

Smart Metering Implementation Programme

Consultation on the Draft DCC Licence and Licence Application
Regulations

5 April 2012

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The consultation can be found on DECC's website:
http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx.

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Executive Summary

The Government's vision is for every home and smaller business in Great Britain to have smart electricity and gas meters. Domestic consumers will also be offered an In Home Display. The rollout of smart meters will play an important role in 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.

Consumers will have real time information on their energy consumption to help them control energy use, save money and reduce emissions. There will be an end to estimated billing and switching between suppliers will be smoother and faster which will be beneficial to many customers. New products and services will be supported in a vibrant, competitive, more efficient market in energy and energy management. Suppliers will have access to accurate data for billing and to improve their customer service. They will also be able to reduce costs, for example by reducing call centre traffic, removing the need for a site visit to read meters and better manage debt. Energy networks will have better information upon which to manage and plan current activities and the move towards smart grids which support sustainable energy supply.

Smart meters will be rolled-out over two implementation phases; the Foundation stage and Mass roll-out stage. During the Foundation stage, which began last year, the Government is working with industry, consumer groups and other stakeholders to ensure all the necessary groundwork is completed for the Mass roll-out stage. The Mass roll-out stage is expected to start in 2014 and be completed in 2019. The Foundation stage is crucial to the successful mass roll-out of smart meters, because it provides the opportunity for suppliers and others to learn from early experiences in installing and operating smart meters in practice. Some consumers will receive smart meters during the Foundation stage, as the energy suppliers start up their programmes in preparation for the Mass roll-out stage. The majority of consumers will receive their smart meters during the Mass roll-out stage.

The Data and Communications Company ("DCC") is a key element of the Government's approach to rolling out smart meters in Great Britain. The principal role of the DCC will be to provide communication services with smart meters at all domestic gas and electricity consumer premises. The DCC will be appointed through a competitive process and will be responsible for enabling service users (energy suppliers, energy network companies and other parties for specified purposes) to communicate remotely with smart electricity and gas meters through the contracts it procures and manages.

A consultation on the detailed policy design of the regulatory and commercial framework for the DCC was published in September 2011. The responses to that consultation have informed the development of the conclusions set out here. The Government's response to the views expressed by those who responded to questions relevant to the DCC's licence are included throughout the text.

Views are now sought on the draft DCC licence and on the draft Licence Application Regulations which provide the regulatory framework for the award of this licence.

The DCC Licence

The DCC licence will be the key tool used by the Gas and Electricity Markets Authority ('the Authority') as the regulator overseeing the conduct of the DCC. The licence establishes the overall objectives for the DCC which are to ensure efficient delivery of communication services to smart meters under the new Smart Energy Code (on which there is a separate consultation in parallel with this one); and to facilitate effective competition in the energy market, innovation in energy supply networks and price reductions. As the DCC is not a consumer-facing body, the Government does not propose to give it a consumer related objective; instead it will serve consumers indirectly through providing efficient and effective services to suppliers and networks.

The DCC's services are grouped into core and elective communications services, associated enabling services, and value-added categories. Core communication services, provided to all DCC users as

appropriate to their role in the market, must be provided at a standard ('postage stamp') charge to service users for meters at domestic premises throughout GB, regardless of geographic differences in the cost of providing the service. This is to ensure customers are not disadvantaged in terms of access to the benefits of smart meters as a result of their location. Elective communications services (i.e. other communications services connected with energy supply, provided at the service user's request) should facilitate competition in energy supply and related activities and have charges reflecting costs. Enabling services are those things that DCC undertakes in support of the provision of Core and Elective Communications services, and may, for example include the provision of a helpdesk and enrolment services. Value added services are potential future services not relating solely to energy supply but which may use the underlying DCC capabilities and whose provision must be authorised by the Authority.

It is anticipated that, in its early operational phase, the DCC will focus on getting itself established in a robust and effective manner. Its initial service offerings are likely to be the core communications services alongside associated enabling services necessary for establishment, such as enrolment. As the DCC becomes more established it would be expected to become more proactive in developing its service offerings, moving into elective and then, potentially, value added services.

The licence draws where appropriate on existing energy licences but has some novel features reflecting the unique position of the DCC within the energy industry.

The DCC will be appointed following a competitive licensing process run under the Licence Application Regulations. As a consequence, unlike typical existing licences, it is proposed that the DCC licence will be granted for a fixed, non-rolling term (for 12 years, with a potential 6 year extension).

The licence consists of terms relating to its grant and revocation (including handover requirements to ensure the efficient transition from an incumbent DCC to a successor) and a range of conditions covering the following issues:

- The division of the DCC's licensed business into mandatory business (comprising the provision of core and elective communications services as well as associated enabling services) and permitted business (comprising the provision of value added services and minimal services);
- Obligations to offer certain types of smart meter communication services and restrictions on undertaking other types of activities;
- Security obligations, such that it maintains an adequate and proportionate level of security on its systems and assets;
- Independence requirements, such that the DCC would not be unduly influenced by its users or service providers;
- Start-up and transitional obligations, giving powers for the DCC to be involved in smart meter market readiness activities;
- High-level principles controlling how the DCC is allowed to charge its users for its mandatory business services;
- An obligation to maintain and comply with the Smart Energy Code which will set out the detail of its conduct and those of its service users;
- Price control licence conditions, which will limit the amount of revenue the DCC will be able to recover from its users for operating its mandatory business, and set appropriate incentives for increasing efficiency while maintaining the DCC's financial viability; and

- Provisions to ensure continuity of service in the event of a serious deterioration in the DCC's financial health by providing for the Authority to intervene in certain circumstances. (It should be noted that the Government believes the best solution would be to establish a full special administration regime for the DCC. However, this would require primary legislation and will not be available at the launch of the DCC.)

It is also proposed that the DCC licence could be revoked in the event of serious underperformance.

The draft DCC licence is published alongside this consultation as a separate annex (Annex 3).

The Licence Application Regulations

The DCC will be granted its licence following an open and transparent competitive application process, the regulatory framework for which will be provided in the DCC Licence Application Regulations ('the regulations').

The regulations are based on best practice for such competitive tenders in the energy field (including for offshore transmission) and elsewhere. The regulations are high-level, setting the context for running the licence application process; the Secretary of State (acting through the Department of Energy and Climate Change) will run the first process with the Authority taking over this role in the future.

The process will involve four mandatory stages: qualification; proposal; best and final offer; and preferred applicant. Each stage will have a declining number of bidder participants until a single successful applicant is selected, to whom the DCC licence will be granted.

Qualification: following an open advertisement, the qualification stage is designed to identify those bidder-applicants possessing the minimum qualifications to fulfil the licence and to eliminate all others not meeting these minimum criteria. It will focus on an applicant's capability and capacity to perform the role, rather than the specifics of its proposal to establish and run the DCC. For the first licence application, the Secretary of State will limit the number of qualified applicants invited to the next stage of the tender process to a pre-determined maximum number of the best qualified.

Proposal: Qualifying bidders that have passed the first stage will be asked to submit detailed proposals (including on costs and performance management) for how they would establish and run the DCC against the service requirements defined in the application documentation and the wider licence conditions and SEC. These proposals will be evaluated against published criteria so as to determine a 'preferred applicant' and 'reserve applicants', or if appropriate, to shortlist those applicants who submitted the best proposals and invite them to participate in the 'best and final offer' stage, where the 'preferred applicant' and 'reserve applicants' will be determined.

Best and Final Offer (BAFO): The optional BAFO stage will be applied at the discretion of the Secretary of State (or the Authority for future applications). It is the stated intention of Government to include a BAFO stage within the first licence application process, given the increased complexity of the first licensing competition and the start-up obligations on the first licensee. The BAFO stage will entail detailed dialogue with the remaining applicants, with a view to testing that the service requirements are deliverable through their proposals; confirming acceptance of Licence and SEC obligations; and establishing taut pricing through best and final offers. The objective is to be able to select against pre-defined criteria a preferred applicant and at least one reserve applicant.

Preferred Applicant: This stage will involve licence finalisation with the preferred applicant and, as required, with one or more reserve applicants if progress is not achieved with the preferred applicant, with a view to the Government nominating a single successful applicant to be awarded the DCC licence.

The draft DCC Licence Application Regulations are published alongside this consultation as a separate annex (Annex 4).

Related publications

In addition to this consultation and its separate annexes, the Government is publishing a number of other documents related to the Smart Metering Implementation Programme, available at http://www.decc.gov.uk/en/content/cms/tackling/smart_meters/smart_meters.aspx.

General information

How to respond

The Government invites and welcomes any comments including supporting evidence and arguments that you have on the draft licence and application regulations in this consultation paper.

Responses should be clearly marked: *consultation on the draft DCC Licence and Licence Application regulations*. Responses and any enquires related to this consultation should be addressed to:

Smart Metering Implementation Programme – Regulatory Design Team
Department of Energy & Climate Change,
3 Whitehall Place,
London, SW1A 2AW
Tel: 0300 068 5895
Email: smartmetering@decc.gsi.gov.uk
Consultation reference: URN 12D/030

Additional copies:

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Issued: 5 April 2012

Respond by:

For the questions on the DCC licence (questions 1-14), responses are requested **by 1 June 2012**.

For the questions on the Licence Application Regulations (questions 15-18), responses are requested **by 16 May 2012**.

Territorial extent

This consultation applies to the gas and electricity markets in Great Britain. Responsibility for energy markets in Northern Ireland lies with the Northern Ireland Executive's Department of Enterprise, Trade and Investment.

Confidentiality and data protection

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on our website at www.decc.gov.uk/en/content/cms/consultations/. This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

Quality assurance

This consultation has been carried out in accordance with the Government's Code of Practice on consultation, which can be found here: <http://www.bis.gov.uk/files/file47158.pdf>

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

DECC Consultation Co-ordinator
3 Whitehall Place
London SW1A 2AW
Email: consultation.coordinator@decc.gsi.gov.uk

What happens after the consultation

Following the close of the consultation the Government will summarise and consider stakeholder responses to the proposals. We will then update the draft DCC licence, the proposed licence application process and the Licence Application Regulations as appropriate.

The Government plans to lay the Licence Application Regulations before Parliament in the summer of 2012. Over the summer the Government will also publish (for information only) the qualification documentation for the initial licence competition.

The Licence Application Regulations are expected to take effect towards the end of the summer. Following this, the Government will commence the initial DCC licence competition via advertisements in the national and international press inviting bidders to submit a completed qualification questionnaire.

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1. Introduction

Policy Context

- 1.1. The Smart Metering Implementation Programme (“SMIP”) is the central programme established by the Government to oversee the design and implementation of the arrangements necessary to facilitate the rollout of smart meters in Great Britain.
- 1.2. In July 2010, the Government and Ofgem jointly published The Smart Metering Prospectus¹. Two hundred and seventy-nine responses were received and in March 2011, the Government and Ofgem published a response to the Prospectus consultation. Among other things, this document confirmed that the communication of data to and from smart metering equipment in the domestic sector will be managed centrally by a new organisation, referred to as the Data and Communications Company (the “DCC”).
- 1.3. A further consultation paper² was published in September 2011 (the “September consultation”) consulting on the regulatory framework for the DCC, including: the Prohibition Order, which will amend the Gas Act 1986 and the Electricity Act 1989 (collectively, “the Acts”) to create the licensable activity of the DCC; the DCC licence; and the Smart Energy Code.
- 1.4. The purpose of this document is to consider responses to the September consultation document and to consult on a draft of the DCC licence (which is published separately as Annex 3 to the document) and a draft of the Licence Application Regulations (published separately as Annex 4). A consultation on the Prohibition Order was published on 10 February 2012 for response by 23 March, and a consultation (“the SEC consultation”) on the contents of the Smart Energy Code (“SEC”) is published alongside this document at http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx. Stakeholders with an interest in the DCC licence are also encouraged to read the SEC consultation as the SEC sets out the detailed rules applying to interactions between the DCC and its users. The SEC will also include more general rules applying to smart meters even if the DCC does not communicate with those particular meters.
- 1.5. It is important to note that this is a consultation on the proposed licence and Licence Application Regulations and whilst the accompanying narrative in the consultation document explains the policy context, it is not intended to provide guidance or interpretation of the legal text of any future licence drafting. The final licence text and regulations will take precedence over any comment here.

Use of the term “smart meter” in this document

- 1.6. The rollout of smart metering in Great Britain requires the introduction of several new legal documents and defined terms. “Smart Meter” has been defined in the draft prohibition order to mean any gas or electricity meter and associated devices with remote communications capability. In this document we use “smart meter” or “smart metering” in a more general sense to mean typically a smart metering installation by a supplier acting under its rollout licence obligations.

¹ http://www.decc.gov.uk/en/content/cms/consultations/smart_mtr_imp/smart_mtr_imp.aspx

² DECC, A consultation on the detailed policy design of the regulatory and commercial framework for DCC, September 2011

Overview of the DCC

- 1.7. 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.
- 1.8. In the March 2011 response, the Government concluded that the DCC should be created as a new licensed entity and that a single organisation will be granted a licence to provide services within the domestic sector throughout GB. The licence will be granted for a fixed term through a competitive licence application process. It is proposed that the initial licence will be granted by the Secretary of State and that, as the holder of a gas and electricity licence, the DCC will subsequently fall under the regulatory aegis of the Gas and Electricity Markets Authority (otherwise referred to as “the Authority”, or “Ofgem”).
- 1.9. Initially the DCC’s activities and services will be limited to those functions that are necessary and essential 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. In the future, meter point and supply point registration responsibilities may be transferred to the DCC. Initially, the DCC will access existing registration systems as part of its verification of which parties are authorised to access which meters. This will be important in ensuring 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 long-term.
- 1.10. The Government has decided that, rather than the DCC itself providing the services, best value for the consumer will be derived by ensuring the separation of its service and contract management roles from the principal operation delivery roles. The DCC will not therefore be permitted to deliver communication services directly but will be required to competitively procure the principal resources (specifically data and communication services) required to enable it to deliver its mandatory business services to users. To deliver the early establishment of DCC’s services and bring forward the benefits, the Government decided to initiate procurement of the data and communication services on behalf of the future DCC licensee and in parallel with running the process to identify the first DCC licensee. Once appointed the DCC will be required to enter into contract 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.
- 1.11. Under its licence, the DCC will provide a range of services. These services will be split between Mandatory and Permitted business functions, together comprising the ‘Authorised Business’ of the DCC. The Mandatory business will include ‘core’ and ‘elective’ communications services as well as other enabling services set out under the SEC. These enabling services will include enrolment and, potentially, the provision of communications hubs (see further discussion at paragraph 4.272 below). The Permitted Business will comprise the provision of ‘value added services’ (which includes, amongst other things, any communications services which are not solely related to the supply or use of energy) and a minor category of minimal services. The service types are discussed in more detail in paragraphs 4.116-4.123 below.
- 1.12. It may be prudent for the early operational phase of the DCC to require a focus on ensuring that it is robust and stable. If so, the DCC is likely therefore to concentrate initially on ensuring that its working arrangements with its service providers and service users are effective. Similarly, in

its early operational phase the primary service offerings would be the core communications services and enabling services such as enrolment and potentially the provision of communications hubs, in addition to discharging other obligations under the SEC, with a move towards expanding provision of elective services over time. The SEC consultation (see paragraph 1.4 above) discusses the timeframe for these developments in more detail.

- 1.13. In recognition of this need, in the first instance, to focus on ensuring a stable and robust DCC, the incentive mechanisms for the DCC will initially be limited in scope, becoming more wide-ranging as the DCC becomes more established. This approach will allow the DCC to focus on reducing costs and providing more innovative services at the appropriate stage in its development without impacting upon its stability in the crucial start-up phase.
- 1.14. In addition, the DCC will be obliged to be a party to and comply with a new Smart Energy Code (or “SEC”). This code will, amongst other things, detail the relationships between the DCC and other industry parties. The SEC will require suppliers to use DCC for all communications with relevant smart meters within the domestic sector. Parties responsible for the operation of smart meters installed at non-domestic sites will have the option of using the DCC to undertake communications with their smart meters.
- 1.15. The regulatory framework for the DCC will sit within the existing regulatory frameworks for gas and electricity. The main building blocks of the arrangements are as follows:
- a new DCC-related licensable activity will be included in both the Gas Act 1986 and Electricity Act 1989. It will be prohibited to carry out this activity without a licence or appropriate exemption³;
 - a competitive process will be used to appoint the company that is to be licensed to carry out the DCC activity. The person identified will be granted a licence to carry out the DCC activity under both Acts;
 - as with other gas and electricity licences, the DCC licence will include a number of conditions governing the behaviour of the licensee. Monitoring and enforcement compliance with licence conditions will be overseen generally by the Authority but also in some respects, and for a limited period, by the Secretary of State; and
 - one of the conditions of the DCC licence will require it to have in force and comply with the SEC. In this context, a “code” is a document that relevant licensees are required to comply with as a condition of their licence. The SEC will also be made contractually binding between parties through a legal framework agreement. This means that compliance with the code will be both a condition of relevant licences and a contractual requirement. Licences of other relevant gas and electricity industry participants, such as suppliers, will be modified to require them to sign up to the code and comply with it.

³ On 10th February 2012, DECC published a consultation on a draft Statutory Instrument – the Electricity and Gas (Prohibition of Communications Activities) Order 2012. This Statutory Instrument sets out the licensable activity that it is proposed should be added to existing gas and electricity licensable activities in the Gas and Electricity Acts. It also sets out a number of proposed consequential changes to legislation. The consultation period closed on 23 March.

Structure of this document

- 1.16. Following this introduction (Section 1), Section 2 provides an overview of the background legislation, Section 3 identifies some specific features of the draft DCC licence that are unusual in the energy sector, Section 4 provides the Government's response to DCC licence issues raised in the September consultation and the rationale for the subsequent drafting of the DCC's licence and Section 5 details the Government's response to the proposals in the September consultation on the licence application process and the rationale for the drafting of the Licence Application Regulations.
- 1.17. Annex 1 provides a summary of the consultation questions and Annex 2 is an index to the draft DCC Licence. The draft DCC Licence itself is published separately as an annex (Annex 3), as is the draft Licence Application Regulations (Annex 4).

2. Background Legislation

- 2.1. The electricity industry is primarily governed by the Electricity Act 1989 and the gas industry primarily by the Gas Act 1986, both of which have been amended and supplemented by the Utilities Act 2000, the Energy Act 2004, the Energy Act 2008, the Energy Act 2010 and the Energy Act 2011 as well as by consequential amendments from other legislation.
- 2.2. These Acts prohibit the undertaking of certain activities (“licensable activities”) except under licence, or by exemption. Examples of licensable activities include the generation of electricity, the shipping of gas and the supply of gas or electricity. Licences include conditions that the licensee must adhere to, which can be enforced by the Gas and Electricity Markets Authority (otherwise referred to as “the Authority”, or “Ofgem”), as regulator.
- 2.3. Schedule 4 of the 2008 Energy Act amended both the 1986 Gas Act and the 1989 Electricity Act to provide the Secretary of State with the powers to introduce new licensable activities relating to smart metering. Any such order may also include the determination of any standard conditions that would apply to the new licensable activity, and consequential amendments to legislation or licences.
- 2.4. The Government intends to use these powers to introduce a new licensable activity relating to the DCC, although as set out in the September consultation (paragraph 2.22 of that document) it is not proposed that any standard licence conditions will apply to the DCC, but instead the conditions will be drafted as conditions of a particular licence (sometimes referred to as “special” conditions). (In this context “standard” licence conditions are those that apply to particular classes of licences in the energy sector.) In this document the Order that will be used to do this is referred to as the “Prohibition Order”. The Secretary of State is required to consult upon the contents of the Prohibition Order with the Authority and any other appropriate persons. Prior to the Prohibition Order being made, a draft must be laid before, and considered by, each House of Parliament.
- 2.5. A discussion of the proposals for the Prohibition Order was set out in the consultation document published in February 2012, for comment by 23 March (see paragraph 1.15 above).

3. Specific features of the DCC Licence

- 3.1. Where appropriate, the Government has sought to base the draft DCC licence on existing gas and electricity licences, so far as they contain relevant precedents. There are, however, a number of specific features which are different in the DCC licence and reflect the nature of the organisation.
- 3.2. Firstly, it is intended that the DCC licence would be granted following a competitive licence application process and that this process would be periodically re-run to appoint future DCCs to prevent lock-in to any one organisation. As a consequence, unlike typical existing licences, it is proposed that the DCC licence will be granted for a fixed, non-rolling term. It is proposed that the duration of the initial licence should be twelve years, although this will be kept under review in order to ensure that this does not result in an expectation that the DCC licence will end at or around the same time that a major service provider contract is being replaced. It is also proposed that the licence term should be capable of being extended (for a period of up to six years) if the Authority considers this necessary or expedient to fit with service provider contract re-procurement, a subsequent DCC licence application process or if the replacement process for the DCC would clash with or adversely affect some other major energy industry development (Part 1 of the licence, paragraphs 3-12 refer).
- 3.3. Secondly, the policy of periodic replacement of the DCC means also that the DCC licence needs to contemplate the handover of DCC activities to a successor DCC. Provisions have been included in the licence to deal with this, including that the licence of the outgoing DCC may continue to place obligations on it for a period of time after a successor has assumed operational responsibility for carrying out the role (Condition 44 in particular refers).
- 3.4. Thirdly, as the DCC is required to competitively procure the principal resources it needs to carry out its role, in contrast with existing monopoly licensees, the DCC may have relatively modest assets of its own and hence a modest amount of shareholder capital in the company. In such circumstances, this may limit the extent to which the DCC can be subject to regulatory incentives and the effectiveness of actions that could be brought against it in the event that it was not adequately performing. Therefore to guard against this, and in recognition more generally of the vital role that the DCC will undertake, it is proposed that the DCC licence should be capable of being revoked in the event of a serious or repeated failure on the part of the DCC to perform. This is encapsulated in the proposed "Other Revocation Event 5" in the draft licence. It is also proposed that the DCC should be required to lodge a degree of financial security which may be drawn down upon in certain circumstances (Part E of Condition 26 and Condition 41.13 refer).
- 3.5. Fourthly, other regulatory controls that it is proposed to apply to the DCC's business, given the nature of its activities, include a framework of general constraints relating to corporate governance, internal controls and risk management arrangements. These are contained within Condition 7 of the draft licence. Condition 8 requires the licensee to have an over-arching set of security controls in place.
- 3.6. Lastly, whilst the Government intends ultimately for a special administration regime to apply to the DCC, it is not expected that such arrangements will be in place in time for the initial DCC licensing arrangements in 2013. As a consequence, the DCC licence includes provisions for the Authority to intervene in the strategic management of the DCC in certain circumstances. These circumstances include serious poor performance or significant financial or operational

failings in the way the DCC is carrying out its business. The proposed powers for the Authority (which stop short of an actual hands-on management role for the Authority) are set out in Condition 41 (Management Orders for the Licensee) and include, for example, the ability for the Authority to require the removal or suspension of DCC directors and to appoint advisers whose advice must be followed by the licensee.

4. Response to September 2011 Consultation and Draft DCC Licence

Structure of the DCC's licence

- 4.1. 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 in the Acts, by the Authority or by the Secretary of State as the case may be; and Part 4 contains schedules to the conditions which can also be so modified.
- 4.2. The conditions are divided for convenience into a number of chapters, each containing conditions addressing a particular aspect. These are:
 - Chapter 1: Interpretation, modification, 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.
- 4.3. The draft licence has been produced in the light of policy set out in earlier consultations, most particularly the September consultation (see paragraph 1.3) on the DCC regulatory framework and the responses to that consultation. Not all matters raised in the September 2011 consultation are addressed here. Some issues have been addressed through the Prohibition Order consultation (see paragraph 2.5 above); others are covered in the SEC consultation (see paragraph 1.4 above).
- 4.4. As part of its broader engagement strategy, the SMIP works with stakeholders through a number of stakeholder groups. The Smart Meter Regulation Group is the parent group for four working groups including Working Group 1 (WG1) which concentrates on DCC Licensing matters. WG1 includes representatives from across the industry, Ofgem and other bodies representing consumer interests.
- 4.5. Following the September 2011 consultation, the Government produced a draft licence for pre-consultation comment and clarification with WG1 to help inform this consultation and the licence drafting, and the Government is grateful for the contribution that WG1 has made to this process.

Terms

September Consultation Paper

- 4.6. In the September consultation, it was proposed to issue a single document to the first DCC licensee with a single set of terms and conditions that would apply to both the gas and electricity licences and to adopt an approach whereby the DCC licence conditions would be treated as “special” conditions. Views were invited on the proposal to grant the initial DCC licence for a term of (as was then proposed) ten years and for the geographic scope of the licence to apply to Great Britain. (Responsibility for energy markets in Northern Ireland lies with the Northern Ireland Executive’s Department of Enterprise, Trade and Investment.)
- 4.7. On the issue of licence revocation, the September Consultation proposed arrangements which would allow for a repeated or material failure by the DCC to meet service levels to be capable of triggering a licence revocation.

