



Smart Metering Implementation
Programme - DCC Licensing Team
Department of Energy and Climate Change
3 Whitehall Place
London
SW1A 2AW

*Promoting choice and value for
all gas and electricity customers*

Date: 24 November 2011

Dear Colleagues,

Ofgem's response to DECC's consultation on the detailed policy design of the regulatory and commercial framework for the Data and Communications Company (DCC)

Introduction

We welcome the opportunity to respond to DECC's consultation on the policy design for DCC. As the gas and electricity market regulator, our principal objective is to protect the interests of existing and future gas and electricity consumers, wherever appropriate by promoting effective competition. As such, we have an important role in helping to ensure the interests of consumers remain protected, both during the transition to smart meters and once DCC is licensed. We will also play a key role in monitoring and, where appropriate, enforcing compliance with the new DCC licence conditions and associated regulatory framework. We are therefore providing advice to the Smart Metering Implementation Programme ('the Programme') during the implementation phase.

As you know, Ofgem E-Serve managed the policy design phase of the Programme on behalf of DECC. This concluded with the publication of the Government's Response in March 2011 ('the Response') which set out the high-level policy design for the new central data and communications function. We agree that the DCC model as outlined in the Response is a central element of the smart meter roll-out, and will facilitate interoperability of meters and efficiency of the arrangements associated with smart metering.

This consultation is a positive step in developing the commercial and regulatory framework that will govern DCC. However, we consider that further work is needed to ensure that the regulatory and commercial design of the DCC model is coherent and integrated with existing regulatory frameworks. This is important to protect the interests of existing and future consumers and for the long-term competitiveness of GB energy markets. We are committed to continued constructive engagement with the Programme on the further work needed to develop and refine those frameworks. There are three key themes that we believe need particular attention.

Key themes

(a) A clear and robust regulatory framework

We welcome the progress that the Programme, in conjunction with stakeholders, has made so far to develop policy proposals for DCC's role and the obligations and incentives that will govern it. The scope of regulatory change needed to support the creation of a DCC is significant and will be fundamental for the future operation of the energy market.

We believe it is important that the new arrangements governing DCC are consistent with and complement the existing regulatory framework for metering to form a coherent, robust and enduring regulatory framework. This should help to ensure that new obligations being placed on parties are both appropriate and enforceable. We therefore consider it necessary for the Programme, supported by Ofgem and industry, to review the existing commercial and regulatory framework for metering to determine the scope and scale of change needed to current frameworks to deliver the Programme effectively. Mapping the existing arrangements into the new frameworks would help to:

- identify any gaps or overlap in the framework that may need to be addressed with regulatory or contractual solutions;
- identify where changes may have unintended consequences; and
- define more clearly DCC's position within the new framework and inform the regulatory design stage of DCC policy development.

(b) Specifying the parameters of the DCC commercial model

We support the Response's conclusion that DCC should be established as a commercial business, financially incentivised to achieve service standards, but with the necessary safeguards against abuse of its privileged position. As detailed below, we consider that aspects of the DCC commercial model are underdeveloped.

To secure the most efficient outcome from the competitive tender process to grant a licence to DCC and ensure that DCC is a commercially sustainable entity, the commercial model must be viable and attractive to potential applicants. Key to this is clarity of obligations and achieving a fair balance between DCC's exposure to risk and reward. Risk should generally sit with the party that is best placed to manage it and the scope for reward should be commensurate with the risk the licensee is exposed to. In our view, further work is needed to ensure that the obligations on DCC are clear. For example, the current proposals on adoption criteria for communications contracts may not provide sufficient certainty to enable applicants to formulate a competitive bid. Having clear obligations will help ensure value for money for consumers because it will avoid parties that bid to be DCC including a risk premium because of uncertainty. Understanding DCC's risk profile (relative to its users and service providers) and the behaviours that DCC is expected to demonstrate to earn additional revenue will be key to ensuring an efficient tender outcome.

Allowing DCC to provide elective and value-added services can increase the benefits of the smart meter roll-out, by allowing for flexibility and innovation in the market and reducing costs to gas and electricity consumers. It is important that appropriate protections are in place to ensure that:

- core operational delivery is not compromised;
- DCC cannot derive an unfair commercial advantage in related markets or discriminate between types of users; and
- the benefits flow back to consumers (via lower DCC charges).

DCC's service provision and the extent to which it is able to derive commercial benefits from its elective and value added services will be key to ensuring the viability of DCC and enabling future market developments. We look forward to continued constructive engagement with the Programme to help ensure the commercial model is sustainable.

(c) Market development- Enabling future benefits of smart metering for consumers

Smart metering has the potential to enable the energy market to evolve to provide many benefits to future consumers, such as:

- the development of new products and services, such as innovative tariffs and tailored energy efficiency advice;
- the development of smart grids, providing for actively managed distribution networks;
- the potential for greater demand-side response (eg dynamic tariffs Introduced by suppliers and reserve capacity arrangements); and
- the centralisation of further activities within DCC where there is a business case (eg electricity data processing and aggregation).

DCC will have a key enabling role in these areas, so it will be necessary to ensure that the framework being developed to regulate DCC's activities is sufficiently adaptable to facilitate such future innovations. We recognise the complex and difficult trade-offs that the Programme must make in procuring communication and data services. This includes the need to accommodate uncertainties regarding potential future demands for DCC services in a way that delivers economic efficiency for end consumers. It is important to ensure that the services procured are scalable and can be adapted to accommodate future developments so that service providers do not oversize the initial WAN services and pass the costs of that inefficiency through to consumers. Including an option value for access to greater capacity and better performance in the evaluation criteria for the WAN service provider contract is likely to enable efficiency.

We recognise the importance of the work that the Programme has done with stakeholders to understand the current requirements for DCC's services. Industry participants are best placed to quantify the costs and benefits of their requirements for DCC's services and this work should help inform the specifications that the Programme adopts on behalf of industry to undertake the procurement. The Smart Grid Forum is committed to playing a key role in helping the Programme understand future smart grid requirements.

Concluding thoughts

We support the Programme's commitment to introduce changes to the regulatory framework that are workable at an early enough stage to enable an efficient competitive tender process to grant a licence to DCC. Regulatory certainty will be an important factor in delivering the Programme efficiently. We welcome your constructive engagement with us and other stakeholders thus far in the regulatory design phase of this work, and look forward to further discussions in the coming months.

Yours sincerely