally, namely data and communications services.
- 2.331. The relevant contracts in *Schedule 1* are expected to include the initial contracts for data and communication services in addition to any communications contracts adopted by the DCC from suppliers.
- 2.332. *Schedule 2* set out a proforma for the Deed of Novation for external service provider contracts. It is intended that all such contracts would include provision for novation of the contract to a successor DCC substantially on the terms set out in the deed of novation.
- 2.333. *Schedule 3* provided a framework for the inclusion of a number of matters established as part of the DCC licence application process. On initial grant it is anticipated that the DCC could be a relatively skeletal organisation which has been appointed on the basis of commitments made as part of the licence application process to fully establish the organisation shortly after licence grant. Where any such commitments are made and form an important part of the decision making in the licence application process, it is proposed to include them as enforceable licence obligations on the DCC in this schedule.

### Response and Proposed Licence Drafting

- 2.334. The April consultation did not seek specific views on the schedules and did not receive any comments. Further drafting developments include a transparency requirement in *Schedule 1* for the DCC to publish its legacy procurement contracts and any other external service provider contracts to which it is a party (subject to confidentiality requirements in those contracts). *Schedule 2* now also includes a requirement (as per the discussion at paragraph 2.332) for the novation of all rights and liabilities from an outgoing to an incoming DCC.

### 3. Next Steps

- 3.1. The DCC Licence will be awarded following the competitive application process set out under the Electricity and Gas (Competitive Tenders for Smart Meter Communication Licences) Regulations 2012 ('the Regulations') that have been developed taking into account the offshore transmission experience and other relevant best practice for running procurements and similar competitions. The Regulations set out the licence application process itself, with detailed requirements for each stage being published at the commencement of that stage in the associated competition documentation.
- 3.2. The Regulations set out the required procedure for each of up to four stages of the application exercise. Each stage will have a declining number of bidder participants until a single successful applicant is selected, to whom the DCC Licence will subsequently be granted. The application process is as follows:
- The first stage ('Qualification') is designed to eliminate applicants who are not qualified to fulfil the role of Licensee and to ensure that the proposal stage contains a manageable number of participants.
  - Qualifying bidders will be invited to submit detailed proposals for how they would establish and run the DCC during the 'Proposal' stage. A short list will progress to the BAFO stage (see below), if required; otherwise a preferred applicant (and one or two reserve applicants, if appropriate) will be selected.
  - The optional Best and Final Offer (BAFO) stage will open with detailed dialogue with the selected qualifying bidders, who will then be asked to submit a best and final offer. The objective is to select, against pre-defined evaluation criteria, a 'preferred applicant' and up to two 'reserve applicants'. While optional, it is anticipated that in the first competition we will use the BAFO stage to discuss and negotiate with remaining bidders.
  - Preferred Applicant: Once any outstanding issues have been addressed, the single 'successful applicant' will be identified and subsequently granted the DCC Licence during the Preferred Applicant stage. The target is to grant the first DCC licence in mid-2013.
- 3.3. The intention is to award the DCC licence for a fixed term of 12 years. The DCC will subsequently be replaced by a new DCC appointed following a separate competitive application process. The first exercise will be run by the Government. It is intended that all subsequent competitions are run by the Authority.
- 3.4. The draft licence will be finalised through dialogue with applicants for the licence and as policy in certain areas continues to be refined, in particular in response to other consultations. Of most direct relevance to the DCC licence will be future consultations on the SEC, but others will also have an impact. For example, the August 2012 consultation on SMETS 2 sought views on whether procurement of the communications hub should be the responsibility of the DCC. Similarly, the Foundation Smart Market consultation seeks views on enrolment and adoption criteria and the resolution of disputes on those matters. Those areas that the Government considers most likely to further evolve have been highlighted in this response document. As the

draft licence evolves the Government will continue to engage with Stakeholders, in particular through the Smart Meter Regulation Group<sup>12</sup>.

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<sup>12</sup> [http://www.decc.gov.uk/en/content/cms/tackling/smart\\_meters/industry/reg\\_groups/reg\\_groups.aspx](http://www.decc.gov.uk/en/content/cms/tackling/smart_meters/industry/reg_groups/reg_groups.aspx)

## **Annex 1 Draft DCC licence (published as a separate annex)**

The draft DCC licence is published separately alongside this document at [www.decc.gov.uk/en/content/cms/consultations/cons\\_smip/cons\\_smip.aspx](http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx)