Views of Respondents

- 4.8. Respondents expressed broad support for the DCC to have a GB wide licence with some raising the issue of potential devolution and others suggesting that where the DCC provided services outside GB, for example to the Isle of Man, these could be treated as value added services.
- 4.9. There was widespread support both for the proposal to treat the DCC’s licence conditions as “special” conditions and for a single set of conditions to be included within a single licence. One respondent raised the issue that technical options for communicating with gas and electricity meters will be different and may affect what can be generalised in a single licence that covers both gas and electricity.
- 4.10. The majority of respondents expressing a view were in favour of a ten year licence duration, although a number identified the need to ensure appropriate coordination with Service Provider contract durations. Two thought that ten years was too long and that a shorter rolling duration would give better accountability, whilst another thought that it was too early to tell what the duration should be and that it would be necessary to have further information as to the duration of the service provider contracts.
- 4.11. One respondent stated that whilst ten years was acceptable, there should be break points and/or the ability for SEC parties to raise grievances. One suggested that at the end of the initial DCC term there should be the option to extend the existing licence rather than replace if the initial DCC had performed well.

Response and Proposed Licence Drafting

- 4.12. Part 1 of the licence sets out the proposed terms in respect of licence grant. The Government remains of the view that a single document should be developed which constitutes a licence to carry out both the gas and electricity related DCC activities, and that a single set of terms and conditions should apply. Thus the terms explain that the licence has effect as a licence under both the Gas Act 1986 and the Electricity Act 1989. Thus far, the need to differentiate between gas and electricity has not arisen, although this matter will be kept under review as the more detailed arrangements are progressed.
- 4.13. Since the September consultation, further consideration has been given to the likely durations of the principal Service Provider contracts. These durations are anticipated to be between 7

and 9 years with a 3 year extension option (i.e. to follow the initial 7-9 years) for the initial “Data” contract and between 9 and 15 years with a 5 year extension option for the initial “Communications” contracts. In light of this it is proposed that the duration of the DCC licence should be set at 12 years with provision for the Authority to extend the term of the licence for up to 6 years. This duration would allow the initial DCC to remain in place over the expected period of mass rollout and, in light of the above contract durations, would allow arrangements which ensured that any DCC would be required itself to operate any replacement contract it had put in place for a minimum of 2 years prior to a handover to a successor DCC. It also means that no incoming DCC would be required to finalise a replacement contract without having been in post for at least 2 years. This is designed to ensure that any DCC undertaking a major procurement of service provider capabilities would be both experienced and have a future stake in the operation and performance of those contracts.

- 4.14. Provision is made in the terms for the licence to be capable of being extended more than once (subject to the maximum period of 6 years), for example to allow for a situation in which the DCC licence term is initially extended for reasons associated with coordination of major service provider contracts and then there is a subsequent delay in appointing a successor. The power to extend the licence for a period of more than 1 year is restricted to being exercised only once (without the consent of the DCC) in order to protect the DCC against the uncertainties that may arise from multiple long duration extensions. Extension to the licence could also be required to avoid the replacement of the DCC occurring simultaneously with, and adversely interacting with, any other major industry development that might be taking place at the time.
- 4.15. The terms also provide for modification of the licence by the Secretary of State up to 31 October 2018 as discussed below under Condition 3 in Chapter 1.
- 4.16. Finally, the terms also envisage that when the licence expires (i.e. following the expiry of the term, which may have been extended, or as a consequence of being revoked) obligations within the licence would be capable of continuing to apply for a further two years without the principal obligations on the DCC remaining active. This allows for specified conditions to continue to apply to the previous DCC for the purpose of facilitating handover after the operational DCC role has switched to a successor. The specific matters that would continue to apply in this period to an outgoing DCC are set out in licence Condition 44 which is discussed below as part of Chapter 10 of the licence conditions.
- 4.17. Part 2 sets out the terms for licence revocation. The majority of these reflect standard revocation terms included in gas and electricity licences. There are a number of DCC specific revocation events.
- 4.18. First, in order to reflect the importance of appropriate protection of data by the DCC, a failure of the DCC to comply with an enforcement noticed served on it by the Information Commissioner under Section 40 of the Data Protection Act has been included (paragraph 16(e) of “Other Revocation Event 4”). To the extent that the DCC is not a Data Controller under the Data Protection Act, this trigger would not apply, but it might become more relevant following the possible transfer of responsibility for registration to the DCC, and it is therefore considered prudent to include it in the framework from the outset. It is important to note that the issue of such an enforcement notice (or the other types listed in Other Revocation Event 4) does not trigger an automatic licence revocation. If the DCC has failed to comply with such an

enforcement notice the Authority would still have to consider whether the circumstances justify revocation.

- 4.19. “Other Revocation Event 5” has been developed to allow for revocation in circumstances where the DCC is failing to perform appropriately (e.g. it repeatedly or materially fails to meet its performance targets). The form of words proposed to cover these or equivalent events is that the licensee contravenes the licence in a manner or extent that is so serious as to make it clearly inappropriate for it to continue to hold the licence. This provision is based on similar arrangements in Section 24 of the Water Industry Act 1991.
- 4.20. It is also proposed to include “Other Revocation Event 6” which is aimed at ensuring the ongoing independence of the DCC and is discussed further in Condition 9 in Chapter 3. The revocation event could be triggered if the DCC were, for example, to cease being independent of SEC parties (i.e. its customers) or external service providers (i.e. its major service providers). The licensee is also under a duty to inform the Authority if it becomes aware of any contravention of the independence requirements of Condition 9.
- 4.21. “Other Revocation Event 7” is if the Authority is satisfied (whether having regard to the conduct of the Licensee under this Licence or otherwise) that the Licensee no longer is, or never was, a fit and proper person to carry on the Authorised Activity. This test has not appeared thus far in energy licences but is a feature of Broadcasting Act licences and other regulatory regimes, such as that applying to the National Lottery. Given the importance and sensitivity of the DCC activity, i.e. its central role in the smart metering system which involves the transmission of individual energy consumption data, the Government considers it appropriate to propose that such a test be included for the DCC.
- 4.22. The last revocation event, “Other Revocation Event 8”, is that the licensee has ceased to carry out any part of the Authorised Activity.
- 4.23. As noted above, the Government has proposed a fixed term licence for the DCC of 12 years, extendable by a further 6 years. The Government believes this fixed term provides certainty to the DCC and to stakeholders. However, Ofgem has suggested an alternative approach to guard against the risk of there not being a DCC in place, which is to issue a licence in perpetuity but with a fixed term revenue stream and a commitment to re-running the licence application process after 12 years, after which it would revoke the licence. It believes this approach minimises the risk of any failure in a future DCC licence application process by ensuring that there is always a DCC licence holder. There is potentially a trade-off to be made between the risk of a failure in a future DCC licence application process leaving no DCC in place and the risk that the DCC would not have the certainty over its ability to exit from its licence obligations that a fixed licence provides (potentially reducing the number and quality of potential bidders for future DCC licences). The Government welcomes views on this issue.

Consultation Question

1.	Do you agree with the structure and content of parts 1 and 2 of the licence?
2	Do you agree with the proposed list of licence revocation events, in particular

	<p>do you agree with the inclusion of revocation triggers linked to:</p> <ul style="list-style-type: none"> i) A failure of the DCC to comply with an enforcement notice issued under Section 40 of the Data Protection Act; ii) A contravention of the licence condition or statutory requirement in a manner so serious as to make it inappropriate for the licensee to continue to hold the licence; iii) A contravention of the independence Condition 9; and iv) The licensee no longer being, or never having been, a fit and proper person to carry out the Authorised Activity?
3	Do you agree that the DCC licence should be issued for a fixed-term only?

Chapter 1 of the DCC licence: Interpretation, Modification and Payments

September Consultation

4.24. Section 88 of the Energy Act 2008 allows the Secretary of State to make modifications to conditions of supply, distribution, transportation and shipper licences for the purpose of implementing the smart metering programme. This power was extended in the Energy Act 2011 to include electricity transmission licences and to extend the duration of the power for a further five years to November 2018. In the September Consultation the Government proposed that this power should be extended to include the DCC licence.

Views of Respondents

4.25. A significant majority of respondents agreed with the proposal to extend Section 88 powers to the DCC licence, noting that there are likely to be aspects of the SMIP which are not entirely concluded by 2014 and that commensurate changes to the DCC's allowable revenue might be appropriate were changes to the DCC's licence be made. However, one respondent did not understand the rationale, whilst another argued that the powers were already available implicitly, and a third said that commercial consequences needed to be considered.

Response and Proposed Licence Drafting

4.26. Conditions 1 and 2 set out definitions used in the conditions of the licence and rules of interpretation and are conventional conditions for any energy sector licence.

4.27. The Government continues to believe that there are advantages in having the ability to amend the DCC licence until 2018, in line with the current powers in Section 88 of the Energy Act 2008. It accepts that they would need to be exercised with caution and only following discussion with the licensee, to ensure the implications were understood and appropriately managed, for example by examining the DCC's financial position should any modification require it to take on additional responsibilities.

4.28. The intention is to amend the Energy Act 2008 powers through consequential amendments as part of the Prohibition Order, to include the DCC licence in the list of licences covered by the powers to amend licences generally in order to introduce smart metering. The principal alternative to this would be to use new primary legislation to achieve the same purpose, which would take longer to implement. If the consequential change to the 2008 Energy Act is made as

part of the Prohibition Order, Condition 3 as drafted would not be needed. However, as a fallback, the Government is consulting on draft DCC licence Condition 3, which also provides for modification of specified conditions of the DCC licence by the Secretary of State for specified purposes.

- 4.29. Condition 4 makes provision for the DCC to pay fees to the Authority to cover the Authority's costs. Such a condition is a feature of all energy licences, with the scale of the fees payable by individual licencees being set out in the Authority's licence fee cost recovery principles⁴.

Consultation Question

- 4. Do you have any comments on Chapter 1 of the licence conditions; in particular do you have any comments on the drafting of the definitions?**

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

September Consultation

- 4.30. In the September 2011 consultation the Government noted that statutory duties on network licensees included those relating to the development and maintenance of efficient and economical systems; duties to promote competition in supply; and, for gas licensees, duties to avoid undue preference or discrimination. It was also noted that statutory duties for network licensees were different in gas and electricity legislation and, as it is intended that the DCC will hold a licence under both Acts, having a consistent set of duties for the DCC would mean that the DCC's statutory duties would differ from those of existing licensees under one or both sets of legislation. To avoid this scenario, and the potential for confusion it would create, the Government stated that it may be appropriate not to have any general duties on the DCC in legislation and, instead, proposed to address such matters in the DCC's licence conditions. Views were invited on this proposal.
- 4.31. The Government proposed to include the following objectives for the DCC in the licence:
- an obligation on the DCC to discharge efficiently its obligations under the licence;
 - a requirement for the DCC to develop, maintain and operate an efficient, coordinated and economical data and communications system;
 - an obligation on the DCC to carry out its business in a manner that promotes or facilitates competition in the supply of gas and electricity and, if not implicitly captured within this obligation, energy efficiency services, metering services and other energy related services (for example services to encourage demand side solutions);
 - an obligation to have due regard for the environment, to the extent that this is not already captured by the first two objectives;
 - an obligation to facilitate successful rollout of smart metering in accordance with Government policy;

⁴ "Licence Fee Cost Recovery Principles", Ofgem, April 2009.

- an obligation relating to security in the provision of DCC Services; and
- a data privacy objective related to, or part of, the security objective.

4.32. It was suggested that the DCC would be required to protect the interests of consumers by following these objectives in carrying out its business and stated that it was for consideration whether the DCC should have a separate general objective of promoting energy efficiency.

Views of Respondents

4.33. The question of whether it would be necessary to include any statutory duties in legislation received a mixed response, with several respondents agreeing with the proposed approach that it should be in the licence and not in legislation, including for reasons of flexibility and practicality, but several others arguing that that the objectives should be set out in legislation.

4.34. There was a broad degree of support for the proposed general objectives. Nevertheless, a number of comments were raised, including:

- the need to recognise that the DCC objectives and SEC objectives have different purposes;
- the proposals included too many objectives and should be condensed to the first three;
- objectives should extend to privacy and security;
- the scope of the objectives should extend to promoting efficient distribution networks;
- the objective on facilitating competition should extend to the DCC's supply base;
- consideration should be given to impacts from the Third Package⁵;
- one objective should be linked to facilitation of transmission of information;
- no objective related to the environment was necessary and would be better dealt with as part of the SEC; and
- the principal objective should be to maintain and develop an efficient, co-ordinated, economical and secure system, with the second being related to rollout.

4.35. Moreover, the majority of respondents believed that the proposal to facilitate competition in distribution as part of any future smart grid proposals was not appropriate and that either these matters should be considered at a later date or that such matters were not relevant to the DCC. A few respondents did think that it was important that smart grids/distribution issues should be included from the start, including a requirement to facilitate competition in distribution.

4.36. There was widespread support for the proposal that the DCC should not have an explicit obligation to protect the interests of consumers but that instead, this would be achieved by the DCC meeting its other objectives. A number of respondents specifically stated that they did not think it would be appropriate for the DCC to have a direct obligation as they themselves had no direct relationship with consumers. Only one respondent disagreed with the broad approach and thought that it was appropriate for the DCC to have an explicit obligation to protect the interests of consumers.

⁵ The "Third Package" is a package of European legislative proposals for the energy sector. See http://ec.europa.eu/energy/gas_electricity/legislation/third_legislative_package_en.htm

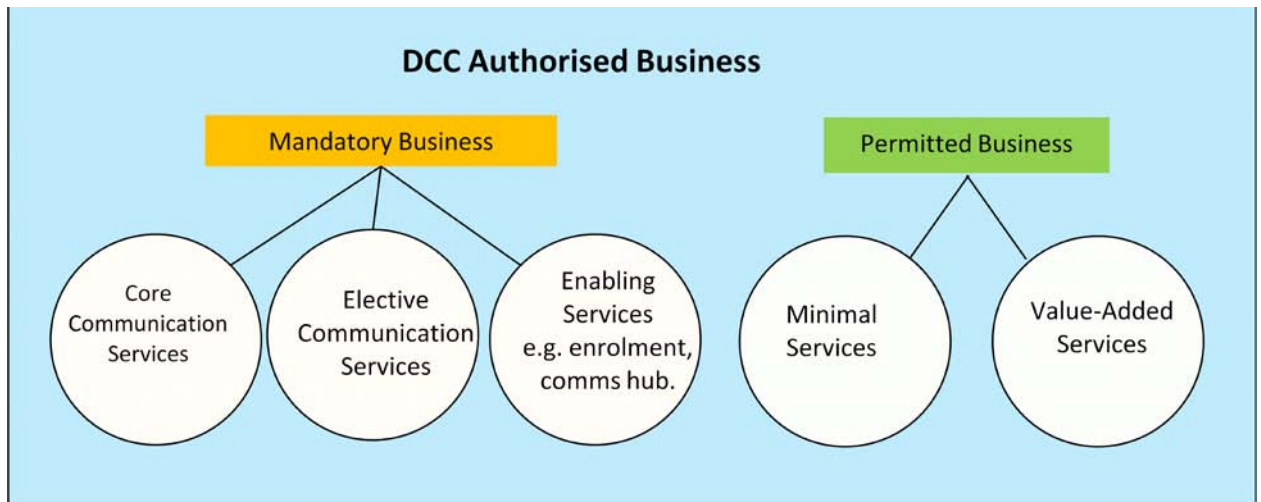
- 4.37. There were mixed views on the issue of whether or not to include specific obligations on the DCC relating to energy efficiency with some respondents arguing that such an obligation would be inappropriate for the DCC whilst others believed it was important. A number of those in favour of such an obligation believed that the DCC should be required to "facilitate" rather than "promote" energy efficiency.

Response and Proposed Licence Drafting

- 4.38. In line with the proposals in the September consultation document, the Government remains of the 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 is appropriate to set out the general objectives of the DCC in its licence rather than in legislation. These DCC objectives are set out in Condition 5.
- 4.39. Further consideration has been given to the number, structure and scope of the DCC objectives, recognising that the DCC and SEC have different purposes and different objectives are thus proposed for the DCC and the SEC. Two general objectives are proposed for 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, which is required to be balanced in the round with the first, requires the DCC to carry on the Mandatory Business in a manner most likely to facilitate:
- (a) effective competition in Supply and in Commercial Activities connected with Supply;
 - (b) 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
 - (c) 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.
- 4.40. The first of these objectives reflects the general legislative duties placed on network licensees in the Gas and Electricity Acts. The second also reflects such general duties in relation to facilitation of competition in supply, but, in light of the fact that 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 is intended to cover the kinds of activities undertaken by energy services companies.
- 4.41. Sub-paragraph (b) of the second objective is intended to reflect the DCC's potential role in facilitating the development and operation of smart grids. Smart metering is intended to be an enabling technology for smart grids and hence it is considered appropriate to include this in the objectives. The objective is framed more widely, as an objective to "facilitate innovation in the design and operation of energy networks" and it is considered that this will also address the comments made regarding the efficiency of distribution networks.
- 4.42. Finally, sub-paragraph (c) is intended to reflect the fact that where the DCC provides value-added services and there is a reduction in the charges it levies in providing Mandatory Business services as a consequence of this, such arrangements are considered to be consistent with the DCC's objectives.
- 4.43. Part C of Condition 5 places 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. Part D requires that the licensee does not do anything that would prejudice or impair its ability to carry on the Mandatory Business in accordance with the General Objectives.

- 4.44. In drafting the objectives the Government has been 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). Having considered the matter further, rules around data protection and security appear logically as obligations rather than objectives. Furthermore, by making them specific obligations through licence conditions – that is rules that must be met – they would not be expected to be balanced in the round against other potentially competing objectives. The SEC will also contain detail on these issues.
- 4.45. This also applies to rollout, which it is proposed will be dealt with separately in Condition 13 as a transitional matter. It is also accepted that it would probably not be appropriate for the DCC to have a specific environmental objective, although the DCC would of course need to comply with environmental legislation and, in line with other industry Codes, SEC Modification reports should include an assessment of the quantifiable impact (if it is likely to be material) of the modification proposal on Greenhouse Gas emissions (Condition 23.10). (See discussion around Chapter 6 of the draft licence below.)
- 4.46. The Government has further considered the need for a reference to consumers in the DCC's objectives and remains of the view that it would not be appropriate to include an explicit objective in relation to this in the DCC's licence. 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. That said, the SEC objectives are intended to include a specific reference to consumer interests (see paragraph 4.163 below).
- 4.47. On the issue of energy efficiency, not just in respect of distribution networks, but more generally, the Government believes that whilst it is important that the DCC provides services to third parties offering energy efficiency related services, it is not for the DCC itself to take a view on energy efficiency matters. Consequently, it is not proposed that the DCC should have a specific energy efficiency related objective. However, it is not envisaged that this would prevent the DCC from proactively offering new elective services to its users that support energy efficiency / better energy demand management. (The DCC itself would not offer energy efficiency services to consumers as it would not be able to use its own services.)
- 4.48. Condition 6 sets out the scope of the Authorised Business of the licensee, as depicted in Figure 1.



- 4.49. It is recognised that further work to define the detail of the DCC services is in progress and that the service definitions may need to be revisited as this work progresses. For the purposes of the draft licence, the business of the DCC authorised by its licence has been split into two separate businesses, the Mandatory Business and the Permitted Business. The Mandatory Business is split into the provision of 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 resources necessary to enable the DCC to provide them. 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 both the connection to the DCC's wide area network (WAN) and to the home area network (HAN) which connects devices in the home), then this would be treated as an enabling service within the Mandatory Business (see discussion at paragraphs 4.272-4.273 below).
- 4.50. The Permitted Business comprises the provision of Value Added Services and Minimal Services. Prior to providing a Value Added Service, the DCC must gain the consent of the Authority. It is intended that as part of the process of granting any such consent, the Authority would take into account proposals from the DCC for Mandatory Business service costs to be offset by revenues derived from the Value Added Service. It should be recognised that whilst Condition 11(4)(b) prevents the licensee from cross subsidising between licensed businesses, it is envisaged that any funding of the Mandatory Business from Value Added Services would not be in contravention of this condition, as it would fall under the carve-out in Condition 11(5) as being expressly permitted under the licence where approved by the Authority. Condition 6 also provides that the Authority may issue guidance as to the criteria that it will take into account in considering whether to approve a Value Added Service.
- 4.51. Minimal Services are those which do not exceed a turnover of more than £500,000 per annum and which are not provided to any material extent from the capability or resources that DCC uses to carry out the Mandatory Business. The purpose of this service category is to set a de minimis threshold for regulatory intervention, to avoid unnecessary burdens on the Authority and the DCC.
- 4.52. Condition 7 provides for a number of general controls that it is proposed to apply to the DCC's business, given the nature of its activities. The condition provides for constraints relating to

corporate governance, internal controls and risk management arrangements to be applied to the DCC.

- 4.53. From a corporate governance perspective, the DCC is required to comply with the main principles of the UK Corporate Governance Code, which is a document that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. The DCC is required to provide the Authority with a Corporate Governance Statement setting out how it has complied with this Code in the prior year.
- 4.54. The DCC is also required to have in place an Internal Control Document demonstrating its maintenance of an appropriate organisational structure, audit trails, monitoring processes etc. It is also required to establish and maintain a Risk Management Strategy which sets out a robust framework for identification, evaluation and management of risk. Both the Internal Control Document and the Risk Management Strategy require the approval of the Authority following consultation with SEC Parties and other appropriate persons. Both documents are required to be published on the DCC's website (although for certain reasons, including security, it may be necessary to redact certain elements). These obligations reflect the particular position of the DCC where, as an asset-light entity with relatively large external contracts, occupying a crucial role in the GB energy infrastructure, it is vitally important that it has the necessary internal controls in place to maintain its operational effectiveness.
- 4.55. Condition 8 also requires 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 makes reference to an "Authorised Security Standard". 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, the Government is considering further the governance arrangements for this document, including who issues it and its ongoing governance.
- 4.56. Condition 8 also sets out additional more detailed obligations in relation to physical, organisational and information security and requires the DCC to maintain a register of security incidents. It also prevents the DCC from entering into any contractual arrangements that do not contain appropriate provisions for ensuring that the security arrangements can be met. The high-level obligations on the DCC in relation to security in Condition 8 are expected to be supplemented by additional more detailed obligations in the SEC. These obligations will be the subject of a later consultation and may include, for example, an obligation on the DCC to provide information on security incidents to impacted SEC parties. Alternatively, some of these security requirements may be better placed as licence obligations. Stakeholders are therefore encouraged to read both documents before submitting views on the security controls and their appropriate location.

Consultation Questions

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| 5. | Do you have any comments on Chapter 2 of the licence conditions, in particular do you have any views on: |
| | i) The general objectives of the DCC; |

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| <ul style="list-style-type: none"> ii) The way in which the Mandatory and Permitted businesses of the DCC have been constructed; iii) The interaction between the mandatory and permitted businesses iv) The proposed general and security controls for the DCC? |
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Chapter 3 of the DCC licence: Arrangements for the Licensee's Independence

September Consultation Paper

4.57. In the September consultation paper, the Government recognised the importance of the DCC providing services in a manner that does not discriminate between users, and of the DCC being managed in a way that provides assurance of its ongoing ability to provide those services. It discussed a number of issues relating to independence, including:

- non-discrimination by the DCC in the provision of its services;
- independence of the DCC from service providers;
- independence of the DCC from users;
- independence of service providers from users;
- restrictions on the use of confidential information; and
- the use of DCC infrastructure to provide other value-added service.

4.58. The September consultation also raised the issue of whether the restrictions apply only to the DCC or whether they also apply to:

- an affiliate, being a holding company of the licensee or any subsidiary or subsidiary of a subsidiary of a holding company;
- a related undertaking being a company in which the licensee holds 20% or more of the shares; or
- a related associate, being an affiliate or related undertaking in which the licensee holds shares or other investments.

4.59. Specifically, in respect of the DCC's general behaviour, the September consultation proposed:

- a general prohibition on undue discrimination between users or classes of users of Core and Elective Services with consideration to be given to whether this extends also to Value-Added Services (although the obligation on the DCC relating to non-discrimination does not apply to its contracts with service providers and the telecommunications and IT industries from which they will be drawn);
- a prohibition on the use of confidential information by the DCC for any purpose other than the activities permitted by its licence;

- a prohibition on the DCC competing with users in the activities they undertake where these can only be undertaken using the services that the DCC provides; and
- standard provisions requiring the appointment of a compliance officer to secure compliance with the DCC's independence requirements.

4.60. Regarding the relationship between the DCC and DCC Users, the September consultation proposed:

- a prohibition on the DCC itself holding a gas or electricity supply licence, a shipper licence or a transportation, transmission or distribution licence;
- no more than 20% of the shares in the DCC to be held by any individual user operating in a competitive energy market (i.e. shippers, suppliers) or related unlicensed activities which may nonetheless be SEC parties (i.e. ESCOs);
- no explicit constraint on monopoly licensees, i.e. GTS, DNOs and transmission licensees, owning the DCC, although ring-fencing arrangements to be considered where any one licensee owns more than 20%; and
- a prohibition on the DCC or its subsidiaries owning any shares in DCC Users.

4.61. Regarding the relationship between the DCC and Service Providers, the September consultation proposed:

- a prohibition on the DCC and its affiliates and related undertakings being a service provider, subject to permissible de minimis levels of affiliation; and
- a prohibition on the DCC or its subsidiaries owning any shares in a Service Provider.

4.62. Lastly, the September consultation said that it was not considered necessary to introduce a specific requirement for business separation between DCC Users and Service Providers but that the DCC would be expected to manage Service Provider contracts to ensure that services were provided in a manner that does not discriminate between users of classes of user.

Views of Respondents

- 4.63. Respondents generally agreed with the proposed conditions on DCC behaviour. One respondent considered that the obligation not to discriminate should be backed by a requirement to publish an annual statement demonstrating how it had behaved in a non-discriminatory manner. One respondent said that the obligation should extend also to Value-Added Services whilst another said that the DCC should be free to continuously improve and develop Value Added Services without fear of breaching a non-discrimination condition but that the DCC should be prepared to agree to a prohibition in relation to Value Added Services.
- 4.64. Similarly, most respondents agreed that specific provisions requiring the DCC not to discriminate between service providers were not required and that the obligations on the DCC to maintain and develop an economic system and to promote competition in the provision of services to it would be sufficient. However, one respondent believed that discrimination would occur and that a provision was appropriate and that a list should be kept of where interventions were necessary. Similarly, another respondent said that the obligation to promote competition was too subjective and that, instead, DECC should consider provisions that would require the

DCC not to discriminate either directly or indirectly in its procurement processes against services providers or potential service providers. They also stated that the DCC should not act in any way which would make it more difficult for one service provider to apply or be considered over another potential service provider, whether on the grounds of their relationship with the DCC or lack thereof, its position as a 'favoured' service provider, its country of origin, company size or other criteria which, by its nature would preclude a service provider from applying to be considered to provide services.

- 4.65. Most respondents also supported a prohibition on the DCC using confidential information for any purpose other than the licensed DCC activity. A number stated that the prohibition should be imposed contractually on Service Providers. Nevertheless, a few respondents argued that the use of data would be governed by the Data Protection Act and that no explicit provision need be made in the licence. However, it is important to note that this relates to personal information and so may not apply to all confidential information, some of which may be commercially confidential material rather than personal data. One also further argued that, whilst some information might be subject to the proposed restriction, extending the restrictions to other information, such as aggregated or anonymous data, could limit the development of Elective or Value Added Services, although the use of such information would have to be at arm's length and made available in a non-discriminatory manner.
- 4.66. Most respondents agreed with the proposals for separation between the DCC and DCC Users. Some respondents believed that the limit should apply also to groups or classes of users, whilst other respondents believed that there should be no exemption and that the limit should apply also to monopoly licensees having an interest in the DCC. Some respondents said that, rather than a fixed limit, the degree of influence was the key consideration (e.g. a much lower shareholding but with the right to appoint a director) and that the risk of undue influence should be considered on a case-by-case basis, while one respondent said that, if there were concerns then perhaps a lower limit might be appropriate. Some respondents felt that it was inappropriate for DCC Users to have any shareholding in the DCC, whilst one respondent took the opposite view and argued that there should not be any limit as that could limit the leveraging of services from parent organisations that could deliver economies of scale.
- 4.67. Respondents' views were divided on the appropriate maximum for the level of affiliation between Service Providers and the DCC, with some respondents saying that 20% was an appropriate limit and some saying that it was not appropriate for Service Providers to have any interest in the DCC. One respondent said that affiliation was permissible provided a party did not have control of the DCC's operations, while another said that it was a matter for discretion and best governance practice in procurement and that affiliation limits could not be quantified and that undue influence could be policed ex-post.
- 4.68. On separation between DCC Users and Service Providers, respondents were evenly divided between those that thought no explicit requirements were needed and those that thought that they were. Of those that argued against explicit requirements, views were that there was a low risk of affiliation between DCC Users and Service Providers and that oversight by the DCC would be sufficient. Conversely, those in favour of explicit business separation argued that, without it, undue influence could arise and service provision could be distorted.

Response and Proposed Licence Drafting

- 4.69. Parts A and B of Condition 9 are based on standard provisions from existing energy licences. In the case of the DCC, they prohibit it 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 is therefore envisaged that the DCC will have to be a discrete corporate entity, operationally separate from any company or companies that own it.
- 4.70. Part C of Condition 9 places further restrictions intended to ensure that the DCC's corporate structure does not unduly influence its behaviour. To this end it:
- (i) prohibits the DCC from holding any interest in either DCC Users or Service Providers or any Affiliate or Related Undertaking of such persons; and
 - (ii) prohibits any person that can influence the DCC from having any interest in DCC Users or Service Providers.
- 4.71. Here 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 licences granted under the Gas and Electricity Acts in the definition of "Related Undertaking", and relies on the Financial Services and Markets Act 2000 ("FSMA 2000") definition which is:
- "an interest held by an undertaking in the shares of another undertaking which it holds on a long-term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest".
- 4.72. The FSMA 2000 also states that "a holding of 20% or more of the shares of an undertaking is presumed to be a participating interest unless the contrary is shown". Thus participating interest appropriately encapsulates not only the 20% threshold but also the notion of influence. However, Part D of Condition 9 provides that the Authority may consent to alternative arrangements that secure a sufficiently equivalent level of independence. An example of such an arrangement may be that which applies to Elexon under the Balancing and Settlement Code (BSC) whereby National Grid, although it owns 100% of Elexon, agrees through the BSC to the appointment of directors that are entirely independent of it.
- 4.73. As discussed in paragraph 4.20 above, a serious breach of these independence requirements could lead to the DCC's licence being revoked.
- 4.74. The Government has also considered whether groups of users with similar interests, e.g. suppliers or network operators, should also 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). The Government's view is that the risk of a DCC exercising undue discrimination as a result of it being owned by a particular user group (for example, suppliers) is sufficiently small. 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 provide sufficient protection against the DCC exercising favouritism. The Government is not therefore minded to extend these restrictions from a single user to groups of users.

- 4.75. An exclusion is also made to allow for persons influencing the DCC also 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. Without this exclusion it is possible that such persons could cause a contravention of the requirements through having inadvertent interests in DCC Users or Service Providers.
- 4.76. Part E of Condition 9 implements a requirement for a number of sufficiently independent directors. These requirements emerged, together with some proposed licence amendments, from the Authority's review of ring-fencing of network licensees⁶ and may become a standard provision in energy licences in future. The proposed licence amendments have been used as the provisional basis for Part E of Condition 9 and will need to be kept under review in light of the Authority's conclusions on this matter.
- 4.77. Likewise, Conditions 10 and 11 are similar to conditions in existing energy licences. Condition 10 provides a prohibition on the disclosure of confidential information, except as required by the licence and other similar exceptions. Including the protection of confidential information as a licence condition will ensure that the Authority can enforce compliance which is essential if the integrity of smart metering is to be maintained. Condition 11 prohibits abuse of the licensee's special position, which includes a prohibition on undue discrimination between any persons or classes of persons which applies to any activity that the DCC is required or permitted to undertake, including the provision of Value Added Services.
- 4.78. Condition 12 is also similar to conditions in existing energy licences, and further requires the DCC to appoint a compliance officer and to produce an annual report on its compliance with Conditions 9, 10 and 11. While the role of compliance officer is common in energy licences, the role of the DCC's compliance officer reflects its particular characteristics and so the officer has specific obligations in relation to the needs of the DCC's users and external service providers.

Consultation Questions

- 6. Do you have any comments on Chapter 3 of the licence conditions, in particular do you have any comments on:**
- i) the independence requirements of the DCC and the interaction with the revocation provisions;**
 - ii) the broad condition on protection of confidential information;**
 - iii) the scope and nature of the role of the compliance officer?**

Chapter 4 of the DCC licence: Start Up and Development Obligations

September Consultation Paper

- 4.79. In the September consultation, the Government proposed to include in the DCC licence a condition which gives it a high-level obligation in relation to its activities in the foundation period, i.e. those required to be undertaken by the DCC prior to its provision of an operational

⁶ "Proposed Modifications to the Ring Fence" Conditions in Network Operator Licences", Appendix 13, Ofgem, 25th March 2011

smart meter communication service (“go-live”). The September consultation proposed that the detailed obligations required to support this should be dealt with in more flexible subsidiary documents which the Government will develop as part of the Smart Metering Implementation Programme, and that compliance with these should be a requirement of the licence.

- 4.80. The September consultation went on to suggest that similar arrangements should also apply to additional obligations required to cover the period between the establishment of the initial DCC services (“go-live”) and the completion of mass rollout, although specific issues (for example reporting) may be dealt with directly in the DCC’s licence.
- 4.81. In relation to energy registration services, the Government proposed to include a high level licence obligation on the DCC covering its future provision of registration services, and referring to the SEC for the detail of the services to be provided. It was explained that it was expected that this condition would initially be “switched off”. It was also explained that it would be necessary to make changes to gas transporter and electricity distribution licences that provide the ability to discontinue the obligations on those licensees to provide the registration services that transfer to the DCC. Accompanying changes to relevant industry codes would also be made. Finally, the Government proposed to include a condition in all relevant licences (gas and electricity suppliers, distribution licensees and gas transporters) requiring the relevant licensee to take steps to facilitate the switch on of the DCC registration condition and the discontinuation of the other licensee obligations in relation to registration.

Views of Respondents

- 4.82. In relation to foundation and rollout obligations, most respondents agreed with this proposal with a number suggesting that further clarity on the detailed obligations was required, with several stating that these should be set out in the SEC. One respondent strongly believed that the DCC should not have an obligation to support foundation rollout of meters.
- 4.83. On the issue of registration, there was a mixed response. Whilst most respondents were broadly in favour of the proposal to include a licence condition that facilitated transfer of registration to the DCC but which was initially switched off, several believed that further detail and consultation was required. A few respondents were strongly against the transfer of registration to the DCC particularly during the period of smart meter rollout and advised against progressing two major projects (i.e. rollout and registration transfer) in parallel. A number of other respondents believed that registration activities should transfer from initial rollout. Several other related points were raised, including:
- that the scope of registration may change on transfer to the DCC;
 - that the DCC should have the option to use existing systems, but should not be required to do so;
 - that a requirement to maintain legacy systems could remain for non-smart meters;
 - that this should be accompanied by an obligation to enhance supplier switching arrangements;
 - that the transfer should depend on the DCC being able to provide better value for money;

- registration was key to providing access control and should move to the DCC on day 1;
 - supplier volume allocation services should also eventually transfer to the DCC;
 - affected licensees should have a mutual assistance obligation in relation to the transfer; and
 - if the DCC dealt only with domestic customers, there would always be a need to have multiple parties delivering registration services.
- 4.84. In discussions on a pre-consultation draft of the licence in WG1 (see paragraph 4.4 above), stakeholders discussed the concept of a development plan for the DCC. This document would provide users and other stakeholders with a forward looking overview of how the DCC planned to develop its services and operations. A number of stakeholders commented that a three year development plan was insufficient and that five years would be more appropriate, although others thought that the difficulties inherent in long term planning meant that a three year plan would be more appropriate.
- 4.85. There was general agreement however that, in addition to a detailed business plan, a more broad long term commentary on likely developments would assist the DCC's stakeholders in their long term planning around smart meters and therefore in the efficient and effective deployment and use of smart meters.

Response and Proposed Licence Drafting

- 4.86. It is expected that the DCC will be subject to a number of detailed transitional obligations both in the period after it has been licensed and "DCC go-live" (i.e. when its systems are ready to be used); and in the subsequent mass rollout period. Whilst the DCC will not itself be required to rollout smart meters, it is expected that the DCC will have obligations to ensure that its services are delivered in a manner that supports the rollout of smart meters by suppliers. Chapter 4 of the draft licence thus covers a range of matters dealing with start-up of the DCC and subsequent development of its services.
- 4.87. The Government is continuing to consider the overarching approach to transition in the various stages of the programme. A range of options exist for managing the period between the award of the DCC licence through "go-live" and beyond. It is likely that when the Government has decided on its overall transition strategy for the smart meter programme that it will need some form of regulatory underpinning. The proposals as set out in Condition 13 of the DCC licence and in this consultation have been drafted to support debate, covering one possible mechanism to underpin the transitional period. The Government has not yet reached a firm view on these matters and this chapter of the DCC licence will need to be kept under review as the proposals are developed further.
- 4.88. The arrangements set out in Condition 13 provide for a Smart Metering Transition Scheme to be designated by the Secretary of State in order to effect transition from the SEC Commencement Date. It is anticipated that any Smart Metering Transition Scheme would be put in effect by the Secretary of State using powers under Section 88 of the 2008 Energy Act and consequently the scheme may include general changes to licences for the purposes of transition. Under such a model, the DCC would be just one of a number of licensees who were subject to the scheme. From the perspective of the DCC, the scope of matters that the scheme

might provide for includes those required in the period between the grant of the licence and commencement of DCC service provision and those in the subsequent mass rollout period. Other potential options including using the SEC as the appropriate vehicle for these transitional arrangements; in such a scenario the 2008 Energy Act powers referred to above would only be used to effect change to licences and the SEC rather than creating a transition scheme.

- 4.89. The September consultation set out a number of proposals in relation to the adoption of communications contracts put in place by suppliers to allow communication with smart metering equipment that had been installed prior to the commencement of the DCC's services. It is envisaged that any arrangements associated with adoption of such contracts would be dealt with as part of the transition arrangements. A summary of the proposals on these matters, the responses received and the proposed next steps, is included below (see paragraphs 4.276-4.285 below).
- 4.90. Condition 14 requires 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 which is approved by the Authority and made generally available. The plan must cover a period of five years and cover a range of matters which include matters such as: trends and factors likely to affect its future business development; likely opportunities for the DCC to develop infrastructure, systems and processes; their current loading and utilisation and the availability of spare capacity. The plan is also required to include information relating to, and evaluation of, potential changes in ways of working, new technologies that could improve the management and operation of the business and the assessment criteria used to determine the business objectives. The Government expects that the DCC would use this requirement to proactively set out manners in which the smart meter market could develop, including "advertising" potential elective services on a multi-lateral basis to its users. The licensee is required to publish the plan on its website.
- 4.91. The Government recognises that in its early operational phase the DCC is likely to focus on ensuring its services are stable, efficient and secure. However, as it evolves beyond its start up phase the DCC would be expected to become more proactive in developing new and existing services within the confines of its permitted business.
- 4.92. The focus of the Programme since the September consultation has been on establishing the appropriate regulatory framework for the DCC, in particular for its initial operational phase. However, the Government remains of the view that moving responsibility for registration services to the DCC from gas transporters and distribution network operators at some future date is appropriate, and Condition 15 provides for this future incorporation of energy registration services. The Government recognises that further work is needed to consider in more detail the policy on the transfer of registration. As a consequence, the current drafting of the condition is necessarily high-level. It is also the case that in transferring responsibility for registration from existing licensees to the DCC it will be necessary to amend other existing licences and the condition reflects the fact that it comes into effect in conjunction with other such changes.
- 4.93. Specifically, the condition confers a time-limited power on the Secretary of State to direct the licensee to secure the incorporation of Energy Registration Services into the services provided by the DCC under the licence or pursuant to the SEC. It sets out the scope of the direction that may be given by the Secretary of State in relation to these matters and requires the Secretary of State to consult relevant persons prior to giving a direction. The scope of Energy

Registration Services to which the direction may apply is linked back to specific services provided under conditions of gas transporter and electricity distribution licences.

Consultation Question

- 7. Do you have any comments on Chapter 4 of the licence conditions, in particular do you have any comments on the drafting of:**
- i) the transitional obligations on the DCC, possibly as part of a wider transition scheme;**
 - ii) the proposals for how the DCC would set out its future business development objectives;**
 - iii) the proposed inclusion of a licence condition that would facilitate future transfer of registration to the DCC?**

Chapter 5 of the DCC licence: General Arrangements for Services

September Consultation Paper – Procurement

- 4.94. In the September consultation paper the Government concluded that the DCC will be a “thin” organisation, procuring the bulk of its services from external service providers, thereby offering greater flexibility and offering the ability to maximise existing competitive markets for the provision of data and communication services. It was proposed that the DCC licence should list the activities that the DCC must procure externally, and define high-level principles that would determine whether other activities should be provided in-house or procured externally
- 4.95. Whilst the initial procurement of service providers is being progressed by the Government, with the final service provider contracts to be signed by the newly-appointed DCC, the DCC will be required to provide additional services and/ or replace the initial service providers as their contracts expire. To ensure that the benefits of a well-run procurement process are realised, it was further proposed that, in addition to its general objectives, the DCC should have procurement objectives to ensure that:
- the service procured from individual service providers fit together to form a coherent, functional and secure end-to-end solution;
 - the way in which it procures services from third parties facilitates competition in the provision of services to the DCC;
 - the DCC achieves an appropriate level of flexibility in the services that it procures; and
 - the DCC adopts, where relevant, best industry practice approaches to the procurement and management of its service provider contracts.
- 4.96. It was proposed also that the DCC licence should require the DCC to ensure that contracts with service providers will include adequate arrangements for continuity of service in the event of financial or operational failure of the service provider.

- 4.97. It was suggested that the DCC should be required to prepare, consult upon, publish and comply with a contract management approach document designed to achieve the procurement objectives.

Views of Respondents – Procurement

- 4.98. Most respondents agreed that the DCC should be a thin organisation and that the licence should list activities that it must procure externally and principles determining whether other activities should be externally procured or provided in-house. One respondent argued that the DCC should have the option to procure or self-provide data services as these services will form a critical link in the continuity of service, delivery and compliance with the service level agreements and will form the hub for all of the other service providers; and be free also to determine whether to procure or self-provide other services such as legal and HR. One respondent argued that it was reasonable that the DCC be required to procure all services apart from those it can demonstrate it can do more efficiently in house, whilst another argued that the DCC should not be required to pursue external procurement where this would undermine the core activities of the DCC. Some respondents, however, believed that the requirement was overly prescriptive and that the DCC should be free to discharge its licence in a cost effective and efficient manner and that restricting the range of options available to the DCC could drive up costs.
- 4.99. Most respondents also agreed with the proposed procurement objectives. One respondent suggested an additional objective concerning the migration to future technologies; another felt that, in addition to flexibility, scalability was an important objective; a third said that service integration is a specialism that the DCC should outsource; whilst another said that the DCC should have an objective to deliver an effective and efficient common DCC approach to strategic sourcing, supply chain management, and supplier and contract management.
- 4.100. Most respondents agreed with the proposal that the DCC should be required to produce a procurement and contract management approach document. One respondent further suggested that the document should be part of the SEC, whilst another suggested that the DCC should be audited against the document. However, one respondent said that such a document should be aimed at the principles and should not be a detailed manual on how to manage each contract; whilst another disagreed on the grounds that such a requirement would be inflexible, inefficient and restrict the DCC's freedom to deliver the best overall value for money.
- 4.101. Respondents were divided between four broad groups. Firstly, those that believed that the procurement and contract management approach document should be approved by the Secretary of State. Second were those that believed that it should be approved by the Authority. A third group believed that it should be approved by either the Secretary of State or the Authority. A final group argued that it did not need to be approved. A number of respondents said that the document should be submitted as part of the DCC application and hence implicitly approved by Secretary of State, with occasional review by the SEC Panel.

Response and Proposed Licence Drafting

- 4.102. Part A of Condition 16 ("Procurement of Relevant Service Capability") requires the DCC to procure certain services, referred to as 'Fundamental Services Capability', as will be defined in schedule 1 of the licence. It also requires the DCC to procure other services, which together with Fundamental Services Capability' are referred to as 'Relevant Service Capability',

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. The Fundamental Services Capability, i.e. the services that the DCC must externally procure will be defined in a schedule to the licence. The Government's intention is that this will be restricted to the principal data and communication service provider contracts, which the Government is currently taking through the procurement process on behalf of the DCC.

- 4.103. Part B establishes a number of principles that will apply to external procurement. These principles largely reflect the statutory requirements of existing legislation in relation to 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; and, in particular, the need to ensure that appropriate arrangements are in place to secure business continuity.
- 4.104. The suggestion that the objectives should include the incorporation of future technologies was noted. However, rather than being a specific procurement objective, Condition 15 (Future Business Development Objectives) requires that emerging technologies is one of the matters to be included in the DCC's Development Plan.
- 4.105. Part C requires 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 require the DCC to keep its Procurement Strategy under review and to maintain records of all its procurement transactions and arrangements.
- 4.106. Procuring the fundamental services needed to fulfil its functions will be a critical activity of 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 therefore appears important to consider how the wider public interest is assessed and represented in these procurement exercises.
- 4.107. For example, the decision to procure a particular communications solution could have a significant impact on the reach or quality of service offered by the DCC. Given the potentially high cost of serving the most difficult to reach consumers (for example, those in geographically remote locations) 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.
- 4.108. The Government is aware that 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. Government can impose obligations to take a particular approach or consider certain factors at a high level through primary legislation and then in more detail at a lower level through various regulatory tools (such as licences or authorisation regimes). Examples of the approaches in different sectors include:
- Postal services, where legislation (Postal Services Act 2011) places minimum requirements around the frequency of delivery and collection of post but allows the regulator (in this case Ofcom) to set more detailed requirements with respect to quality of service and density of post boxes (for example). The regulator can also make exceptions for the universal delivery and collection obligations set out in the legislation - for example in exceptional geographic circumstances.

- Telecoms, where BT as the designated universal service provider (with the exception of the Kingston-upon-Hull area) is obliged to provide access to basic telecoms services upon reasonable request and at uniform prices. However, with the regulator's permission, it applies a threshold whereby if connecting a user would cost more than a pre-agreed amount, BT can charge the excess cost to the consumer.
- Electricity transmission, where National Grid is required by its licence to offer terms for connection (with defined exceptions). It also has general duties to develop an efficient, co-ordinated and economical system of electricity transmission and to facilitate competition in generation and supply. Its networks must also comply with pre-determined quality standards set out in secondary legislation.
- Rail, where Network Rail has a licence obligation to secure the improvement, enhancement and development of the rail network but most do so in an efficient and economical manner (amongst other obligations). Network Rail has developed a consultation process for use with its stakeholders when developing its network. When it produces a proposal following such a consultation it must send it to the regulator who can accept it or reject all or part the proposal.

4.109. Given the potential impact of how the DCC weighs up the various factors behind procurement decisions and the precedent from many other sectors, the Government considers it appropriate to explore the inclusion of an appropriate mechanism for balancing the various competing public interests (low costs, universal coverage) when the DCC undertakes these procurement exercises. The Government will continue to discuss with the Authority how best to achieve this and is seeking views more widely on both how effective the approaches taken in other sectors are and on what would be the most appropriate approach for the DCC. Following further consideration of this issue, it may then be necessary to consider the implications for the DCC's obligation to provide or offer to provide services.

September Consultation Document – Provision of Services

4.110. The September consultation described the services that it was envisaged that the DCC will or may provide as follows:

Core services: are key communication services with smart meters that will be defined in the SEC and which we have developed with prospective DCC users. The initial procurement of DCC services will support the provision of these core services by the DCC. The DCC would be required to provide core services to any authorised user.

Elective services: are additional communication services over and above core services, and which relate to energy use by consumers. The DCC may offer to provide these services to users, or may be required to offer to provide them, depending on the type of metering system involved.

Other SEC Services: the DCC may also provide other services to SEC parties as defined in the SEC. For example, if in the future the DCC provides data collection and aggregation services they would be set out in the SEC.

Value-added Services: these are other non-energy related services whose provision may impact the systems the DCC uses to provide core and elective services to users. For example provision of communications for smart metering outside the energy sector.

4.111. It was proposed to include the following matters in the DCC's licence in relation to service provision:

- a) The DCC will either be required or permitted to offer terms to provide core and elective services. Whether it is required or permitted to offer terms depends on the nature of the metering system concerned.
- b) The DCC will also be permitted (or required) to provide additional services which are set out in the SEC. Where these are not included in the initial SEC, a code modification approved by the Authority would be needed before the DCC could provide the service.
- c) The DCC will initially provide translation and secure access control. Communication services will include core services which will be defined in the initial SEC and elective services, i.e. services that the user can elect to seek from the DCC.
- d) The DCC licence will include conditions that require the DCC to offer terms for the provision of core and elective services in relation to:
 - compliant smart metering systems associated with a supply to a consumer premises; and
 - certain non-compliant metering systems associated with a supply to a consumer premises (e.g. AMR meters).

In the case of compliant smart meters, it was intended that the offer of terms for provision of core services will be conditional only upon the person seeking services complying with the SEC and, where necessary, being properly authorised by the consumer to receive those services. Hence, so long as the user is an appropriately authorised party, the DCC will be required to provide the relevant core services in accordance with the SEC. The precise scope of meters which falls into the non-compliant category requires further consideration.

- e) The DCC should be permitted to offer terms for core and elective services in relation to:
 - other non-compliant metering systems where the metering system is associated with a supply to a consumer premises; and
 - any compliant smart meter which is not associated with a supply to a consumer premises.

Again, the precise scope of the other "non-compliant" metering systems to which this applies will require definition in order that the obligations on the DCC can be clearly defined.

- f) The scope of the elective services that the DCC can or must offer to the parties outlined in the preceding paragraph should be, at least initially, limited to meeting those which:
 - involve the use of the relevant metering system; and
 - are concerned with energy use by the consumer.

4.112. The DCC would therefore provide a range of services which includes core and elective services and potentially other services as defined in the SEC. The DCC would be required to have in

place systems and processes in order to provide these services to users. Where permitted by the Authority, the DCC may also offer “value-added” services.

Views of Respondents – Service Provision

- 4.113. There was a general agreement in consultation responses to the proposed service definitions put forward, although several respondents sought additional clarity on definitions. One respondent believed that an additional core service from day 1 should be registration of new smart meters with the DCC.
- 4.114. A variety of responses were received to questions over which compliant and non-compliant metering systems the DCC should be required or permitted to offer services. These included:
- The obligations to offer terms needed to be reviewed in light of the charging proposals;
 - The DCC should be required to offer terms for all compliant meters and permitted to do so for all non-compliant;
 - The DCC should be permitted to offer terms where practical to all non-compliant meters installed in foundation – additional costs should be charged to relevant suppliers;
 - The DCC should be permitted to provide services for non-compliant meters where doing so is financially viable and does not affect security;
 - The DCC should be required to offer terms for all rollout compliant meters without replacement of the communications module;
 - The DCC should be permitted to offer terms only where meters are security compliant;
 - The DCC should be under an obligation to maximise return on investment;
 - The DCC should be required/permitted to offer terms where a mechanism for technical interoperability exists;
 - The DCC should be permitted/required to offer terms for a minimal range of non-compliant meters defined by SMIP;
 - It was noted that a due diligence process would be needed in relation to any non compliant meters;
 - The DCC should be permitted/required to offer terms for compliant and AMR meters only;
 - The DCC should be permitted/required to offer terms for any non-compliant meters; and
 - The DCC should be permitted/required to offer terms (or where associated with supply to premises).
- 4.115. On the question of what information should be made generally available in relation to elective and value added services, there was a mixed set of views from respondents. Most argued in favour of full transparency for Core and Elective services with several extending this also to value added services. Others felt full transparency should apply to Core and Elective alone. Some suggested that only certain commercially sensitive data items should be kept confidential, whereas one suggested that it was necessary to make available sufficient

information for the impact of the services to be assessed. On the issue of whether the contractual arrangements for elective and value added services should be set out in the SEC or in bilateral contracts, a range of views was also expressed. Some believed all services should be defined in the SEC whereas others drew a distinction between Elective (SEC) and Value Added (non-SEC). Others suggested bilateral agreements with principles in the SEC, whilst others proposed proforma agreements in the SEC.

Response and Proposed Licence Drafting

- 4.116. 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 with the development of the Smart Metering Equipment Technical Specification (“SMETS”) documents. This will set out the technical specification for the equipment that suppliers will install in consumer premises and will evolve over time.
- 4.117. Subject to any changes that arise from development of these matters, it is proposed to retain the basic delineation of services set out in the September consultation. 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 where it will be specified by the Secretary of State. This is still subject to discussion and development. However, it is envisaged that Core Communications Services (Part A of Condition 17) will be the minimum set of communications required to be made available in relation to all compliant smart metering systems in order to achieve the Government’s objectives in rolling out smart meters, whereas Elective Communications Services (Part B of Condition 17) would be bespoke services taken by individual users or groups of users.
- 4.118. It is proposed that, in order to qualify as a Core or Elective Communications Service, the relevant communication would need to be related solely to the supply or use of energy. Whilst being related solely to the supply or use of energy is a broad concept, it does mean that communications that are partially or wholly unconnected with supply or use of energy would fall outside these definitions, and hence would need to be treated as value added services. This reflects 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.
- 4.119. Part C of Condition 17 also requires the DCC to enrol eligible meters through an Enrolment Service as part of its Mandatory Business. The concept of 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. As highlighted above (paragraph 4.116), precisely which metering equipment the DCC will be required to enrol or may enrol continues to be considered.
- 4.120. Similar arrangements would apply to communications services. Where a meter system was enrolled with the DCC, the DCC would be required to provide Core Communications Services in accordance with the SEC to any SEC party. It would also be required to respond to service requests for elective communications services and would be permitted to provide Value Added Services where the DCC is given permission to do so by the Authority. 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 scope of these would be defined in the SEC or other associated documents

- 4.121. Part D of Condition 17 (“Requirement for the provision of Services”) refers to 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 is considered in more detail at paragraphs 4.272-4.273 below.
- 4.122. The timeframe within which, and process for dealing with, requests for services would be expected to be dealt with are different for the different types of service. For Core Communications services the draft licence (Condition 17.5) makes it clear that time will be of the essence in making such services available following a valid request. However, it is proposed that for Elective Communications services (Condition 17.7) the DCC must respond to service requests following a two stage approach. The first stage will be an initial scoping exercise, during which the DCC would be expected to form an initial view as to the practicality of the request. It may be the case that very straightforward requests can be fully accommodated within this initial period. If necessary, in the second stage the DCC would undertake a more detailed investigation of the work required. Any work undertaken by the DCC in the initial scoping exercise and subsequent second stage could be charged to the service requester. The DCC would be expected to respond to service requests as soon as reasonably practical and in any case no later than 10 working days after the request is received for the first stage. For the second stage, the DCC would again be expected to respond as soon as reasonably practical, and in any case no later than 20 working days after it has been told by the requester that it wishes to proceed with the service. The Government considers that a longer timeframe could potentially apply to the second stage in recognition of the wide range of possible service requests – some of which may be significantly more demanding to fully evaluate than others. Comments are welcomed on whether these timeframes are appropriate (see question 8 (ii)).
- 4.123. Part F permits the DCC also to offer Value Added Services to SEC Parties and any other person, subject to the approval of the Authority. While the provision of Value Added Services is permissive, unlike the provision of Core and Elective Services, which is obligatory, the terms on which Value Added Services 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.
- 4.124. Value Added Service recipients may be required to accede to the SEC for certain specific purposes, for example compliance with the security requirements. Furthermore, the SEC may place requirements and restrictions on the content of Value Added Service contracts. More generally however, Value Added Services are expected to be provided outside the SEC in bilateral contracts between the DCC and relevant users. Such contracts would have to put in place equivalent protections, for example with regards to security, as are contained in the SEC (see also discussion at paragraph 4.56).
- 4.125. As noted in the introduction and in the discussion on Chapter 9 (“Price Control Conditions”) below, there is likely to be a clear distinction between the DCC’s focus in its early operational phase as compared to when it is more established. The primary objective of the DCC in getting itself established will be to ensure it is robust and effective. Its principal service offerings will be the Core Communications Services discussed above, alongside enrolment and the provision of

communications hubs if appropriate. As it becomes more established, the Government would expect it to become more proactive in offering and developing elective services and then, potentially, value added services.

- 4.126. The remaining parts of Condition 17: require the charges set out in any offer to be consistent with the DCC's charging methodology and statement of charges (see discussion below); relieve 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 provide for disputes regarding Core and Elective Communication Services to be determinable by the Authority. Such disputes will be dealt with following the provisions in Condition 20 (see paragraph 4.145 below). The Government proposes that there is no equivalent right of determination for Value Added Services as these services are neither obligatory nor energy-related and therefore are outside the Authority's regulatory scope. However, the Government recognises the need to ensure appropriate safeguards in relation to DCC provision of Value Added Services and considers that the Authority's role in approving such services will provide a degree of regulatory assurance to the users of non-energy related services. The Government and the Authority are continuing to discuss the regulatory framework for these Value Added Services.
- 4.127. The draft licence assumes that the terms and conditions for provision of Core Communications Services would be set out under the SEC. It also envisages that proforma terms for the provision of Elective Communications Services may be provided for in the SEC and that whilst some elements of Elective Services may be dealt with in separate bilateral agreements outside the SEC, such services would be being provided "pursuant to" the SEC.
- 4.128. The issue of what information is made available to SEC parties in general about Elective Communications Services is discussed in the SEC consultation (see paragraph 1.4) and at this stage, the licence drafting does not require or preclude any particular solution to this matter.

September Consultation – Charging Statements

- 4.129. The September consultation asked a number of questions on the charging methodology. Some of these relate to details of the particular charging methodology that the DCC might adopt. These are being addressed in the separate SEC consultation(see paragraph 1.4 above).
- 4.130. In the September consultation, the Government proposed that the charging methodology would be set out in the SEC but that the DCC licence would contain specific objectives that the charging methodology should achieve. Specifically we proposed that the objectives of the DCC charging methodology should comprise:
- (a) that the charging methodology facilitates competition; and does not restrict, distort, or prevent competition in the supply of energy, provision of energy related services or energy distribution;
 - (b) that the charging methodology should take account of developments in the DCC's business;
 - (c) that the DCC's charges for a core service will be the same for each meter point, so-called "postage stamp pricing";
 - (d) that, subject to (c), charges overall should be, as far as reasonably practicable, cost reflective;

- (e) charges should be predictable;
- (f) charges should not be a disincentive to early rollout of smart meters; and
- (g) charges should be non-discriminatory.

- 4.131. It was suggested that, were certain charges to network operators to vary by region, (c) would have to reflect this, and considered whether a further objective of the charging methodology should be to promote innovation in the supply of energy, provision of energy related services and energy distribution.
- 4.132. The September consultation also stated that a Government objective is for all energy consumers to have access to smart metering services. Whilst it was recognised that the costs of providing these services could vary according to the location and technical differences of premises in which Smart Metering Equipment is installed, it was thus proposed that charges should be equal for all consumers (including non-domestic consumers). This was to ensure there were no barriers to particular customers in taking up the benefits of smart meter equipment, in line with the commitment to roll-out smart meters to all GB domestic premises. It was, nevertheless, suggested that it was for consideration as to whether charges to network operators should be postage stamp or whether charges to them could vary by region, given the different relationship with the end-consumer compared to suppliers.
- 4.133. The September consultation also said that it was for consideration as to whether the objective for the charging methodology should be to promote innovation in the supply of energy, provision of energy related services and energy distribution.

Views of Respondents – Charging Statements

- 4.134. Most respondents supported the proposed charging principles. Some respondents said they supported Objective (a), i.e. facilitating competition, whilst one said that it was important that the charging methodology was simple and straightforward and another acknowledged that the charging methodology would necessarily be a simplification of the DCC's actual costs. A further respondent argued that Objective (e), i.e. predictability of charges, would be delivered by Objective (a).
- 4.135. Other respondents variously commented: that it was important that different charges could apply to different service levels for the same service (unless these were defined as being different services), for example more frequent meter readings of the same type and that there was merit in charges to network operators varying by location and or technology; that there must be flexibility as the DCC service evolves over time; that charges should be reflective of marginal costs; and that there should be a fair allocation of fixed and volumetric costs between network operators and suppliers.
- 4.136. One respondent disagreed with Objective (f), arguing that DCC charges were an inappropriate instrument with which to influence Suppliers' commercial approach regarding the timing of smart meter roll-out.
- 4.137. Almost all respondents agreed with the proposal that the charges should be on a postage stamp basis. Most of these respondents said that they agreed with the principle that some customers should not be penalised for the higher costs of providing the same communications service and that locational or customer-specific charges could foster a sense of unfairness.

Another respondent said that non postage stamp pricing would avoid further tariff complexity which discourages consumers switching between Suppliers. One respondent felt that postage stamp pricing was inconsistent with the objectives of the programme but, nevertheless, thought it might still be the most practical policy.

- 4.138. The majority of respondents were of the view that postage stamp charging should apply to distribution network operators (DNOs) also. One argued that the charging principles applying to network operators should be the same as applies to suppliers, whilst another argued that charging different network operators a different amount would put the DCC in breach of its proposed obligation not to be discriminatory. Another respondent pointed out that deriving postage stamp prices could be difficult to calculate when costs varied locationally and hence postage stamp pricing could lead to the need to revise charges more frequently when stability was, for them, probably more important.
- 4.139. A number of respondents disagreed, however. One respondent said that it wasn't clear that network operators would be mandated to use smart metering services and that charge might be better based on the benefits to network operators. Two respondents said that charges should be cost-reflective whilst one of these said that there was an important distinction in this regard between network operators and suppliers and that failure to charge cost-reflectively could result in smart metering subsidising smart grid developments.
- 4.140. Views were divided on whether an objective of the DCC charging methodology should be to promote innovation in the energy supply, energy distribution and the provision of energy related services. Several respondents argued that it was up to the market, not the DCC, to deliver innovation, although some said that it was appropriate for the DCC to "facilitate", rather than "promote", innovation. Others argued that the DCC must innovate within its own services and where possible facilitate innovation elsewhere in the industry. Another broadly agreed but said that it was not for the DCC to determine how the distribution and supply sectors are run but to recognise requests made by suppliers and distributors.

Response and Proposed Licence Drafting

- 4.141. The Government has considered further the approach to the charging of core services, and in particular the difference between domestic and non-domestic energy consumers. The Government is aware that there is an existing market for the provision of smart metering type services to non-domestic consumers. Therefore, if the DCC were to apply uniform charging for these consumers' meters, it is likely that non-domestic customers in more expensive to serve locations would seek 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 expensive areas. Non-domestic consumers in less expensive to serve locations would remain with their existing service provider (as these service providers 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. The prices for domestic consumers would therefore rise as a result of offering uniform pricing to non-domestic users and competing providers of these services would be disadvantaged.
- 4.142. The Government remains of the view that there are clear universal service benefits in applying uniform charges to core services for domestic consumers as it believes this approach will maximise the number of people using smart meters. However, because of the potential for market distortion and cross-subsidy discussed above, it does not now believe that specifically

requiring geographically uniform charges for core services is appropriate for non-domestic consumers.

- 4.143. Condition 18 (“Charging Methodology for Services Charges”) requires the DCC to have in force a charging methodology which, initially, is to be designated by the Secretary of State and incorporated into the Smart Energy Code. Part C sets out the objectives of the charging methodology, being, in summary:

Objective 1: that charges in respect of Mandatory Business Services (other than Elective Communications Services) do not distinguish between domestic energy consumers in different parts of GB, i.e. are “postage stamp”;

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.

- 4.144. Condition 19 (“Charging Statement for Service Charges”) requires the DCC to have a charging statement for services in a form approved by the Authority. The condition also provides for the review, amendment and publication of the statement.

- 4.145. Condition 20 (“Determination of disputes by the Authority”) follows a similar approach to that taken in other energy licences and provides 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.

Consultation Questions

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| 8. | <p>Do you have any comments on Chapter 5 of the licence conditions, in particular do you have any comments on:</p> <ul style="list-style-type: none"> i) The procurement obligations, including the balance between what the DCC must competitively procure and what it may self provide; ii) The most appropriate role, if any, for the Authority in influencing how the DCC should balance various competing public interests, when preparing for future procurements of Fundamental Service Capability; iii) Do you have any evidence from other sectors about how the public interest is taken into account by regulated bodies when making major procurement decisions; iv) The obligations on the DCC in relation to provision of services, recognising that these conditions will need to be reviewed in light of a more detailed definition of services; and v) The charging methodology provisions, particularly the objectives of the methodology? |
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Chapter 6 of the DCC licence: Arrangements for Core Industry Documents

September Consultation

- 4.146. The September consultation included a number of proposals in relation to the Smart Energy Code. In particular, the Government proposed to draft the DCC's SEC licence condition to provide that the SEC should encompass a list of initial matters and also to provide flexibility for future changes in scope. This would mean that the SEC licence condition will be permissive and will not explicitly limit the scope of matters that may be included in the SEC. Instead it would place a reliance on the modification process and any other governance arrangements that are put in place to provide a limitation on these matters, i.e. that the proposed modifications would only be accepted if they meant that the SEC would better meet the objectives or any other tests that are set down.
- 4.147. The September consultation also proposed to include the following matters in SEC Applicable Objectives in the DCC's licence, recognising that there may be some scope for consolidation when developing the legal drafting of the licence conditions:
- a. the efficient discharge by the DCC of the obligations imposed upon it by its licence;
 - b. the efficient, economic and co-ordinated provision of DCC services;
 - c. promoting effective competition in the supply of gas and electricity;
 - d. promoting efficiency in the implementation of the administration of the SEC;
 - e. an objective related to having due regard to the environment;
 - f. an objective related to promoting or facilitating competition in energy efficiency, metering services and other energy related services; and
 - g. an objective related to maintaining data privacy and security, and security of the smart metering system.
- 4.148. It was also proposed that the transitional objectives of the SEC should include an objective related to facilitation of rollout of smart meters.
- 4.149. The Government said that it would consider further whether to introduce an objective of the SEC to promote energy efficiency more generally. Furthermore, in line with the proposed treatment of consumer interests in the DCC's objectives that was suggested, the September consultation proposed that the SEC would protect consumers' interests by being designed to meet its applicable objectives, rather than having an explicit objective related to the protection of consumer interests.
- 4.150. It was anticipated that a number of key requirements for the SEC modification procedure would be contained within the DCC licence and a number of potential issues were discussed. It was explained that the Government intended to progress these matters further as part of the detailed drafting of the DCC licence conditions and in light of the parallel development of the SEC.

Views of Respondents

- 4.151. Stakeholders responding to consultation questions relating to the SEC all agreed that the SEC licence condition should be drafted in a permissive, flexible manner. The rationale given for

this approach included experience from other codes which shows they do (and need to) evolve significantly over time. Some respondents observed the necessary link with the need for a robust change management process in the Code.

- 4.152. A wider range of views was expressed in relation to the SEC applicable objectives. While the majority agreed with the applicable objectives in general there were some areas of disagreement relating to specific objectives and a number of suggestions of ways to refine them. Comments also suggested that the intent of the wording of the objectives needed to be clearer in some cases, as did the relationship to DCC objectives and what this means in terms of rights and obligations. One respondent was 'extremely uncomfortable' with the objectives and thought they were badly focused with multiple overlaps. Others commented on specific objectives or suggested new / alternative objectives. These included that:
- objectives (a) and (b) should be merged;
 - objective (c) should read gas "and/or" electricity;
 - in (d) wording should refer to administration in itself, not implementation of administration of the SEC;
 - objective (e) was unnecessary;
 - objective (f) may also be unnecessary; and
 - objective (g) may duplicate provisions in the Data Protection Act.
- 4.153. A number of new or alternative objectives were also suggested as follows:
- that all parties should facilitate overall integration of the system;
 - that the SEC should provide for competition in supply of data and communication services to the DCC;
 - that it should promote an efficient, coordinated and economical system of electricity and gas distribution; and
 - that the SEC should protect and/or empower consumers.
- 4.154. There was also general support for the inclusion of provisions relating to smart meter rollout. Mixed views were received on the issues of including provisions to support efficiency of energy networks, with some respondents being in favour of this and others arguing that this matter was already dealt with sufficiently in DNO licences; and on the issue of energy efficiency, with some suggesting that the SEC objectives should refer to this explicitly whilst others argued that it was sufficient for the SEC to facilitate competition in the provision of services relating to energy efficiency.
- 4.155. Stakeholders in WG1 (see paragraph 4.4 above) discussed whether a discrete objective was necessary to further the consumer interest. It was noted that all of the objectives should in of themselves further consumers' interests. However, a body representing consumer interests was concerned that the objectives as drafted might not on their own capture all potential modifications to the SEC that could further consumers' interests. Therefore it argued that a separate discrete objective was necessary to ensure all potentially beneficial modifications

could be accepted. Some stakeholders also put forward the view that explicit reference to consumers' interests was necessary to ensure consumer interests were at the forefront of the SEC Panel's deliberations on code modifications.

Response and Proposed Licence Drafting

- 4.156. Condition 21 ("Compliance with Core Industry Documents") places obligations on the DCC to become a party to and comply with a number of gas and electricity industry codes. In particular, it must maintain and have in force the SEC (see below). Precisely which codes it will be necessary for the DCC to become party to remains to be determined following the more detailed development of the contractual arrangements underpinning the DCC, in particular the further development of the Smart Energy Code. The licence condition also requires the DCC to comply with the Fuel Security Code. Whilst there are no immediate plans to amend the Fuel Security Code to reflect the smart energy arrangements, the DCC would be required to comply with existing arrangements insofar as they are relevant to the DCC and it is possible that the DCC's role under the Fuel Security Code may be amended in the future.
- 4.157. Condition 22 ("The Smart Energy Code") requires the licensee to be a party to and comply with the Smart Energy Code (SEC) and recognises that fact that the initial SEC will be designated by the Secretary of State, following appropriate consultation.
- 4.158. Condition 22 also requires that the DCC must maintain and have in force the SEC. The purpose of this requirement is to ensure that the SEC is always up to date and contains the necessary components and procedures set out in Condition 22 ("The Smart Energy Code") and Condition 23 ("Change Control for the Smart Energy Code"). The Government is mindful of the need to strike a balance between two potentially competing factors. On the one hand, there is the need for an appropriate regulatory mechanism (in this case an enforceable licence condition) to ensure that the SEC is always appropriately maintained. On the other hand, the SEC is not intended to be a DCC-only document, and its users will be heavily involved in its ongoing evolution - with oversight by the Authority - after it is first determined by the Secretary of State.
- 4.159. Therefore it would not be appropriate for the DCC to have a disproportionate influence on the SEC's contents and so Condition 22 has a number of requirements with respect to the ongoing governance arrangements, secretariat and administration of the SEC (see paragraph 4.174 below). As set out in the SEC consultation, the Government is proposing that the DCC would 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 to inform the assessment of them by the SEC Panel). The Government welcomes views on whether this approach strikes the right balance between ensuring that there is a sufficient regulatory requirement to keep an in force SEC in place with the requirement to ensure that decisions on the contents of, and procedures for, the SEC are appropriately independent from the DCC.
- 4.160. Condition 22 also defines the objectives of the SEC. In light of the responses to the consultation and further consideration as part of developing the detailed drafting of the DCC licence, the objectives now proposed are:
- 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.
- 4.161. Recognising that in some circumstances, these objectives could conflict, for the purposes of the condition, the drafting recognises 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.
- 4.162. Many of the comments raised in the responses to the consultation are dealt with in these re-crafted objectives. Whilst ideally, there would be fewer objectives, the Government is of the view that each of the objectives set out above is relevant to the SEC and consequently the scope for further rationalisation seems limited. In line with other Codes, it is not proposed that the SEC objectives should explicitly include a reference to the environment, although it is proposed that Condition 23 should require that any modifications to the SEC should (if likely to be material) include an assessment of the impact on greenhouse gas emissions, and furthermore that the cost impact of these emissions should be taken into account in the assessment process.
- 4.163. The SEC arrangements are likely to have a more significant impact on consumers than with other Codes: for example, the specification of the In Home Display (IHD) may be contained in a document governed under the terms of the SEC. Therefore, it is proposed to state that the Code achieves the objectives if it does so in the round with due regard to consumers’ interests. It should be noted that this explicit recognition of the need to have regard for consumer interests would be unique to the SEC, reflecting its anticipated content.
- 4.164. However, the objectives do not include a specific objective to protect consumers interests, which is in line with the approach in other industry codes, none of which has such an objective. Some stakeholders have raised concerns that it will not be possible to raise modifications in the interests of consumers if they do not facilitate any of the other proposed objectives. They have suggested that the only way of addressing this is to include a specific consumer protection objective.
- 4.165. Under this approach, when a modification proposal is submitted to it for approval, the Authority will consider this against the relevant code objectives and also in view of its wider statutory duties, including its primary duty to protect the interests of consumers.
- 4.166. This arrangement will work for the SEC if modifications that protect consumer interests can be raised that better facilitate the meeting of the relevant SEC Objectives. The objectives currently proposed cover a wide range of matters that are potentially of relevance to consumers,

including security, privacy, competition, provision, installation and maintenance of smart metering equipment, and innovation (amongst other things this captures smart grid related developments) and consequently it is considered that the potential for there to be a modification that would be in the interests of consumers but that did not better meet one of the proposed objectives is unlikely.

- 4.167. The Government also recognises, for example, that the inclusion of SMETS (see paragraph 4.116) in the SEC will set out meter functionality which provides benefits (information) to consumers rather than SEC parties (through the IHD specification). If changes were proposed to this meter functionality from a consumer interest perspective, it is important that such changes could be justified on the basis of the SEC Objectives.
- 4.168. Similarly, if the initial list of core services set out in the SEC covers certain services which provide benefits to consumers, and these services can be amended, then it is also important to explore whether this can be done from a consumer interest perspective, based on the SEC Objectives.
- 4.169. One view is that both of these issues have at their heart the provision of timely, accurate and informative information to energy consumers, associated with their energy consumption. This is not directly addressed by the other objectives, and it might therefore be appropriate to add a further objective in this regard. Alternatively, taking the first example, it might be considered to facilitate the more efficient operation of smart metering equipment and so could be captured by the first objective listed above.
- 4.170. Adding a more general objective related to protecting consumer interests looks straightforward in principle and potentially attractive in that it could capture any unforeseen consumer interests not already addressed by the other objectives. However, in practice, this may risk opening up the scope of the code so widely that modifications could be raised and justified on almost any matter. It also risks diluting the importance of protecting consumer interests because these would have to be balanced in the round against other objectives.
- 4.171. The approach set out in the draft licence is intended to highlight the importance of ensuring that the interests of consumers are taken into account whilst at the same time continuing to recognise that the code is a commercial agreement between parties that does not deal directly with the relationship between those parties and consumers. The Government welcomes views on this proposed approach to capturing consumer interests in the licence condition relating to SEC Objectives.
- 4.172. An objective relating to innovation in Energy Networks has been included in recognition of the fact that smart metering is intended to be an enabling technology for smart grids and hence the interaction with such arrangements needs to be recognised.
- 4.173. The Government has stated that the SMETS (see paragraph 4.116 above) will be governed under the SEC and that detailed arrangements for this will be subject to further consultation⁷. Given that these arrangements will make provision for the SMETS to be changed over time, it may be necessary for the objectives of the SEC to explicitly make reference to interoperability.

⁷ See Government Response to the Consultation on draft licence conditions and technical specifications for the roll-out of gas and electricity smart metering equipment

- 4.174. The licence condition also sets out the principal contents of the SEC. This will need to be kept under review as the detail of the SEC continues to be developed, for example, arrangements in relation to non-domestic meters that are 'opted out' of DCC or more general arrangements applying to smart meters. This is also the case with the governance and administration of the SEC that is also set out in this condition, and discussed in more detail in the Smart Energy Code consultation. It includes, for example the requirement to establish a SEC Panel responsible for proceedings specified for the governance and administration of the SEC, including the arrangements for establishing and funding a SEC Administrator. Condition (22.23(b)) provides for the Authority to appoint an appropriate person to be Chairman of the Panel. The Government will discuss in a future consultation paper whether, in the first instance, this person should be appointed by the Secretary of State. If the Government decides it would be more appropriate for the first Chairman to be appointed by the Secretary of State then a further minor modification may be needed to this draft licence condition.
- 4.175. Condition 23 ("Change Control for the Smart Energy Code") sets out arrangements for establishing an effective and transparent compliance and change control framework for the SEC. In particular, it sets out the modification arrangements that the SEC must contain. Again this is discussed in more detail in the Smart Energy Code consultation.
- 4.176. One proposal which may be of particular interest in this condition is the proposal to allow the Secretary of State to prevent modifications to the SEC in the period up to 31 October 2018. Given the powers under Section 88 of the Energy Act 2008 to modify licences and codes for the purposes of implementing the smart energy programme this requirement may be redundant, but it is considered pragmatic to include it as doing so would avoid the need for the Secretary of State to use Section 88 powers to undo SEC modifications which were inconsistent with the wider implementation of the smart metering programme.
- 4.177. The condition also allows the Authority to put forward modification proposals. It would put forward such proposals following a Significant Code Review process. As currently drafted the condition provides the Authority with relatively broad powers to bring forward modifications, the intention is that the power would be limited to specific, defined areas that will be set out in the SEC. The Government recognises this is unusual for industry codes and is interested in views from potential SEC parties and others on the implications of the condition.

Consultation Question

- 9. Do you have any comments on Chapter 6 of the licence conditions, in particular do you have any comments on :**
- i) The scope of the SEC as set out in the SEC condition and the SEC objectives;**
 - ii) Whether the DCC should have a licence obligation to maintain and keep in force the SEC;**
 - iii) The proposal to allow the Secretary of State to block SEC modifications in the period up to 31 October 2018; and**
 - iv) The way in which interoperability should be addressed through the SEC objectives?**

10.	<p>Do you have particular comments on how best to ensure the consumer interest is met in the SEC Objectives, in particular:</p> <p>i) Can you identify any potential scenarios where a modification might be proposed which would be in the interests of consumers but which would not be supported by the objectives set out for the code; and</p> <p>ii) If you think the objectives could be set out to better capture the interests of consumers, as opposed to the proposed approach for SEC objectives to be balanced in the round with due regard for energy consumers' interests, how do you think this could be done?</p>
11.	<p>Do you have comments on the proposed condition allowing the Authority to put forward code modifications and for this power to be limited to specific areas defined in the SEC?</p>

Chapter 7 of the DCC licence: Financial and Ring-Fencing Provisions

September Consultation Paper

- 4.178. In the September consultation paper, the Government proposed a package of financial constraints be placed on the DCC which mirror those placed on network licensees generally, but that it would examine the requirements for network licensees before identifying the equivalent requirements for the DCC and also refine the detailed arrangements in light of the Authority's consultation on financial ring-fencing in network operator licences. Subject to this exercise, the Government proposed to include conditions regarding:
- disposal of relevant assets;
 - restriction of activity and financial ring-fencing;
 - availability of resources;
 - undertaking from the ultimate controller; and
 - restriction on indebtedness.
- 4.179. As applied to offshore transmission, the Government proposed to adopt a flexible approach to credit rating, whereby the DCC could put forward alternative security arrangements to the Authority, where the amount of security would be linked to the financial exposure of the DCC.
- 4.180. The Government invited views on whether the DCC should be liable to pay a proportion of the additional costs of appointing a new DCC in the event that an incumbent DCC's licence was revoked, and on whether any security from the DCC would be needed to cover this potential liability.
- 4.181. The Government also invited views on whether a special administration regime should be created to provide protection against financial failure of the DCC, recognising that additional legislation would be needed to put this in place.

- 4.182. Lastly the Government proposed that the DCC should be required to use financial standing as a key criterion in the procurement of major service providers and to monitor and report it on an ongoing basis, and also to require service providers to have in place appropriate business continuity plan.

Views of Respondents

- 4.183. The majority of respondents agreed that the ring-fencing provisions applied or to be applied to network operators were appropriate for the DCC. Other respondents stated that adequate ring-fencing was important but were not specific as to what was required. Some respondents emphasised the need for flexibility to adapt to the DCC's circumstances, such as if the restrictions presented a barrier to DCC procurement or in the event of the DCC needing to fund assets. One respondent said also that any arrangements should allow signals of financial distress to be identified early and for pricing re-openers where necessary to protect the licensee.
- 4.184. Most respondents agreed also with a flexible approach, with several respondents observing that the appropriate security would depend on the level of exposure to risk for the DCC and that security should be assessed on a case-by-case and not a "one size fits all" basis. One respondent stated that the OFTO approach was a useful precedent. Some respondents also stated that security should be provided to ensure that the DCC had an incentive not to cease operations and to continue to perform its functions.
- 4.185. Most respondents agreed also with the proposal that the DCC should be liable for the costs of appointing a successor, at least where the reasons for revocation were not outside the licensee's control, and that security should be provided. One respondent agreed that in principle the licensee should be liable but argued that security would be costly and have limited benefit. Some respondents thought that recovering such costs from a failed licensee would be impractical or that such a requirement could deter bidders, whilst another argued that there should be more than one licensed provider, so that it would be easier to continue service provision.
- 4.186. The majority of respondents believed that other conditions were not required. However, some respondents suggested that there should be additional and frequent reporting, with clarity on the consequences of breaching defined thresholds. A couple of respondents argued that systems, including special administration or a system of service providers invoicing suppliers directly, should be in place to carry on paying service providers in the event of DCC financial collapse. Almost all respondents agreed with the proposals for business continuity. Only one respondent disagreed, believing that it was the responsibility of the regulator. Respondents also supported the proposal that there should be a special administration regime for the DCC.
- 4.187. The majority of respondents stated that there should be further protections. Suggestions included: replicating provisions in MRASCo and DCUSA, step-in rights, parent company guarantees and exit plans. One respondent suggested that the WAN service provider would have to be financially ring-fenced and that the rail industry could provide a model. Another felt that step-in rights would be difficult to implement. Three respondents felt that no additional provisions were required.

Response and Proposed Licence Drafting

- 4.188. The conditions in Chapter 7 are 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. As noted above, these requirements draw on those in network licences more generally. However, the DCC as potentially an asset-light organisation requires further obligations on financial security (see Condition 26 below). In drafting these conditions the Government has been 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 to deter sufficiently suitable applicants for the DCC licence.
- 4.189. Condition 24 (“Availability of all necessary resources”) requires 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 requires 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 requires the DCC to certify to the Authority before paying any dividend and to notify the Authority if there is any change in circumstances that could undermine the basis on which certificates have been given.
- 4.190. Condition 25 (“Undertakings from an Ultimate Controller”) requires 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.
- Condition 26 (“Financial stability and financial security”) requires the DCC to maintain an investment grade credit rating except where the Authority agrees to an alternative form of security, such as a parent company guarantee, letter of credit or cash collateral. 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. Condition 26 also requires the DCC to put in place additional financial security over and above that required to give assurances as to its financial standing. This additional security is intended to ensure that the DCC has sufficient capital vested in the company to ensure that shareholders have a clear interest in the ongoing financial viability of the business as opposed to walking away in challenging circumstances. It is proposed that the amount of this additional financial security (the Relevant Sum) will be established as part of the licence application process.
- 4.191. Condition 27 (“Indebtedness and transfer of funds”) places restrictions on the DCC incurring debt or creating charges over its assets except on arms-length, normal commercial terms. Recognising the unique and important position of the DCC within the UK energy infrastructure, the condition is intended to avoid the DCC incurring debt (except in clearly defined circumstances related to its authorised business) and thus jeopardising its ongoing financial viability.
- 4.192. Condition 28 (“Disposal of Relevant Business Assets”) prevents 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 condition requires the DCC to keep a register of such assets.
- 4.193. In addition, Part A and Part B of Condition 9 prohibit DCC from undertaking any activity other than the Authorised Business unless with the Authority’s consent (this largely mirrors 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.

Consultation Question

- | | |
|------------|---|
| 12. | Do you have any comments on Chapter 7 of the licence conditions, in particular do you have any comments on: |
| | <ul style="list-style-type: none"> i) The proposals in relation to financial security, in particular the requirement to provide a performance bond in addition to financial security? |

Chapter 8 of the DCC licence: Provision of Regulatory Information

- 4.194. Conditions 29 to 33 are largely standard conditions and deal 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. Quality of service in particular will be an important issue for the DCC's customers and it is through Conditions 31 and 34 (see below) that information will be made available.
- 4.195. Under Condition 31 the Authority would – as is common with other energy licences – issue detailed guidance on the type of information it required. Condition 34 sets out proposals whereby the DCC will be required to provide 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. These conditions will give the Authority the information necessary to monitor the DCC's performance as well as providing DCC users and other stakeholders with information on the DCC's performance.

Chapter 9 of the DCC licence: Price Control Conditions

September Consultation Paper

- 4.196. In the September consultation, the Government discussed a number of issues with regard to the DCC's revenue restrictions and incentives. These issues included consideration of the incentive regime for the management of the DCC's costs and the question of the relative benefits of cost pass-through and volume drivers. In addition, the need for revenue reopeners was raised both in relation to the DCC take-on of meter point/supplier registration and more generally in relation to any materiality threshold or trigger and whether there were other cost areas may require mechanisms to deal with uncertainty. The September consultation also raised the question of the need for independent audit of the DCC's performance and the feasibility of the SEC Panel and the DCC negotiating KPI targets. In raising these issues, the Government was addressing elements of the licence application process and also the longer term position of the DCC when its service provision becomes more stable.

Incentive Regime and DCC Internal Costs

- 4.197. The September consultation proposed that a package of incentives was required to make sure that the DCC both manages and procures its services and manages its internal costs efficiently and effectively. It stated that the incentives would need to be coordinated to prevent the risk of

the DCC procuring “gold plated” services in order to meet key performance indicators (KPIs). It further proposed that the incentive package should ensure efficiency gains made by the DCC on its internal costs or via management of its service provider contracts would be shared with users. In addition, it was proposed that key performance indicators might address the DCC’s internal activities of providing services to users; its contract management and procurement activities and its management of the performance of its service providers.

- 4.198. It was also proposed that the DCC licence applicants should be invited to bid in the revenue at risk and KPI targets and it was expected that the aggregate incentive penalty amount would be restricted to the DCC’s profit margin in order for the DCC to always cover its operating costs. In addition it was proposed that the DCC licence would set out the DCC’s allowed revenue stream for DCC internal costs and would reflect the DCC’s costs as they are estimated to be incurred. The licence conditions would set out arrangements for the pass-through of service provider costs and of the costs required to fund the activities of bodies needed to manage the SEC, for example the SEC Panel and the Secretariat. It was noted that both cost pass-through and volume drivers have merit and can reduce cost recovery uncertainty for the DCC arising from SEC modification.
- 4.199. Respondents were asked to provide comments on the incentive regime proposed for the DCC and to express their views on the relative benefits of cost pass-through and volume drivers for the recovery of the DCC’s internal costs. Respondents were also asked for their views on sharing mechanisms both in relations to changes in the DCC’s internal costs and whether such mechanism should be included in the contracts with the service providers.

Views of Respondents

- 4.200. In relation to the incentive regime proposed, there was general agreement on the proposals put forward, however a number of respondents wished to see more detail before forming a final opinion. A few respondents had concerns that the examples in the consultation document were activity focused rather than output focused. There was a question as to how the KPIs would prevent gold plating in practice. Most respondents agreed that the incentive regime was likely to be different during the early years and that a review at some point after go live was appropriate.
- 4.201. In relation to the relative benefits of cost pass-through and volume drivers for the recovery of DCC internal costs, a majority of respondents preferred the cost pass-through option on the basis that the volume driver approach was unlikely to be feasible. One respondent also expected that the SEC Panel would assess costs. Another noted that any assessment should take into account any net benefit to the DCC (e.g. if its costs increase by £5m but it made £10m in savings).
- 4.202. Another point that was made - in relation to volume drivers - was that it might be difficult to ramp resources up or down in order to meet SEC modification requests. Therefore, some general operating costs may need to be associated with maintaining sufficient expertise and resources to carry out SEC modifications.
- 4.203. One respondent proposed that an option could be to allow these costs as a type of pass-through, but with the costs adjusting the 'target' in the sliding scale incentive. This would mean that any savings are shared with users and the licensee is still incentivised for these costs. However, this would also provide the DCC licensee with an incentive to over-estimate these costs. One reason for including these costs in the sliding scale is that SEC modifications may

result in an ongoing change to the DCC's costs, this would reduce the risk of the DCC gaming the regime, by shifting costs to and from the SEC modification costs.

- 4.204. Aside from two respondents, all respondents supported gain sharing mechanisms on both the DCC and its service providers (through their contracts). An example cited by respondents of this working in practice was the Master Registration Agreement (MRA). A number of respondents considered that the mechanism between the DCC and the service providers was more important as this was for large sums. One respondent indicated that the savings should be proportionate to the risks that the parties take on.

Revenue Reopening

- 4.205. The September consultation proposed that a general revenue reopener should be included in the DCC revenue restriction, which would be triggered if the DCC costs were above or below as materiality threshold. Respondents were asked to consider whether it was practical for applicants for the DCC licence to estimate costs for undertaking meter point/supplier registration or whether a specific reopener would be required. They were also asked to comment on the appropriate materiality threshold for a reopener and to suggest further cost areas which might require mechanisms to deal with uncertainty.

Views of Respondents

- 4.206. In relation to the take-on of meter point/supplier registration, the majority of respondents thought that applicants for the DCC licence would be able to provide a ball park estimate for the costs of such a task. However, there was a near-even split between respondents who thought sufficient information on registration activities was currently available and those that thought that there were timing and scope risks associated with registration. A small number of respondents thought that the applicants would not be able to estimate the costs and a specific reopener should be allowed.
- 4.207. The greatest level of support was for the applicants to bid in cost estimates, but for these to be reviewed closer to the adoption of registration and a specific reopener set to take into account changes in scope and timing. Under this approach there is a question as to whether these cost estimates would be assessed as part of the application process (i.e. to prevent them bidding in high estimates so as to increase their profit when they take over registration).
- 4.208. On the specific topic of revenue reopeners, almost all respondents to this question agreed that a revenue reopener should be included in the revenue restriction. There was however significant variation in the suggested materiality level for the threshold. This ranged from 1% of revenue to 20%. The most common level put forward was 10%, in line with the proposal in the consultation document. A point was raised in relation to small revenue adjusting events and it was suggested that the reopener threshold should be triggered from the accumulation of many small events. A suggestion was also raised that there should be a 'change' allowance to deal with these activities and for a reconciliation of actual versus budget used. A reopener would only be needed if the actual costs were greater than the allowed.
- 4.209. The majority of respondents thought that there were no more specific cost areas that could be identified at this time that would require reopeners. However a small number of respondents indicated some. The following are the areas where they considered costs to be particularly uncertain:
- Procurement costs (unexpected procurement)

- Re-procurement due to technological change
- Changes to the industry structure
- Change in security requirements
- Regulatory changes
- Value-added services
- Changes to the scope of DCC services

Independent Auditor

4.210. The September consultation proposed to provide for the ability for the Authority to commission an independent audit of DCC performance against its licence obligations. Such an audit would provide the Authority with an assessment of whether the DCC had underperformed and provide recommendations. Under the DCC's licence reporting requirements, the DCC would be required to furnish regular reports on its (and its service providers') service performance.

Views of Respondents

4.211. There were mixed views on the use of an independent auditor. Most support was for the audit to be on both a regular basis and an ad hoc basis where the Authority identified any concerns. A few respondents raised a point that undertaking an audit too regularly would cause disruption and cost. It was also noted that it may be best to begin the audits once the DCC has reached a steady state.

Negotiation of KPIs

4.212. Although the September consultation made no specific proposals in this area, respondents were asked for views on the appropriateness and feasibility for the SEC Panel and the DCC to negotiate KPI targets.

Views of Respondents

4.213. With regard to the negotiation of KPI targets, an overwhelming majority supported this proposal, however there were a few issues raised. These included the need to define clearly the Authority's role in the process, concerns about whether the SEC Panel would have the right 'make-up' and expertise and the need to ensure that the scope for negotiation is limited where it would affect the DCC's costs or cost targets.

4.214. One respondent suggested individuals could be appointed to the SEC Panel to negotiate with the DCC but recognised that the Authority would be responsible for ratifying the agreement. Another respondent thought that KPIs should only be updated once a steady state had been reached. Some respondents thought KPIs should be determined as part of the licence award negotiation, two others thought the Authority should be responsible for setting targets. One respondent considered that if more qualitative KPIs were used, then the auditor may be used more regularly, however if robust measurable KPIs were used then ad hoc audits when there are concerns may be more appropriate.

Discussion

4.215. The Government agrees with respondents' view that the incentive regime is likely to be different during the early years and that a review will be necessary. Indeed, it is likely that priorities for the DCC's performance at the beginning of its work will be different from those in a later, more

stable, circumstance. Initially, it is likely that the priority for the DCC should be to work with the service providers and users preparing for effective delivery of services (from DCC go-live) and enabling the mass rollout of meters, while later its efforts to drive down costs should predominate. For this reason, the Government has concentrated on designing a revenue restriction and incentive regime for the beginning of the DCC's work and has drafted the framework of other incentive elements of the "price control" conditions in the licence to support the review of such elements, when the DCC's position becomes more stable or when it is decided that the regime needs review.

- 4.216. The Government agrees that initially, at least, and given that the first period after the award of the DCC licence will be spent developing, testing and trialling the systems with users and service providers, any attempt to associate KPIs with DCC internal costs runs a serious risk of diverting the DCC's attention from those aspects which are most important in preparing for DCC go-live and the beginning of mass roll-out of smart meters. In addition, initial information about users' priorities for DCC services will be very sparse and setting targets would be subject to certain error, with the effect of focussing DCC's attention on issues not of highest priority to its users.
- 4.217. For these reasons, and reflecting the scale of costs of the DCC compared to its service providers, the Government believes that, initially, there should be no specific financial incentives focussed on the reduction in DCC internal costs. The initial level of the DCC's costs will be the subject of competitive pressure, where during the licence application process, bidders should, amongst other things, be driven to propose the lowest costs needed to run the DCC business. Once appointed, and with this cost estimate in the public domain, the DCC will, of course, at all times be subject to its general objective of having to ensure the development, operation, and maintenance of an efficient, economical, and co-ordinated system for the provision of Mandatory Business Services. It is also the case that any allowed costs would need to be efficiently incurred. The Government expects that justifying any significant differences from the costs provided during the licensing process would be difficult.
- 4.218. Furthermore, the Government believes that there are other key targets that should be the initial focus attention for the DCC, namely ensuring that its systems and those of its service providers are ready and working effectively for the planned start of mass rollout of smart meters. In particular it should have some form of financial interest in its achievement of key programme milestones (such as the timely go-live of the DCC).
- 4.219. The Government expects that the applicants for the DCC licence will be asked to include a profit margin (i.e. a margin for its revenue, over and above its internal costs) in its bid. It might also be helpful to ask for applicants to indicate the level at which they would accept putting that margin at risk in relation to its achievement of key programme milestones and in the future other KPIs that will be determined.
- 4.220. Finally, the Government believes it would be advantageous for the DCC to have a financial interest once it begins the provision of services in the level of system wide volume driver, such as the number of successfully delivered messages, to ensure that it has a financial interest in doing more work for users. The Government's vision for the DCC is to be a proactive and responsive body that has an interest in the development of the smart meter market and utilisation of the equipment installed in consumers' premises. Such a volume drive would align the DCC's (financial) interests with that vision.

- 4.221. The DCC take-on of meter point/supplier registration would be a significant change to the DCC role, and it is by no means clear that the initial revenue restriction and incentive regime will be fit for purpose at the end of that change. It is therefore expected that this change would initiate a review of the licence “price control” conditions as well as other licence conditions.
- 4.222. In relation to key performance indicators, it is expected that the revenue restrictions and incentives in the licence will include some KPIs. While it may not be appropriate for these to be subject to financial incentives initially, it is expected that financial incentives would be applied following subsequent review as part of the development of the KPI arrangements. It is expected that the development of KPIs in the SEC and the DCC reporting of performance against such KPIs to the SEC Panel, would inform any review of the price control licence conditions leading to the proposal of appropriate incentives related to KPIs and incentives on the DCC’s internal costs. It is expected that it would be desirable to introduce KPIs in relation to some or all of the following:
- Service availability;
 - Service management;
 - Response to service requests;
 - Contract management;
 - Accreditation and Security
- 4.223. This consultation seeks views – in particular from prospective DCC users – on whether the above list adequately captures the set of activities which should be subject to KPIs, and if not how it should be modified. This consultation also seeks views on the particular KPIs that could be used in order to assess performance in relation to relevant activities, and on when it may be desirable for financial incentives to be applied to such KPIs.
- 4.224. On the question of an independent audit of the DCC’s performance under its licence, the Government proposes to introduce a licence condition giving the Authority the right to require an audit of the DCC and it is possible that the SEC will permit or require a periodic audit of the DCC’s performance against the SEC. In addition the DCC will be required to provide audited regulatory accounts to the Authority. We do not believe that any further audit is justified.

Proposed Licence Drafting

- 4.225. The Government’s revised thinking based upon the responses to the September consultation and reconsideration of the changing role of the DCC from the initial award of the licence, identifies the following issues which suggest the need for 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 onto 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 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 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.
- 4.226. As a result of these considerations, the Government proposes that, initially, the structure of the “price control” licence conditions in the DCC licence should be the following;
- Efficiently incurred DCC internal costs would be passed through to users;
 - On top of the internal costs, the DCC would be allowed a (£/annum) margin, agreed in the licence competition process;
 - A proportion of the margin should be dependent upon the achievement of a key project milestones;
 - Once it begins offering services, the DCC should be subject to a system volume incentive, which would impact upon its agreed margin and which would target a parameter such as the number of successfully delivered messages in that year; and
 - All service provider costs will be passed through to users (without an additional margin from the DCC).
- 4.227. This consultation document sets out the Government’s proposals, but it should be noted that the Government is still in discussion with the Authority in relation a number of aspects of the detail of these proposals and how they might work in practice. While the Government recognises the importance of incentivising the DCC to controlling its costs, it is not proposing direct financial incentives on internal costs for an initial period. The Government has considered the potential costs and benefits of such incentives given the level and nature of the uncertainties in the early stages of the operation of the DCC. On balance, the Government is of 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 is proposed, where 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.
- 4.228. The Government will continue to work with the Authority to consider whether alternative approaches could be more effective and in particular whether alternative arrangements for the initial price control regime with a greater focus on driving cost efficiencies on DCC might be appropriate, given a context in which there are significant risks of unintended consequences. Views are sought through this consultation document 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 also needs further consideration.

- 4.229. In view of the fact that these arrangements allow 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 expected to be required to be established in advance. It is also expected that after the initial stage of the price controls, the conditions would be revised to allow for the additional incentives to be imposed. Drafts of such licence conditions are included in the draft licence, but are calibrated to not have an effect on the DCC's allowable revenues:
- Key Performance Indicators based upon elements of DCC performance and providing an incentive to achieve (at least) defined performance levels in relation to those factors. It is expected that such a condition would be designed to provide an incentive for the achievement of all the areas of performance;
 - A sliding scale incentive relating to the DCC's internal costs permitting the DCC to share in reductions in its costs;
 - The possibility of gain sharing in relation to reductions in service provider costs which result from actions by, or proposals from, the DCC. The DCC would retain an agreed percentage of such gains;
 - Arrangements for the DCC to make a contribution, determined by the Authority, towards its fixed costs, from income from approved Value Added Services.
- 4.230. In using the term "initial" the Government is taking 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. 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 KPIs and incentives for the 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.
- 4.231. In these licence conditions, the values to be calculated have to be determined after the event when real values are known. However, it is necessary to determine the total sum of money that the DCC will charge to users (under the terms of Condition 18) in advance of each year. For that reason, the values are determined in advance on the basis of estimates. The "K" correction factor is used to correct for errors in the estimates by adjusting the following year's allowable revenue after the event.
- 4.232. Condition 35 sets out the definitions used in the Price Control Conditions.
- 4.233. Condition 36 sets out the Principal Formula by which the DCC's Allowable Revenue is determined. In Part A "Duty of Licensee not to exceed its Allowed Revenue", the DCC is expected to take reasonable steps to ensure that its revenue does not exceed its defined allowed revenue for the year. It should be noted that other energy licences typically use the phrase 'all appropriate steps' rather than 'reasonable steps' which is considered to be a stronger obligation. 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 may not be appropriate. This is because the potential uncertainty is such that the level of cost the DCC may incur in taking 'all appropriate' rather than 'reasonable' steps may not be justified in terms of a more accurate forecast.

4.234. The remainder of the Condition shows how the allowable revenue is calculated at all stages and with respect to Core and Elective Communication Services. This shows the components of that allowable revenue 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), which may be positive or negative, whose maximum and minimum are expected to be set as part of the licence award process and which is determined as a result of the incentives described in Condition 37; The minimum value for the BMPA would represent the DCC licence applicant's willingness to put its agreed Baseline Margin at risk. The BMPA is determined from the Baseline Margin Performance Incentive amount, which is set out in Condition 37; 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, which are the costs of procuring the Fundamental Service Capability (referred to in this document as the service provider costs); this value will be set to zero initially; less
- The Value Added Services Contribution which is a sum being the agreed contribution to users costs from approved Value Added Services, which is expected to be agreed with the Authority as a part of each application for a Value Added Service; this value will be set to zero initially; plus
- A correction (K) factor based upon the under-, or over- recovery of costs in the previous year.

4.235. The K factor, as well as correcting for errors in estimates, will be set in a manner that requires the DCC to take appropriate steps to recover any bad debt before passing it through to users. It is proposed that this will be achieved by reducing the K factor by the amount of any bad debt representing the DCC's internal cost element of that debt. It is proposed that this component, which would be determined by the Authority, would be set to zero so that the DCC was not exposed to bad debt unless the DCC had failed fully to comply with its obligations under the SEC in relation to the management of parties credit cover and the recovery of bad debt.

4.236. The DCC's Internal Costs are 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.

4.237. The DCC's External Costs are defined as the costs of procuring the services under the Fundamental Service Capability. This means that the DCC's contract management activities in relation to the prime service provider contracts would be treated as External Costs.

- 4.238. Condition 37 sets out how the Baseline Margin Performance Incentive amount in Condition 35 is determined. This incentive term can either increase or decrease the DCC's Allowed Revenue, and is subject to a maximum and to a minimum value set out in Condition 35; the actual value is dependent upon the DCC's performance in relation to four areas:
- The Milestone Incentive; an incentive based upon the achievement of programme milestones, where a sum of money would be allowed for the achievement of each milestone, but that sum would become negative if the milestone was missed by more than a permitted amount;
 - A Sliding Scale Incentive aimed at the reduction in the DCC's internal costs, where the DCC would share in any reduction or increase around a target value, which it is expected would be agreed as part of the licence application process, but which would not come into effect until a time after the DCC was delivering services;
 - A set of Output Performance Incentives identifying key performance indicators and associated performance standards; the performance against the KPIs is applied to an output performance baseline value which is again expected to be agreed within the licence application process but would not come into effect until after the DCC was delivering services; and
 - A System Volume Incentive associated with an overall system volume measure, such as the total number of successfully delivered messages, again this incentive is applied to a baseline value agreed during the licence application process, but again it is not expected that this would come into effect until a time after the DCC was delivering services.
- 4.239. It is expected that this term will be largely set to zero initially with the exception of the Milestone Incentive, which is expected to be agreed as part of the licence application process. It is expected that the form of that incentive is likely to 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.
- 4.240. As noted above, the Government is still in discussion with the Authority about a number of aspects of the detail of these proposals and how they might work in practice. 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.
- 4.241. Once the DCC is delivering services, it is expected that financial incentives would be applied following subsequent review as part of the development of the KPI arrangements. Whilst the Authority would have the ultimate decision on the development of the incentive arrangements for KPIs, there are a number of mechanisms by which it might choose to arrive at its decision. In some areas, it might be appropriate to establish arrangements whereby the DCC and SEC parties seek a negotiated settlement for example, or the DCC could undertake a stakeholder engagement exercise in order to establish a sound framework for KPIs for approval by the Authority.
- 4.242. Condition 38 sets out how the external contract gain sharing amount in Condition 35 will be determined. It is 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 will have to be based upon action taken by the DCC to reduce external costs not just the operation of KPIs in the service provider contracts where reductions in cost would be passed through to the users. It is expected that in proposing a gain sharing arrangement, the DCC would set out in some detail how the gain (reduction in service provider costs) should be determined and that the gain would be shared ex-post; i.e. after it had been achieved. It will 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.

- 4.243. Condition 39 sets out how the Value Added Service contribution in Condition 35 is determined. This adjustment would have no effect until such a time as the DCC proposes a Value Added Service to the Authority. As part of the process leading to an Authority agreement to a Value Added Service, it is expected that the contribution to DCC costs (which will appear in this parameter) will be agreed. The drafting of the algebra in the condition allows for a number of separate Value Added Services, with different contributions to costs. The Government will continue to work with the Authority how such a contribution should be calculated and passed on to DCC users in the energy sector taking core and elective services. More generally, the Government and the Authority are also considering the wider framework for the regulation of value added services.
- 4.244. Condition 40 is an initial draft of a straightforward condition setting out the process by which the licensee can seek to have restrictions imposed by the Price Control Conditions disapplied.

Interaction between Licence Application Regulations and Revenue Restriction Conditions

- 4.245. As is discussed in Section 5, the licence application regulations will set out the competitive process to be followed in selecting the person to whom the DCC licence will be granted. It is expected that, as part of this process, a number of commercial parameters will be determined that will ultimately need to be reflected within the DCC's revenue restriction conditions. 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.
- 4.246. Whilst these parameters will be determined through the licence application process, the DCC will, as is the case for other gas and electricity licensees, be regulated by the Authority. Under the Gas and Electricity Acts, the Authority may propose changes to the DCC's licence conditions, including its price control conditions at any time. Furthermore, as is discussed in the section "Chapter 9: Price Control Conditions" above, it is specifically proposed that the incentive regime applying to DCC should be reviewed some time after the initial grant of the licence and in the light of experience and further understanding of how the DCC's incentives should be best targeted. Therefore, the Government actively expects the DCC's price control to be reopened during the first licence period.
- 4.247. These arrangements, whereby certain elements of the DCC revenue package are determined as part of the licence application process whereas other elements are specifically intended to be set by the Authority, and where in principle any element of the revenue restrictions may be subject to modification by the Authority, need to be set out clearly, not least so that DCC applicants can gain an understanding of how, when, and by whom their allowable revenues will be set.

- 4.248. The proposed approach to this is to set out those things which are expected to be determined as part of the licence application process in the so called “principal formula” which determines how the licensee’s allowed revenue will be determined in Condition 36. Those other elements that it is expected will be determined by the Authority would be included in a separate condition. For example, the overall cap and floor on the annual performance adjustment incentive for the DCC could be determined as part of the licence application process and set out in Condition 36, with the actual performance adjustments which operate within this cap and floor being set out in other licence conditions and determined by the Authority.
- 4.249. It is intended that by adopting this approach a clear distinction may be made between those parameters that it is expected would be periodically set by the Authority (using its powers under the Gas and Electricity Acts to modify Price Control Conditions), and those considered to be part of the package set as part of the licence application process. It is important to note that where changes are made by the Authority under their normal powers, the DCC is afforded the procedural protection of an appeal to the Competition Commission in relation to price control conditions should the DCC disagree with the licence modifications proposed by the Authority.
- 4.250. This arrangement would not, in principle, prevent the Authority from proposing changes to the parameters in the DCC licence set as part of the licence application process. However, in proposing a modification to these parameters, the Authority would be reopening arrangements that had been set through the competitive licence application process. It is envisaged that, in following due process, a relatively high hurdle would need to be passed for the Authority to be justified in seeking a modification to such parameters when acting in the interests of existing and future consumers. On the assumption that the arrangements operated as expected, it would not be anticipated that the Authority would seek to modify the parameters determined as part of the licence application process and would instead focus upon the KPI regime which it would be expected to review on a periodic basis, and within any relevant parameters set during the licence application process. Precisely how these arrangements will work in practice will have to be agreed in detail with Ofgem.
- 4.251. Please refer also to the discussion on Part 4 which, in the context of Schedule 3, includes a more general discussion of the interaction between the licence application process and licence conditions proposed to apply immediately after licence grant.
- 4.252. The draft DCC licence therefore has 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 is 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 need to be in place on grant, or shortly after grant. In either case, it is 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 (Part B of Condition 7 refers) and any alternative arrangements in respect of the licensee’s financial stability (Condition 26.2 refers).

Consultation Question

- 13. Do you have any comments on Chapter 9 of the licence conditions, in particular do you have comments on:**
- i) The need for the revenue restriction conditions in the DCC licence to evolve as the DCC's role changes;**
 - ii) The need to incentivise the DCC to concentrate on achieving programme milestones at the beginning;**
 - iii) The proposal that the DCC's internal costs should be passed through with a £/annum margin applied;**
 - iv) That incentives on reduction in the DCC's internal costs and on output measures should be applied later;**
 - v) That the DCC should be subject to an element of bad debt risk unless it takes reasonable measures to recover such debt; and**
 - vi) Particular KPIs that could be applied to the DCC after it starts to deliver services?**

Chapter 10 of the DCC licence: Arrangements for Intervention and Continuity

September Consultation

- 4.253. The September consultation discussed the importance of the DCC's ability to continue to provide services to users in the event of financial difficulties, and asked whether consultees felt it would be appropriate for there to be special administration arrangements for the DCC, similar to those that now apply to network licensees and suppliers, noting that additional primary legislation would be required. The Government further questioned whether special administration arrangements should apply, not only in the event of financial distress, but also in the event that the DCC's performance was persistently poor.
- 4.254. We also proposed that, to ensure continuity of services provided to users, that the DCC be required to ensure that contracts with service providers can be novated to any successor DCC, and that the DCC licence should also provide for the handover of a range of other matters, such as accrued rights; IPR; matters relating to contracts for Value-Added Services; licences, e.g. for software; and for the resolution of disputes between outgoing and incoming DCCs.

Views of Respondents

- 4.255. Respondents supported the suggestion that there should be a special administration regime for DCC. The majority of respondents stated that there should also be further protections. Suggestions included: replicating provisions in MRASCo (Master Registration Agreement Service Company) and DCUSA (Distribution Connection and Use of System Agreement), on step-in rights, parent company guarantees and exit plans. One respondent suggested that the WAN service provider could have to be financially ring-fenced and that the rail industry could provide a model. Another felt that step-in rights would be difficult to implement. Three respondents felt that no additional provisions were required.

- 4.256. All respondents on the question of novation of contract with service providers agreed that it was appropriate for arrangements to be made for transfer of such services. Two respondents expressed a view that the scope of any obligation should be limited to “critical services” with one suggesting that these should include Core Services and any others the SEC requires the DCC to provide.
- 4.257. Furthermore, there was broad agreement with the scope of matters proposed in the consultation document. In addition, a number of additional matters were proposed, including:
- dealing with TUPE⁸ issues;
 - transfer of assets;
 - the need for a handover plan and associated manager;
 - the potential need for payments to be made to the outgoing DCC;
 - consideration of a “transition bond” or financial incentives for the outgoing DCC; and
 - the need to ensure that the DCC has adequate resources to manage the transfer.
- 4.258. One respondent suggested that there should be financial penalties for failure to hand over effectively.

Response and Proposed Licence Drafting

- 4.259. Chapter 10 includes four conditions. The first, Condition 41, deals with Management Orders for the Licensee. The purpose of this condition is to allow the Authority to intervene in the strategic management of DCC to take measures to rectify actual or likely material failings in the way in which the DCC is being run. The overall objective is to ensure that there remains continuity of the DCC’s services to users, given its importance for smart metering, in the same way that the special administration regimes for the electricity distribution networks aims to ensure continued secure and safe operation of the networks.
- 4.260. As the drafting indicates, the failings that might need to be rectified by the giving of a Management Order are matters of a serious nature, and the powers the condition bestows on the Authority in such circumstances are correspondingly wide, although subject to a strict test of *necessity* and *appropriateness*. At the same time, the condition is 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.
- 4.261. It is unlikely that Condition 41 would be needed (in part or in whole) once legislative changes are made to put in place a Special Administration Scheme for DCC, so the Government proposes to review its continued position in the licence if and when such a regime has been implemented. The Government is aware that the Authority has raised several issues regarding the potential implications for the Authority if it were to apply such management orders to the DCC. The Government will continue to discuss this issue with the Authority alongside this consultation, in order to better understand its perspective on the proposals.
- 4.262. There are two circumstances in which a Management Order may 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

⁸ Transfer of Undertakings (Protection of Employment) Regulations 2006

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 must be satisfied that it is appropriate to take action under Condition 41 in all the circumstances.

- 4.263. The sorts of actions that it is proposed that the Authority may undertake include: 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.
- 4.264. The proposed powers for the Authority (which stop short of an actual hands-on operational management role) under Condition 41 have 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. As set out above the Government believes that, as the enduring alternative to these arrangements, it would be preferable to introduce primary legislation when possible to implement a Special Administration Regime for the DCC. The Department is exploring the opportunity for future legislation on this matter.
- 4.265. Condition 42 places obligations on the DCC in relation to the expiry and handover of the licence. These include 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 is expected that this plan will include arrangements for the novation of service provider contracts, the transfer of Intellectual Property Rights (IPR) and the variety of matters discussed in the September consultation and raised by respondents.
- 4.266. It is considered that whether or not TUPE arrangements would apply to the DCC is a matter of law, and that there is no need include any further explicit drafting on these matters. Insofar as a “bond” is concerned, it is 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.
- 4.267. Condition 43 deals with Intellectual Property Rights (IPR). It is important 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. The following approach is proposed in the draft licence:
- Where the DCC has received IPR from a service provider or a predecessor DCC, the DCC would be required to novate this IPR (potentially on a non-exclusive basis) to its successor DCCs.
 - Where the DCC holds a licence to use IPR from a service provider or predecessor DCC, these would need to be novated to successor DCCs, and be capable of being novated to subsequent successors.

- Where the DCC creates IPR as part of undertaking its Permitted Business, then it would need to grant an in-perpetuity, novatable, royalty-free licence to its successors. This licence need not be exclusive.

4.268. Condition 44 sets out the scope of the matters in the DCC licence that it is 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 are intended to help ensure that the DCC's successor is able to operate effectively following some unforeseen event that was not sufficiently accounted for in the business handover plan. The obligation is limited to two years as, with the passage of time, a predecessor DCC would have increasingly less expertise and knowledge with respect to the operations of a successor DCC. Furthermore, a successor DCC would be expected to be well established after the same period. (It is important to note that there would be no operational overlap between the two.)

Part 4 of the DCC licence: Schedules to the Licence

- 4.269. The DCC licence includes three schedules. Schedule 1 sets out the Fundamental Service Capability. It is intended to develop the definition of Fundamental Service Capability in light of additional information on the detail of the initial service provider contracts. In essence however, the Fundamental Service Capability is intended to cover the underlying services that the DCC will always be required to procure externally, namely data and communications services. The relevant contracts in Schedule 1 are expected to include the initial contracts for data and communications services developed by the Programme in addition to any communications contracts adopted by the DCC from suppliers.
- 4.270. Schedule 2 sets out a proforma for the Deed of Novation for external service provider contracts. It is intended that all external service provider contracts would include provision permitting the novation of the contract to a successor DCC substantially on the terms set out in the deed of novation.
- 4.271. Schedule 3 provides a framework for the inclusion of a number of matters established as part of the DCC licence application process (detailed in Section 5). 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 licence obligations on the DCC in this schedule (see paragraphs 4.245-4.252 above).

Consultation Question

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| 14. | <p>Do you have any comments on Chapter 10 of the licence conditions; in particular do you have any comments on :</p> <ul style="list-style-type: none"> i) The proposed arrangements applying to Management Orders, including the scope of the powers of the Authority in such circumstances; ii) The arrangements proposed in relation to the Business Handover Plan and the process for resolution of matters between the |
|------------|--|

	<p>outgoing and incoming DCC;</p> <p>iii) The scope of matters that the Business Handover Plan should provide for;</p> <p>iv) The scope of the matters that may need to survive for a period of time to continue to ensure a smooth handover to the DCC's successor and whether the two year timeframe is appropriate; and</p> <p>v) The proposed approach to Intellectual Property Rights?</p>
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Other Matters

Communications Hub

- 4.272. Consideration is being given within the SMIP to assess whether or not the DCC (via its Communication Service Providers (CSPs)) or energy suppliers should be primarily responsible for the design, procurement and installation of communications hubs. These hubs provide the necessary functionality to link devices in consumers' premises through the Home Area Network (including the electricity and gas meters and In-Home Display) with the DCC via the wide area communications solution. Either solution is likely to have an impact on the drafting of the DCC licence. The draft DCC licence attached to this consultation reflects the former position, i.e. whereby the DCC has primary responsibility to provide communications hubs via its communication service providers. This is not necessarily the Government's preferred position.
- 4.273. If the DCC is to have primary responsibility for communications hubs through the CSPs, then it is likely to be appropriate for the DCC licence to recognise explicitly the need for communications hubs to be offered to energy suppliers. Part A of Condition 17 sets out the requirement for the DCC to provide communications hubs. Any DCC procured communications hub would need to meet the HAN interface requirements set out in SMETS such that it was compatible with the metering devices of suppliers. Furthermore the DCC provided communications hubs may also need to comply with a communications hub functional and physical specification (which may be set out in the SEC). It would also be necessary to set out the detail of the commercial arrangements associated with maintenance of the communications hub, as well as potentially providing for their novation via the CSP contracts from one CSP to a successor in the event of a service provider replacement or from one DCC licensee to its successors. The SEC would also set out the appropriate principles to apply to matters such as delivery, installation and repair. Further consideration will need to be given to any additional liabilities that may apply to the DCC should it be decided that it should procure the communications hub. It is intended that any additional liabilities will be discussed in a future consultation on the communications hub.
- 4.274. If the Government concludes that energy suppliers should be responsible for the communications hub, then it will be necessary for the DCC Communication Service Providers (CSPs) to specify the WAN technology employed for each region and to set out what WAN interface requirements suppliers must comply with when procuring and installing communications hubs. It is likely that the detailed interface specification would be set out in the Smart Energy Code, although the DCC licence may need to include provisions which explain how DCC will coordinate the input of CSPs such that any specification in the SEC has the

appropriate input of CSPs, DCC and other SEC Parties. Please note that, as currently drafted, the DCC licence does not reflect this position but rather the approach described above (paragraph 4.272) whereby the obligation rests on the DCC to procure communications hubs through CSPs. Communications hubs procured by suppliers would also need to meet the HAN interface requirements and functional requirements for the Communications Hub set out in SMETS.

Storage of data

- 4.275. There is no specific prohibition on the DCC storing data. The DCC will execute service requests (ad hoc or scheduled) to retrieve meter reading data and will pass this data directly to the requesting party. The data may be retained in the DCC to allow for batching of output or provision of data to multiple parties but under the initial service provider contracts will not be stored for any prospective enquiry by other parties.

Adoption of Communications Contracts

- 4.276. The September consultation anticipated that energy suppliers would begin rolling out smart meters prior to the establishment of DCC services, and that suppliers would enter into contracts with companies to communicate with smart meters during this period. It was acknowledged that some level of deployment during this phase is likely to be essential to achieve the objectives of the Foundation Stage. The Government proposed that the DCC should guarantee the adoption of at least some of these communication contracts when it starts providing its smart meter communication services to enable the ready enrolment of foundation stage meters. In order to be adopted, contracts would need to meet pre-defined criteria, and there may also be a guaranteed adoption volume of smart metering systems that the DCC would be required to adopt. The consultation document put forward a number of proposals for what the adoption criteria should be.
- 4.277. It was envisaged that setting the guaranteed adoption volume would involve a trade-off between the costs and benefits of early rollout and the impact on, for example, the economies of scale associated with procurement of communication solutions by the DCC. Views were sought on the relevant factors that will need to be taken into account in setting the guaranteed adoption volume. In addition it was proposed that the DCC would have the discretion to adopt more communication contracts than provided for by the guaranteed adoption volume. While this would be a commercial decision for the DCC, consistent with its procurement strategy objectives and taking into account the impact on its contracts with service providers, it was for consideration whether additional obligations and incentives need to be provided to the DCC under its licence to guide its assessment as to whether it should adopt contracts in excess of the guaranteed adoption volume.
- 4.278. The guaranteed adoption volume would need to be allocated between the different communication regions and between suppliers. It was proposed to allocate the volume to suppliers on the basis of a combination of market share and smart meters installed.

Views of Respondents

- 4.279. Several respondents were supportive of the proposed adoption criteria for communications contracts, although many raised additional comments, including the following:
- additional factors that should be included within the criteria;

- the criteria should be underpinned by clear definitions to avoid uncertainty;
- the criteria should simply ensure that as many contracts as possible were able to transition to the DCC;
- the adoption criteria proposed did not provide sufficient certainty;
- DCC enrolment or ability to demonstrate operation with the DCC should not be a requirement for contracts; and
- a quantitative threshold should be defined for the criteria.

4.280. On the proposed approach to identifying guaranteed adoption volume, a number of comments were raised. These included:

- it was appropriate to place a limit on the number of contracts that the DCC should be required to adopt and contracts should only be adopted where meters are fully compliant;
- a solution based on annual figures would be likely to lead to disagreement over intended roll out profiles and that it may be uneconomic;
- there should not be any barriers to Foundation activity;
- the adoption level should not be set too low as this could reduce incentives to engage during Foundation;
- a reasonable endeavours obligation should be placed on suppliers to use the DCC;
- any methodology should be revisited once there was greater certainty regarding the scope and form of smart meter technology; and
- the logic of linking guaranteed adoption volumes for the DCC to the costs and benefits of Foundation roll out was flawed.

4.281. In relation to the proposals to allow adoption of additional meters over and above the guaranteed adoption volume, the following principal suggestions/comments were made:

- the DCC should be obliged to take all reasonable steps to adopt compliant Foundation meters;
- the DCC should be obliged to adopt any contract for which there was a visible net benefit;
- it should be at the DCC's discretion to determine whether they wanted to adopt contracts given the risks that could be faced during Foundation;
- the DCC would need additional obligations to actively pursue communications contracts above the guaranteed adoption level;
- any additional incentives should be balanced against the goal of facilitating roll out;

- it was not necessary to place additional obligations on the DCC beyond the initial adoption requirement;
- suppliers should not face any additional costs if they were adopted to the DCC and exceeded the guaranteed adoption level; and
- additional charges by the DCC were appropriate given that this would be a commercial decision taken by suppliers.

4.282. In relation to the proposals on allocation of the guaranteed adoption volume, a variety of views were expressed including advocating Option 3 (adoption on the basis of market share in each region) or a combination of Option 3 and Option 4 (adoption on the basis of the number of compliant systems installed). Views were expressed that Option 1 (adoption of the most economically advantageous contracts) and Option 2 (first come first served) would be difficult to administer.

4.283. There were mixed views regarding the potential for reallocation with some stating allocations should be subject to regular review and redistribution and others concerned that if suppliers did not use all of their allocations they may be reallocated to others that had installed their full allocation of smart meters.

4.284. On the issue of timing for adoption of Foundation stage communication contracts, several respondents thought that the adoption process should take place as soon as possible after go live or within six months thereof. Others suggested that the DCC should have responsibility for determining the timing or that it should be based on the DCC establishing a level of agreed operational readiness. Others suggested that economic costs and benefits should be factored into any decision regarding the timing of adoption of any contracts. It was also suggested that suppliers should have the ability to determine when their contracts were novated to the DCC or that the timing should be agreed bilaterally between the supplier and the DCC. Finally, it was also suggested that contracts should not be novated until transition plans were well defined and standards were agreed for equipment, communications and security.

Next Steps – Adoption of Communications Contracts

4.285. The issue of adoption of communications contracts is dealt with only at a high level in the current draft of the DCC licence and it is recognised that additional work is required to finalise the approach in this area. It is proposed that this issue will be dealt with as part of the overall programme transitional arrangements and as part of the development of enrolment requirements. A separate further consultation will be undertaken on the detailed proposals in this area as part of the transitional arrangements.

5. Response to September 2011 Consultation and Licence Application Regulations

Introduction

- 5.1. The DCC will be granted its licence⁹ through an open and transparent competitive tender application process, the regulatory framework for which will be provided in the DCC licence application regulations¹⁰ (the ‘regulations’). The DCC licence application regulations are a statutory instrument, which will describe at a high level the procedural steps of the competitive application process for the DCC licence¹¹. They will apply in respect of any grant of any relevant licence¹².
- 5.2. The draft DCC licence application regulations are detailed in Annex 4 of this document for information and review. They have been drafted to implement the competitive process outlined in this consultation document, as detailed below.
- 5.3. The Government currently intends to make the regulations and lay them before Parliament in Summer 2012.
- 5.4. Within the legal framework provided by the regulations, more detailed tender documentation will be issued at the time of each competition. This will be specific to that licence application, but consistent with the regulations then in force. The documentation, collectively called the ‘application documentation’, will consist of a set of documentation specific to each of the four stages of the competition, which will set out (among other things):
- the rules and instructions that apply to that stage of the competition.
 - an outline description of the regulated business information¹³;
 - what information is required from applicants at that stage of the competitive process;
 - the competition timelines for that stage (including any dates for asking questions of clarification);
 - the evaluation criteria for that stage;
 - the evaluation methodology by which the evaluation criteria will be applied; and
 - any other such information in relation to the qualification stage of the particular tender exercise, as determined necessary.

⁹ The licence granted to DCC will have effect and be treated as two smart meter communications licences – one for gas and one for electricity.

¹⁰ Electricity and Gas (Competitive Tenders for Smart Meter Communications Licences) Regulations 2012

¹¹ The regulations call this process the ‘tender exercise’, which it defines as a process carried in accordance with the regulations with a view to determining the person to whom both an electricity and gas smart meter communication licence are to be granted.

¹² In the draft regulations, relevant licence means either: an electricity smart meter communication licence, or a gas smart meter communication licence.

¹³ The regulatory requirements and commercial arrangements which will apply to the person to whom the DCC licence is granted.

Competitive Approach

- 5.5. The Government has concluded that the DCC licence will be granted following a competitive tender application process¹⁴, developed in accordance with Better Regulation principles, so as to be fair, transparent and consistent. The proposed approach will consist of a competition over a defined number of stages, with each stage contested by a declining number of participants until a single successful applicant is granted the DCC licence.
- 5.6. This approach draws on best practice from other similar competitive tender processes, including the Authority's tender process for offshore transmission licences. This best practice has been developed and refined over several years. The resulting process has been built on precedents including: the Government's Private Finance Initiative, Ofcom's experience in spectrum auctions, and the Department for Transport's rail franchising model.
- 5.7. The DCC licence application regulations will be drafted so as to describe an application process which will be capable of being applied not only to the initial DCC licence application, but also to subsequent DCC licence applications, where:
- the process may be run by the Authority rather than the Secretary of State;
 - there will be an incumbent DCC in place;
 - there will be service providers with contracts in place;
 - the nature and scope of DCC's obligations may change over time;
 - the type of organisation needed to fulfil an evolving DCC role may change; and
 - the evaluation criteria will likely need to be amended and updated for each tender to match the evolving role of DCC.
- 5.8. To achieve this future flexibility, it is proposed that:
- the timetable and information to be published are specific to each tender, being detailed in the application documentation;
 - the evaluation criteria are specific to each tender, being detailed in the application documentation for each stage of the competition, rather than the regulations; and
 - the regulations contain provisions determining who runs the tender process.

Proposals

A. Four-stage Competitive Process

September Consultation Paper

- 5.9. In the September consultation it was proposed to reduce by one the number of stages used in the existing offshore transmission competitive process to a more streamlined four-stage process, as outlined below:

¹⁴ Referred to in this document as the 'DCC licence application process', 'licence competition', or 'tender exercise'.

- Pre-qualification (PQ), with hurdles based on responses to a pre-qualification questionnaire (PQQ) to enable the selection of applicants who are able to fulfil the role of DCC licensee.
- Invitation to apply (ITA), during which qualified applicants would put forward detailed proposals of how they would establish and run the DCC, together with their expected costs. Selection to the next stage will be via the application of weighted evaluation criteria.
- An optional best and final offer (BAFO) stage in the event that there are two or more similar applications and giving the opportunity for further competitive tension.
- A preferred applicant stage to finalise the details with one or more preferred applicants, including finalising the incentive mechanisms and the terms of the revenue restriction, culminating in DCC licence award to a preferred applicant.

5.10. The September consultation stated that the process had been designed to apply to the appointment of the initial DCC licensee and that the process for a subsequent DCC licence applications may differ from the initial process.

Views of Respondents

- 5.11. Respondents expressed broad support for the four stage competitive application process, believing it to be appropriate to the scale of the tender. There was a general view expressed that the four-stage process would expedite the competitive process, being consistent with the minimum timescales allowed.
- 5.12. There were calls for adequate time to be allowed for applicants at each stage of the process and that it was important that an allowance was made to provide time for clarifications to be sought. There was an associated call for the competitive tender process to be fully transparent.
- 5.13. One respondent questioned the need for the fourth 'preferred applicant' stage, believing that it should just be the preferred bidder left at this stage. Another respondent welcomed the BAFO stage, believing it would improve the competitive process, if it were to be applied. A further respondent proposed that the Secretary of State should invite applicants to give 'proof of concept' presentations, so as to better differentiate between bidders.

Response and Proposed Regulations Drafting

- 5.14. The Government intends to introduce regulations which adopt the four stage competitive tender process which was outlined in the September consultation and widely supported by respondents. Although the previously proposed outline process remains unchanged at a high level, specific details of each of the stages have been further refined to reflect the views of respondents and to improve the overall process to address issues of clarity, practicality, consistency, transparency, and effectiveness, with a view to achieving the best competitive outcome.
- 5.15. The DCC licence application process will be a single competitive tender conducted over four distinct stages by the 'competent authority'¹⁵ to identify a successful applicant to be granted a

¹⁵ The person conducting the tender exercise, which will be either the Secretary of State (administered by DECC) or the Gas and Electricity Markets Authority (administered by Ofgem). Regulation 5 details the conduct of a tender exercise, including who will be the competent authority.

licence authorising it to carry out the DCC-related licensable activities introduced into the Gas and Electricity Acts by virtue of the DCC prohibition order.

5.16. The draft regulations set out the four stages of the competitive tender process:

- **Qualification¹⁶**: Responses to an open advertisement designed to identify those bidder-applicants¹⁷ possessing the qualifications to fulfil the licence and to determine those who are best qualified. Bidders will be asked to complete a questionnaire, which will be evaluated against published criteria to determine a bidder's capability and capacity to perform this type of role. For the first licence application, DECC will limit the number of qualified bidders that it invites to the 'proposal' stage of the tender process to a pre-determined maximum number of the best qualified ranked in order, as will be set out in the tender application documentation for the qualification stage of the application process. The objective is to ensure that this next stage of the application tender process involves a manageable number of the best qualified bidders ('qualifying bidders'), which is sufficient to maintain competition and to avoid unnecessary ongoing expense for weaker bidder-applicants.
- **Proposal¹⁸**: Qualifying bidders will be invited to submit detailed proposals for how they would establish and run the DCC against the service requirements defined in the application documentation for this 'proposal' stage. These detailed proposals will likely be required to include the applicant's cost estimates and underlying assumptions, the proposed revenue at risk, and KPI targets. The objective of the 'proposal' stage of the tender process is to evaluate each qualifying bidder's proposal against published criteria so as to determine a 'preferred applicant' and at least one 'reserve applicant', or if appropriate, to shortlist those qualifying bidders who submitted the best proposals and invite them to participate in the 'best and final offer' stage, where the 'preferred applicant' and 'reserve applicant(s)' will be determined.
- **Best and Final Offer (BAFO)**: This optional third stage opens with detailed dialogue with those qualifying bidders shortlisted from the 'proposal' stage ('selected qualifying bidders'). This dialogue is intended to test that the service requirements are deliverable through the selected qualifying bidders' proposals and to confirm their acceptance of current draft of the DCC Licence¹⁹. Those bidders will then be asked to submit a best and final offer against the refined service requirements resulting from the dialogue phase. The objective is to select, against pre-defined evaluation criteria, a 'preferred applicant' and at least one 'reserve applicant'. Although the regulations provide at the discretion of the competent authority for the BAFO stage of the licence application process to be optional²⁰, the Government considers that it will be appropriate to include

¹⁶ This stage was previously called 'pre-qualification' in the September 2011 consultation.

¹⁷ The term 'bidder-applicant' [or more simply 'applicant'] is a generic term used to describe participants in the licence competition, regardless of their current status in that competitive process. In the regulations, they are called 'tender participants'. Where appropriate, reference is made in both the regulations and this consultation document to the specific status of a bidder-applicant (or tender participant) at the various stages of the licence competition by using the defined term which describes that status, as detailed later in this document (e.g. 'bidder', 'qualifying bidder', 'selected qualifying bidder', 'preferred applicant', 'reserve applicant', 'first reserve applicant', 'second reserve applicant', and 'successful applicant'.)

¹⁸ This stage was previously called 'invitation to apply' in the September 2011 consultation.

¹⁹ This will include the draft Licence Condition 21, whereby the Licensee must be a party to and comply with the Smart Energy Code that is designated by the Secretary of State for the purposes of Licence Condition 22 (The Smart Energy Code).

²⁰ The regulations allow the competent authority to hold a BAFO stage if it is unable to determine a preferred applicant from the ITA stage against the evaluation criteria, OR, if the competent authority considers that it is otherwise necessary or appropriate in the circumstances.

a BAFO stage within the first licence application process, given the increased complexity of the first licensing competition and the start-up obligations on the first licensee.

- **Preferred Applicant:** Finalisation of the tender process, whereby any outstanding issues are addressed with the preferred applicant and, only as may be required, with a reserve applicant, should progress with the preferred applicant not be achieved. Once all outstanding matters are resolved by the preferred applicant, DECC (and in future the Authority) would nominate a single ‘successful applicant²¹’ to be granted the DCC licence.

- 5.17. The specific details of each of these four stages and a discussion of the improvements which have been incorporated to each stage in light of the September consultation are detailed in the remainder of this section.
- 5.18. As discussed earlier, the regulations have been drafted to be applicable to not only the initial licence application tender exercise, which is to be conducted by the Secretary of State as the competent authority, but also to subsequent licence application tender exercises, which will likely be run by the Authority.
- 5.19. Although the regulations can be amended in the future by the Secretary of State, The Government believes that embodying a generic process in the regulations offers a number of advantages. These include providing additional certainty upon which parties may plan for future licence applications and being ready in case a subsequent expedited licensing competition is required before the expiry of the initial term of the licence. Such an approach is considered both prudent and efficient.
- 5.20. The Secretary of State will be responsible for conducting the initial licence competition and, where appropriate, will seek the views of the Authority in its delivery. In practice, the initial licence competition tender exercise will be conducted by DECC on behalf of the Secretary of State, with appropriate participation by the Authority. In this context, we expect that the Authority will play an advisory role in the initial licence competition, without responsibility for decision-making, which will fall to the Secretary of State.
- 5.21. If a subsequent licence competition is required to be run before or on 1 November 2018, then the Government proposes that this would also be the responsibility of the Secretary of State, unless the Secretary of State so determines that it should be conducted by the Gas and Electricity Markets Authority and directs the Authority is to be the competent authority. Post 1 November 2018, the tender exercise will be conducted by the Authority. Part 3 of the regulations have been drafted accordingly, with regard to the competent authority to conduct licence competitions²².
- 5.22. For the initial DCC licence application process, DECC intends to establish a DCC licence application panel to oversee the conduct of the initial licence application process and the short-listing of applicants at each of the competitive stages of the tender process, culminating in the application panel’s recommendation on licence award to the Secretary of State. The remit of

²¹ The regulations define ‘successful applicant’ as meaning a preferred applicant who becomes the successful applicant in accordance with regulation 18(1).

²² Regulation 5 refers.

the licence application panel will be set out in the DCC licence application documentation. It is envisaged that the licence application panel would consist of members of DECC plus an advisor from the Authority who would be a non-voting member on any formal decisions or recommendations that the application panel makes. The DCC licence application panel will keep the Secretary of State informed of the current status of the competition process and will provide details of applicants shortlisted after each stage. The application panel will make a recommendation to the Secretary of State on its preferred applicant, based upon the competitive application of the process described in the regulations²³. The final decision will be that of the Secretary of State.

- 5.23. In the description of the process detailed in this consultation paper and the associated regulations, the term 'the competent authority' is used throughout to describe the person who will conduct the licence application tenders, thereby covering both the initial licence application competition (to be administered by DECC on behalf of the Secretary of State) and any subsequent licence application competition (likely to be administered by Ofgem on behalf of the Gas and Electricity Markets Authority).

B. Financial Security

September Consultation Paper

- 5.24. In the September consultation, it was proposed that in the event that applicants could not demonstrate that they could achieve an investment grade credit rating, a commitment to provide an appropriate financial security, were the applicant be awarded the licence, should be required to be made with their response to the invitation to apply. This would ensure that the applicant had sufficient financial standing to commit to the security. The commitment would only be exercised in the event that the applicant was awarded the DCC licence.
- 5.25. Stakeholders were asked if they considered that applicants should commit to lodge a form of financial security at the invitation to apply stage that would take effect if the licence was granted to the applicant.

Views of Respondents

- 5.26. There was universal agreement that applicants should commit to providing some form of financial security, given the importance of the DCC. Most felt it prudent and many that it was essential. A number of respondents commented that the level of security must be appropriate – both to demonstrate financial standing and to encourage positive behaviour, but not to set an unreasonable barrier to entry. One highlighted the difficulty in obtaining financial security in the present economic climate. Another suggested that the bidders (applicants) should propose an amount of security so as to avoid deterring bidders.

Response and Proposed Regulations Drafting

- 5.27. The DCC licence requires two types of security from the DCC. The first is an appropriate credit rating (or alternative form of arrangement approved by the Authority). This is intended to provide general assurance as to the financial stability of the DCC. The second security requirement, or “additional arrangement for financial security”, is intended to ensure that the shareholders of the DCC have a minimum level of financial commitment to the DCC activity, or Relevant Sum (see discussion on DCC Licence Condition 26 “Financial stability and financial security” earlier in Section 4 of this document).

²³ A separate team of evaluators will undertake the detailed evaluation of the applications against the published criteria.

- 5.28. Precisely what level of Relevant Sum is to be put forward would be determined as part of the licence application process and the level of commitment given would be taken into account in the competitive assessment process. In each case, the financial security or any alternative arrangements would not need to be established or furnished at the 'proposal' stage but, as part of the licence application process, the applicant would need to provide clear evidence that the arrangements committed to could be established shortly after licence grant. The initial licence granted to the successful applicant would include a transitional licence obligation on the licensee to establish the specific arrangements committed to in the application process (see paragraph 4.271 above for more details of Schedule 3, which will provide the framework for the inclusion of such matters established as part of the DCC licence application process).
- 5.29. The details of this are not specified in the regulations; this will be in the detailed application documentation which will be issued to applicants and will be specific for each licence application. It is likely that it will be included as one of the essential evaluation criteria specific to the 'proposal' stage of the tender process, which an applicant must demonstrate in order to be considered for short-listing to the next stage (preferred applicant or BAFO, as appropriate at that time for that competition). The form of the commitment and the need to be able to demonstrate the future delivery of that commitment will similarly be specified in the application documentation.

C. Changes to an Applicant's Consortium

September Consultation Paper

- 5.30. In the September consultation, it was proposed that an applicant group may be allowed to change its membership, but that in that event it must notify the Government as soon as reasonably practicable.
- 5.31. The September consultation proposed that if a change of membership occurs between the pre-qualification and invitation to apply stages, the Government will reassess whether the revised group meets the pre-qualification criteria, and if not the change of membership will be disallowed or the group will be eliminated from the application process.
- 5.32. The Government stated that it expected that the membership of an applicant group would be finalised by the time of its ITA submission, but the proposal did recognise that should unexpected or unforeseen circumstances occur after this time, further changes would be considered by the Government on a case-by-case basis as to whether any change would be fair and equitable to all other applicants. It was also proposed that a change to an applicant group may be refused if it fails to demonstrate it can fulfil the criteria at previous applicant stages.

Views of Respondents

- 5.33. There was universal agreement that changes should be allowed between the PQ submission and the ITA submission. However, one respondent said that no one who failed at the PQ stage should be allowed to join another consortium. The same party was also concerned about the potential for disputes and the leakage of intellectual property, as well as increased costs and delays.
- 5.34. A number of stakeholders responded that it was good that the Government recognised the need for some flexibility in the makeup of consortia and that there was a need for the process

to be pragmatic in order to ensure sufficient participation and that the best parties were not unnecessarily excluded too early in the process.

- 5.35. Only one respondent favoured changes beyond the ITA submission. However, many were concerned about a lack of clarity if changes are assessed on a case by case basis, and commented that if any changes are made beyond the ITA stage there would likely need to be a re-evaluation of the ITA responses adding to timescale, cost, and frustration with the process.

Response and Proposed Regulations Drafting²⁴

- 5.36. It is proposed that - whilst noting that in order to meet the proposed Condition 9 on independence requirements it is likely that DCC will be a discrete corporate entity operationally separate from any company or companies that own it - the applicant may take one of the following three forms:
- a single organisation capable of delivering all the functions;
 - a prime contracted consortium consisting of a prime applicant and one or more key subcontractors; or
 - a special purpose vehicle or joint venture, which may also have one or more subcontractors.
- 5.37. The challenge with regard to consortia membership is to gain as much certainty as possible with regard to membership from the first submission at the qualification stage, whilst allowing the necessary flexibility in membership to respond to changed requirements, accommodate qualified subcontractors which become available, and generally respond to (often unplanned) events.
- 5.38. The Government proposes that it is reasonable that the subcontractor membership may change after the original qualification application has been submitted. This recognises the timescales involved in the original qualification submission, the evolving nature of the requirements, and that some potentially good subcontractors previously committed or unavailable may become available which would enhance a consortium's bid. In line with the stakeholder comments received, the Government suggests that it would be unreasonable to unnecessarily restrict such changes, particularly prior to the proposal submissions. As such, the draft regulations make provision for changes to bidder groups to be considered on a case by case basis at the discretion of the competent authority. In so doing, the competent authority must determine whether or not allowing that change would be fair and equitable to all other bidders. Most importantly in applying this fair and equitable test will be that the revised group continues to meet the qualification selection criteria and that this revised group would have been successful at the previous stage of the competition, had it been formed at that time.
- 5.39. Generally, the further into the tender process, the less likely it will be that changes will be allowed by the competent authority, such that changes after the submission of a qualifying bidder's proposal will only be allowed in exceptional circumstances and where the change is deemed fair and equitable.

²⁴ See Part 15 of the draft regulations.

- 5.40. The Government suggests that this process will deliver the required balance between flexibility and fairness, as highlighted in the comments of stakeholders to the September 2011 consultation.
- 5.41. However, the Government proposes that the prime (lead) member of a bidder group may not change, as this would fundamentally alter the make-up of the organisation that qualified and would effectively be a new applicant. In contrast, where a joint venture or prime contractor is bidding, the composition of the applicant's supply chain – through the addition or removal of key subcontractors - will be considered by the competent authority on a case by case basis.
- 5.42. Note also that in order to allow flexibility and reduce costs, the Government proposes that a joint venture may be qualified at the qualification stage without legal form, but with qualified individual members. The Government further proposes that it would be reasonable that a joint venture's shareholdings could subsequently change between the organisations identified within that joint venture.
- 5.43. Regulation 23 contains the specific details relating to bidder groups, with additional details contained in the application documentation for each licence competition.

D. Confidentiality Agreement

September Consultation Paper

- 5.44. In the September consultation, it was proposed that each applicant group enters into one overarching confidentiality agreement that all consortium members sign at the PQ stage. It was expected that this should result in a lesser administrative burden, but afford the same protection as the situation where members enter into individual arrangements. Stakeholders were asked whether they agreed with the proposal for one overarching confidentiality agreement for each applicant group rather than individual confidentiality agreements for each member of an applicant group.

Views of Respondents

- 5.45. Only one respondent disagreed with the proposal for a single overarching confidentiality agreement for each applicant group. That respondent believed that individual agreements are more flexible if consortia membership changes and therefore preferable to a single agreement.
- 5.46. The majority thought that a single agreement offered administrative advantages – being both simple and inexpensive. It was felt to provide protection for all parties. Another commented that the single agreement showed unity and mirrored the members acting together to deliver the DCC licence obligations. One commented that there needed to be a robust process to ensure that any additions to a consortium's membership also signed the confidentiality agreement.

Response and Proposed Regulations Drafting²⁵

- 5.47. The draft regulations make provision for the competent authority to determine that qualifying bidders will be required to execute a confidentiality agreement as a condition of acceptance into the 'proposal' stage, as detailed in regulation 8.
- 5.48. The Government proposes to require that each bidder group enters into a single overarching confidentiality agreement on behalf of all members of that bidder group. As the prime (lead)

²⁵ Part 6 of the draft regulations refers.

member of a bidder group may not change and all consortia must have a prime (lead) member in order to apply, then this confidentiality agreement will bind the bidder group regardless of any changes to its membership.

- 5.49. The details of the confidentiality agreement are not specified in the regulations; these will be in the detailed application documentation which will be issued to applicants at the qualification stage and will be specific for each licence application, applying to all those qualifying bidders who are invited to apply. Signed confidentiality agreements will not need to be returned by bidders with the submission of the qualification questionnaire, but will be required from all those qualifying bidders who are invited to apply before they will be sent the application documentation for that stage of the process.

E. Clarifications

September Consultation Paper

- 5.50. In the September consultation, it was proposed that all points of clarification should be requested via the data room²⁶ (which the Government expects to provide as a secure electronic means of communication), with responses made available to all applicants subject to any commercially confidential issues.
- 5.51. It was proposed that applicants will be able to seek clarification at both the pre-qualification and the invitation to apply stage. Similarly, a clarification of responses from applicants may be sought at both the pre-qualification and the invitation to apply stage.

Views of Respondents

- 5.52. All respondents agreed with the suggested approach to clarifications, as this had proven elsewhere to be transparent, effective, and efficient. Some respondents emphasised that confidential requests should be avoided/disallowed, or at the very least justified before they can be considered. A number commented that there was a need for a secure, structured process to access data, which they felt the data room would offer. One respondent felt that dialogue during the ITA stage was important, but that the ITA should be restricted to just four applicants in order to make that dialogue effective. All respondents favoured transparency. A couple of respondents commented that questions of clarification and their answers should be published for all applicants to see, so as to ensure transparency and a level playing field is maintained.

Response and Proposed Regulations Drafting

- 5.53. The Government proposes to allow time during the competition for questions of clarification at each stage. These questions and the corresponding answers will be published to all applicants in order to maintain a level playing field except where the competent authority determines that commercial confidentiality applies. The details of this process and the administrative arrangements for access to a data room or equivalent arrangement are not specified in the regulations. Instead, they will be specified in the detailed application documentation which will

²⁶ The details of the data room are not specified in the regulations, being specific to each tender process. At this time it is envisaged that the data room would be a virtual online store – i.e. a secure internet site where confidential data and other documentation relating to the tender can be stored and accessed by bidder-applicants through controlled permissions (e.g. using a secure log-on supplied by the competent authority which can be disabled if a bidder withdraws). The data room will allow the competent authority to disclose confidential information to bidder-applicants (e.g. relevant details of the service provider contracts). It is not envisaged that a traditional data room would be necessary or implemented (i.e. there appears no requirement for the provision of a physically secure continually monitored room at the competent authority's offices, which the bidders can visit to inspect confidential information).

be issued to applicants at each stage of the competition and will be specific for each licence application.

- 5.54. As is detailed below under each stage of the proposed process, the Government has made some improvements to the process to seek to ensure that the competition is restricted to a manageable number of the best applicants at the 'proposal' stage (which among other benefits will improve dialogue) and that the BAFO stage now commences with a detailed negotiation/dialogue with a limited number of the best shortlisted participants from the 'proposal' stage before applicants submit revised offers against an updated set of requirements. This, it is believed, will improve transparency, allow for greater clarification, and improve competitive outcomes, given that the Government (for the initial application) will be better able to define its requirements and applicants will have an improved understanding of those requirements against which to bid. More details of the proposed application process which is embodied in the draft regulations follow under the individual stages of competition, below.

F. Qualification Stage

September Consultation Paper

- 5.55. In the September consultation, it was proposed that the initial stage of competition would be a pre-qualification stage, whereby the selection panel would assess applicants in a robust, transparent manner and make recommendations to the Secretary of State on those applicants considered appropriate to invite to apply for the DCC licence. As such, it was proposed that all applicants will complete a PQQ and the selection panel will assess these against pre-determined hurdles to ascertain which applicants will be asked to submit responses to the invitation to apply.
- 5.56. For the initial licence competition, it was proposed that the Government would publish a draft of the pre-qualification documentation, including the PQQ and instructions regarding responses before the licence application process commences, so as to enable potential applicants to consider their applications at an early stage. The September consultation set out the likely information requirements which applicants would be asked to furnish and the nature of the selection criteria which would be applied. It stated that the selection criteria would be clear and objective and outlined examples of the criteria to be applied.

Views of Respondents

- 5.57. Respondents were in broad agreement with the proposed approach to the pre-qualification stage of the competitive licence application process. However, three respondents felt that the proposed three week response time was inadequate for an appointment of this size and complexity. Alternative timescales offered ranged from four to six weeks. Even in the event of an advanced draft of the PQQ stage documentation being published, one respondent commented that a four week period was required in order to submit a detailed response. That participant highlighted the challenges in gaining internal clearance and sign-off, given internal governance structures, risk management processes, and the need to accommodate a consortium's members.
- 5.58. One respondent commented that the evaluation criteria must be applied to all consortium members. Another requested more details of the assessment methodology and selection criteria which will be used at the PQQ stage.

Response and Proposed Regulations Drafting²⁷

- 5.59. The regulations set out the details of the qualification stage of the competition process²⁸. The evaluation criteria and timelines will be specified in the application documentation to be issued at the qualification stage. The primary objective of the qualification stage is to assess applicants against a robust and transparent set of published evaluation criteria, in order to exclude applicants who are not qualified to progress further and to invite up to a pre-defined maximum number of bidders to apply ('qualifying bidders').
- 5.60. For the initial licence application, the timing of the formal application being issued will be dependent upon successful completion of the legislative process. As such, it is intended to publish *in advance* (i.e. prior to the regulations coming into effect) a draft of the application documentation specific to the qualification stage – including the qualification questionnaire and the evaluation criteria against which answers will be assessed. This early sight of the documentation for the qualification stage is intended to increase the amount of preparation time available to interested parties, thereby hopefully maximising both the number and quality of applications. It will enable a reasonably tight but sufficient timeline for submission of responses to the qualification stage.
- 5.61. On the question of allowing sufficient time for applicant-bidders to prepare and sign-off their qualification submissions, the Government is now proposing to increase the amount of time allowed for submission of qualification proposals from the previously suggested three weeks to five weeks – acknowledging the comments of stakeholders.
- 5.62. Where a tender exercise is to be held, the competent authority must publish a notice stating that such an exercise is to be held and stating the day on which the qualification stage is to be commenced (the 'commencement date')²⁹. The Government expects that the commencement of the DCC licence application process will be advertised in relevant national and international publications, as well as on DECC's website (or, as appropriate, in future licence application competitions, on the Authority's website).
- 5.63. All bidders will be asked to complete a qualification questionnaire, designed to provide an understanding of the applicant-bidder (including a bidder group). This will focus on confirming that the applicant-bidder is of "good standing" and that it has the management, organisational, and financial capability and capacity to deliver the required services. The questionnaire will be designed to provide the evidence necessary to assess whether the applicant-bidder meets the criteria.
- 5.64. The competent authority will assess each qualification questionnaire submitted to it by a bidder in accordance with the evaluation criteria set out in the qualification documentation, in order to determine which bidders shall become qualifying bidders and be invited to participate in the 'proposal' stage of the tender process³⁰. This evaluation will include a check that each bidder has submitted a complete and compliant qualification response, which meets the minimum compliance and legal eligibility criteria – including any statutory requirements – and that that bidder has applied for both gas and electricity licences.

²⁷ See Parts 5 and 6 of the draft regulations.

²⁸ Regulations 8 and 9 refer.

²⁹ Regulation 7(2) refers.

³⁰ Regulation 9 refers.

- 5.65. All complete and compliant qualification questionnaires will be evaluated against published criteria to determine to what extent the bidder has demonstrated evidence of its suitability, capability, and understanding that would qualify it to perform the DCC role. This would likely include the provision of evidence to demonstrate: (i) economic and financial standing; (ii) suitability in terms of good standing; (iii) suitable organisational capability and a track record to deliver these services in a regulated energy sector; and (iv) sufficient organisational capacity to accommodate the scale of services required.
- 5.66. For the first licence competition, the Government intends to limit the number of qualifying bidders and take forward sufficient of the best qualified to maintain competition. Ranked in order of scores, the best bidder-applicants will be invited to apply, up to a maximum of 'x' bidders – where x is a number that will be specified in the application documentation for the qualification stage and it is designed to ensure that the numbers of applicants invited to apply is limited to a manageable number of the very best qualified that successfully completed qualification.
- 5.67. The selection rules for subsequent competitions will be defined at the time by the competent authority in the relevant tender application documentation, but the regulations have been drafted to accommodate either a subset of the best qualifying applicants or all qualifying applicants being invited to apply. DECC (or in future the Authority) as the competent authority will inform all applicants of its decision and reasons for any decisions taken as part of the process.
- 5.68. Schedule 1 of the draft regulations sets out the minimum information to be included in the qualification documentation:
- the instructions particular to the qualification stage of the tender exercise;
 - the date, time and manner in which the completed qualification questionnaire is to be submitted to the competent authority;
 - the qualification questionnaire;
 - the evaluation criteria to be applied by the competent authority in evaluating applicants' completed qualification questionnaires, including any physical limit(s) on the number of qualifying applicants to be selected; and
 - any other information that the competent authority deems necessary to the qualification stage of the tender process – for example, a reference to the licence application regulations and an overview of the DCC licence application process and associated timetable, so that potential bidders may understand the entire process before determining whether to bid; and links to the DCC licence conditions.

G. Proposal Stage

September Consultation Paper

- 5.69. In the September consultation, the main purpose of the ITA stage was described as being “to identify one or more preferred applicants to become the DCC licence holder (and possibly one or more reserve applicants). Where this is not possible, a small number of applicants may be invited to submit a best and final offer.”

5.70. The following proposal for the ITA stage was outlined in the September consultation:

- The ITA documentation will provide detailed information for applicants shortlisted at the pre-qualification stage on the requirements of the response and evaluation approach, including:
 - an invitation to submit;
 - the rules of the ITA stage;
 - any changes since pre-qualification to the regulatory/contractual framework;
 - a detailed statement of the services required;
 - current drafts of the licence and SEC;
 - details of proposed contracts with service providers, although some contractual issues may still be confidential at this stage;
 - the assumptions that applicants should use in their business plans on the timetable for rollout, the services that DCC will be required to deliver and, if available, the timetable for taking over meter point/supplier registration service;
 - detailed instructions on the requirements of response;
 - the rules and process by which questions of clarification may be asked, including the associated timelines during which questions will be allowed;
 - guidance on the data room contents and access arrangements; and
 - a description of the assessment process.
- In summary, the submission would likely be expected to include:
 - an operational business plan;
 - a detailed financial plan (costs and rewards, including revenue at risk and KPIs);
 - proposed transition plans;
 - a commitment to provide the necessary financial security if the applicant is granted the licence;
 - additional information and evidence on relevant experience; and
 - any further information or amendments to the information provided by the applicant during the pre-qualification stage.
- The assessment of ITA applications will be undertaken in two parts – Part 1 being to demonstrate the achievement of certain minimum standards and Part 2 being a detailed assessment of the merits of the applicant’s business proposal for how it would run the DCC.
- Only where it is considered appropriate and necessary, would a limited number of applicants be invited to a best and final offer stage, but there may be sufficient information to nominate one or more preferred applicants to proceed directly to the preferred applicant stage. It was also proposed to nominate one or more reserve applicants as back-up in case the preferred applicant(s) withdraw or are, for any reason, disqualified.

5.71. Stakeholders were asked to comment specifically on:

- the documentation to be provided by applicants for the DCC licence;
- the proposed approach to the ITA stage; and
- proposals for appointing one or more preferred applicants as well as one or more reserve applicants.

Views of Respondents

Documentation

- 5.72. There was general agreement from stakeholders responding to the September consultation with the documentation proposed. Many emphasised the need for as much information as possible to be provided, with particular care taken to ensure that all relevant information was made available as soon as it was available. Much of the focus of attention was on that documentation which would not be “final” at the time of the initial ITA – for example, the emerging details of the service provider contracts, DCC licence, and the Smart Energy Code.
- 5.73. However, one respondent suggested that it would be inappropriate to share updated service provider contracts with applicants during the ITA stage, as this would lead to increased complexity and risk an uneven playing field being created given the complexity of managing such a process. Instead, it was suggested that it would be better and simpler for all applicants to be assessed against a firm set of requirements at the ITA stage and only to update the requirements based upon the latest service provider contracts during subsequent rounds.
- 5.74. Another respondent requested that applicants should have the right to seek additional information, where they felt it would be material to their offer. One respondent requested for more documentation to be provided on how the management of changes to requirements would be handled, including the cost implications. Another respondent stressed how important it was that applicants should be asked to confirm their acceptance of any regulatory/commercial changes applying to DCC, if those changes have materially affected the basis upon which they had previously offered.

ITA Approach

- 5.75. All respondents agreed with the overall approach proposed to the ‘proposal’ stage of the competitive application process for the DCC licence. However, a number of respondents had some concerns about aspects of the detailed process proposed.
- 5.76. Four respondents highlighted that they thought a four week timeframe for ITA submissions was too short – requesting that the timeline be extended. Estimates ranged from six weeks through to eight weeks, and in one case up to ten weeks. One respondent commented that an outline business plan was insufficient, with more detail being required.

Selection Criteria and Weightings

- 5.77. Comments on the suggested criteria were limited, with all of those commenting being generally happy with the criteria. A number, but not all, suggested that the right balance had been struck with the proposed weighting of the criteria. One respondent commented that it thought the list was reasonable, but cautioned against underestimating the need for specific energy experience. Another said that additional weighting should be placed on the value of the operating cost and the business plan, whilst the weighting applied to relevant experience

should be reduced. One respondent stated that when experience is evaluated it is essential that the assessment is of the proposed DCC management and not of the wider bid team. Another respondent said that the selection criteria should be sufficiently detailed to ensure business continuity and transition management were properly accounted.

Appointing Preferred and Reserve Applicants

- 5.78. Stakeholders were more divided in relation to the proposals for appointing preferred and reserve applicants. One respondent called for the Government to be pragmatic about the number of applicants to be appointed, waiting to see how many applicants were suitable as they feared that there may only be a limited number.
- 5.79. Although one respondent called for as many applicants as necessary to ensure there was sufficient to choose from, two other stakeholders cautioned against selecting too many. Three respondents commented that no more than two applicants should be selected for the final stage, believing that any more would impose an unreasonable cost and time burden on both the process and shortlisted applicants. Their preference was for only a single preferred applicant and a single reserve applicant to be selected. Two respondents highlighted that it was important to have at least one reserve, given the risks associated with the emerging service provider contracts and other uncertainties which could lead to applicants wishing to revisit their earlier submissions. Another respondent suggested that the service provider due-diligence should be conducted after the award, with an appropriate reopener.

Response and Proposed Regulations Drafting³¹

- 5.80. The Government has sought to address the issues highlighted by stakeholders, most especially with regard to ensuring sufficient time is allocated and also to limiting the number of applicants which are to be selected as preferred and reserve applicants.
- 5.81. On the question of selection or evaluation criteria, the Government believes that the criteria previously suggested in the September 2011 consultation will form a good basis for the evaluation criteria to be used for evaluating the proposals received to the initial licence competition. These evaluation criteria do not form part of the regulations, but will be detailed in the licence application documentation applicable to the proposal stage of the tender exercise. The Government reserves its right to use evaluation criteria and weightings other than those set out in the September consultation.
- 5.82. On the question of allowing sufficient time and reducing the risks associated with uncertainty of service provider contracts and other material information, the Government is now proposing to increase the amount of time allowed for submission of proposals for the initial licence competition from the previously suggested four weeks to six weeks – acknowledging the comments of stakeholders.
- 5.83. Further, for at least the initial licence competition, it is now believed appropriate to invite a limited number of the best bidder-applicants from the ‘proposal’ stage to participate in a best and final offer stage, where they will have the opportunity to submit an updated proposal against the latest set of requirements for the DCC. This is discussed in further detail in this chapter below, but among the many benefits it offers will be that bidder-applicants will be given

³¹ See Part 7 of the draft regulations.

a second opportunity and a period of dialogue and detailed clarification before shortlisted applicants will be asked to submit their final offers.

- 5.84. For the first application, the Government will also seek to minimise the time it takes to process and assess the applications, so as to maximise the time available for applicants to bid.
- 5.85. On the question of assessing the number of applicants to select/appoint, in order to address the issues highlighted, the Government now proposes to:
- restrict to a manageable number (so as to maintain competition) those applicants it invites to the next stage of the competition, which will be the ‘best and final offer’ stage; and
 - select a single ‘preferred applicant’ and at least one ‘reserve applicant’ to take into the fourth and final stage of the competitive application process³².
- 5.86. The regulations specify that the competent authority must invite all qualifying bidders to whom the proposal documentation has been issued to submit a proposal for providing a smart meter communication service in accordance with the requirements set out in the proposal documentation³³. As detailed in regulation 10(4), the submission by a qualifying bidder is an application for the grant of both a gas and electricity smart meter communication licence.
- 5.87. Proposal documentation (and access to the data room) will only be given to those qualifying bidders that have submitted a signed confidentiality agreement in accordance with the notice given under regulation 9(5). Regulation 10(5) makes provision for a qualifying bidder to be disqualified if it fails to submit its signed confidentiality agreement within a defined timeframe.
- 5.88. Schedule 2 of the draft regulations details the information relevant to the proposal stage that the competent authority will provide to all qualifying bidders that have submitted a signed confidentiality agreement.
- 5.89. ***For the initial licence application*** for which the Secretary of State will be the competent authority, commercial negotiations on the core service provider contracts will be being conducted in parallel with the DCC licence application process. It is therefore suggested that in this instance³⁴:
- As well as giving bidder-applicants an opportunity to see proposed service provider contracts, they will be provided with information on the service provider procurement process as available at that time.
 - As the service provider contracts continue to develop throughout the application process, where relevant, up-to-date information will be made available to all bidder-applicants still remaining within the process, subject to any confidentiality issues.
 - If there are any developments in the service provider contracts (particularly ones which are likely to materially affect the preparation of DCC proposals), the competent authority may determine, where it is necessary in the circumstances, to extend the ‘proposal’ stage of the competition in order to allow bidder-applicants more time to rework and submit proposals against this changed specification.

³² Regulation 12 refers.

³³ Regulation 10(3) refers.

³⁴ Regulation 11 refers.

- Any changes considered material by the competent authority in the service provider contracts post submission of a qualifying bidder's proposal will be addressed in the BAFO stage, where those qualifying bidders selected and invited to the BAFO stage of the process³⁵ will have the opportunity to submit a revised application against the latest known requirements and information – including the latest development at that time in the service provider contracts. In this way, the Government has minimised the need for resubmissions of proposals, thereby addressing the concerns of stakeholders regarding the practicalities of this process. The revised approach is considered preferable to resubmissions at the 'proposal' stage, avoiding much complexity and potential confusion, and helping to maintain the overall timelines. It is better to compare all applicants at the 'proposal' stage against the then best known set of requirements and, as necessary, to invite those shortlisted to offer again against an updated set of requirements and make an informed comparison against those new requirements. However, it should be noted that the regulations do make provision³⁶ for the competition to be cancelled in the event of a material change in the regulated business information³⁷ where the change is so large that to continue would not be fair to other bidders, and the process to be restarted at the beginning of the 'proposal' stage³⁸ in that eventuality. The Government notes that this event appears unlikely, but that it is prudent to make such provision in the regulations.

- 5.90. As part of their submission of a proposal at the 'proposal' stage, an applicant bidding for the initial licence application will be expected to confirm its acceptance of any changes to the regulatory and commercial framework applying to DCC, which may have occurred since the qualification stage.
- 5.91. The evaluation of proposals³⁹ will be conducted against the published evaluation methodology. This methodology will commence with an initial confirmation that qualifying bidders have demonstrated that they have fulfilled the requirements outlined in the instructions for the 'proposal' stage, including the submission of a complete and compliant proposal. Bidder's detailed proposals will then be assessed against clear, objective evaluation criteria, whereby each criterion is assigned a weighting in accordance with the evaluation methodology.
- 5.92. The evaluation methodology, including the evaluation criteria and their associated weightings, will be specified in the application documentation for the proposal stage, so as to ensure transparency of process. The methodology and criteria/weightings may vary between different licence applications. For example, for the first tender application where it is the stated intent to operate a BAFO stage of the competition, the financial proposal at the 'proposal' stage will be given a lower weighting than it will be in future licence applications where it is not intended to operate a BAFO stage. This is because the 'proposal' stage in this instance is seeking to ascertain understanding, capability, and capacity (i.e. can they perform the role well and are their assumptions realistic against the business requirements?) rather than do they offer the best value for money or lowest cost, which will be determined at the BAFO stage⁴⁰.

³⁵ Defined in draft Regulation 13 as a 'selected qualifying bidder'.

³⁶ See Schedule 4 "Events of Cancellation" of the draft regulations.

³⁷ Regulated business information would include the stated business requirements in the application documentation for that stage against which proposals have been drafted.

³⁸ Part 12 of the draft regulations refers.

³⁹ Regulation 12 refers.

⁴⁰ For the initial competition, the financial offers at the 'proposal' stage will also be an important input for discussion during the dialogue phase of the subsequent BAFO stage.

- 5.93. The regulations have been drafted so as to either determine a ‘preferred applicant’ and one or more ‘reserve applicants’ at the end of the ‘proposal’ stage, or a shortlist of those bidders with the highest weighted scores which will be invited to participate in the BAFO stage of the competition, if a preferred applicant cannot be determined or the competent authority determines that a BAFO stage is necessary or appropriate in the circumstances – as the Government proposes would be appropriate for the initial licence application.
- 5.94. For the initial licence application, the Government proposes that where there are sufficient qualifying bidders whose bids have been evaluated as worthy of being invited to participate in the BAFO stage, that the number so invited should be limited to no fewer than three applicants.

H. Best and Final Offer Stage

September Consultation Paper

- 5.95. In the September consultation, the BAFO stage was described as being optional, with the detail being dependent upon the reasons for requiring a further stage, the applicants remaining, and any specific issues at that time.
- 5.96. In the proposal outlined in the September consultation, each BAFO applicant was to be asked to provide an updated application against a limited number of revised issues. Pre-defined criteria would be required for evaluating responses, as set out in the BAFO documentation issued at that time. The timing of the BAFO stage was to be dependent on the nature and extent of any issues to be resolved. As with the ITA stage (now renamed ‘proposal’ stage), following any BAFO stage, it was proposed that one or more reserve applicants may be selected as well as one or more preferred applicants.
- 5.97. Stakeholders were asked whether they agreed with the proposal for the licence competition to include an optional best and final offer stage in the event that two or more applicants having similar positions.

Views of Respondents

- 5.98. All of the consultation responses agreed with the proposal for a BAFO stage, although some cautioned against using it unless absolutely necessary. Indeed, there was a range of views of the purpose of the BAFO stage and when it should be applied. This range of views perhaps reflects the lack of clarity about the BAFO stage. For example, one respondent stated that: *“The optional ‘best and final offer’ stage is a welcome addition to the process and should help the fine-tuning of applicants’ submissions, as well as providing the Government with any additional clarity needed, with the onus being on the applicant to flex their application as they see necessary in order to win selection.”*
- 5.99. This ability to flex one’s application in light of updated information, and in order to win the competition, was a desirable feature of the BAFO stage which a couple of respondents highlighted. For example, one respondent commented that the BAFO stage should only be applied if it added value – for example, one respondent stated that the BAFO stage was valuable as it would provide much needed clarity to the competition process at a time of continued uncertainty. Another said that BAFO would allow material issues to be finalised – for example, if there had been a material change in the requirements such as revised service provider contracts. This view of the value of the BAFO stage is quite different to the thinking

which underlies the comment of two respondents who both said that the BAFO stage should only be used if absolutely necessary.

Response and Proposed Regulations Drafting⁴¹

- 5.100. In the September 2011 consultation, the BAFO stage was less well specified than the rest of the competitive application process, with resulting confusion as to its purpose and when it would be applied. The diversity of consultation responses suggests that some additional clarity about the process and its application is needed. The September consultation stated, “*where it is considered appropriate and necessary, we propose to invite a number of applicants to a best and final offer stage*”, but failed to adequately explain the circumstances in which it may be “considered appropriate”.
- 5.101. Elsewhere in the consultation it was suggested that the BAFO stage would be applied where DECC is unable to determine one or more preferred applicants at the conclusion of the ‘proposal’ stage. As noted under the discussion of the ‘proposal’ stage, the Government now proposes to clarify the detail and application of the proposal, BAFO and preferred applicant stages. Whilst the overall four stage process is unchanged, the Government hopes that the new detail will provide the additional clarity and certainty regarding the process and its application.
- 5.102. Although provision has been included in the draft regulations to make the BAFO stage discretionary, the Government considers at this stage that it is highly likely to be appropriate to operate a BAFO stage for the initial application. As such, the Government’s current expectation is that this best and final offer stage will be applied in all foreseeable circumstances for the initial application in order to give selected qualifying bidders a second opportunity to bid against an updated set of requirements⁴². As is detailed below, the Government is proposing to introduce some additional features to the BAFO process that was first described in the September 2011 consultation, most notably an initial ‘dialogue phase’ prior to it finalising its updated requirements and asking for shortlisted applicants to submit a final offer in the ‘final offer phase’ of BAFO.
- 5.103. The Government is also now proposing to appoint only a single preferred applicant at the end of the BAFO stage and at least one reserve applicant.
- 5.104. The regulations set out the details of the optional BAFO stage of the licence competition process – most notably regulations 13-16 inclusive. The BAFO stage would operate in order to give selected qualifying bidders a second opportunity to bid against an updated set of requirements. It is intended that these offers will be improved by the additional information and understanding gained through dialogue phase.
- 5.105. Draft regulation 13(2) states that where the competent authority has determined that a BAFO stage is to be held and the selected qualifying bidders have been determined, it must give notice to each qualifying bidder as to whether that bidder has or has not been invited to participate in the best and final offer stage.
- 5.106. As detailed in draft regulation 13(3), the competent authority must issue to each selected qualifying bidder the best and final offer documentation, which must include the information specified in Schedule 3 of the draft regulations. This will include updated regulated business

⁴¹ See Part 8 of the draft regulations.

⁴² Referred to in the draft regulations as ‘regulated business information’.

information, the evaluation criteria to be applied to the BAFO stage final offers, a description of the process for both the dialogue and final offer phases, and the BAFO timelines (including the minimum duration of the dialogue phase).

- 5.107. The regulations specify that the BAFO stage would commence with detailed dialogue and negotiations with all bidder-applicants shortlisted from the 'proposal' stage, to seek to explore in more detail their proposals in order to identify systematic issues with requirements or the Smart Energy Code, undue risks, excessive pricing, and weaknesses in solutions⁴³.
- 5.108. In the case of the initial licence application, the dialogue phase of the BAFO stage of the competition process would offer the opportunity to provide the shortlisted bidders with updated information on the service provider contracts – which are being procured in parallel. The Government suggests that for the initial licence application competition, a period of 10 weeks will be allowed for the dialogue phase of the BAFO stage. This extensive period shows the importance that the Government places on this dialogue phase in assisting all parties to better understand the requirements, against which final offers will be prepared.
- 5.109. During the dialogue phase, the competent authority will draft an updated set of regulated business requirements, which will be informed by the detailed dialogue and negotiations with applicants as well as the emerging detail of the service provider contracts, SEC, DCC Licence, etc. These updated requirements will form the basis of the documentation for the final round of the tender, which will be issued to all selected qualifying bidders in the form of:
- the updated regulated business requirements;
 - a confirmation of, or update to, the instructions⁴⁴ published at the commencement of the BAFO stage in the application documentation for that stage;
 - a confirmation of, or update to, the evaluation criteria published at the commencement of the BAFO stage in the application documentation for that stage; and
 - any other relevant information, as determined necessary by the competent authority.
- 5.110. At the end of the dialogue phase, the competent authority in accordance with regulation 15(2) must commence the final offer phase by giving a notice to each selected qualifying bidder that the dialogue phase of BAFO is ended and that the final offer phase of BAFO is commenced. This notice will include the following information:
- an updated statement of the regulated business information;
 - a confirmation of, or update to, the evaluation criteria originally included in the BAFO documentation; and
 - an invitation to submit a best and final offer in accordance with the application documentation for the BAFO stage.
- 5.111. For the initial application, the Government proposes to allow selected qualifying bidders a further five weeks to submit their best and final offers, following the end of the ten week

⁴³ Regulation 14 refers.

⁴⁴ These instructions will include the date, time and manner in which the best and final offer is to be submitted.

dialogue phase. Thus, in total, the BAFO period for the initial competition will extend for fifteen weeks prior to submissions closing.

- 5.112. The competent authority shall evaluate⁴⁵ each best and final offer submitted by a selected qualifying bidder in accordance with the evaluation criteria set out in the BAFO application documentation, in order to determine: (i) which applicant shall become the preferred applicant; and (ii) which applicant(s) shall become the reserve applicant(s).
- 5.113. The competent authority may decline to consider a best and final offer where they determine it does not comply in any material respect with the requirements specified in the application documentation for the BAFO stage.
- 5.114. The preferred applicant will be the selected qualifying bidder with the highest weighted score and that applicant will be invited to participate in the final stage of the competition (Stage 4, preferred applicant).
- 5.115. Where additional suitable applicant bidders exist, the intent is to shortlist at least one reserve candidate – although the regulations provide some limited flexibility depending upon the state of the competition – i.e. no reserve applicants could be appointed, or up to two could be appointed.
- 5.116. If no BAFO stage is run, the preferred applicant will be the applicant bidder with the highest weighted score from the 'proposal' stage of the competition. The reserves will be similarly selected from the next best weighted scores from the 'proposal' stage.

Consultation Question

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| 15. | For the initial licence application, do you agree with the Government's intention to apply the BAFO stage in all circumstances, so as to mitigate the risks associated with the changing requirements and improve the competitive outcomes? |
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1. Preferred Applicant Stage and Grant of Licence

September Consultation Paper

- 5.117. In the September consultation, the fourth and final stage of the proposed competition was described as being required to finalise the details of any outstanding issues and that it would culminate in the identification of the successful candidate to whom it will be recommended that the licence should be granted.
- 5.118. Once all outstanding issues have been resolved, including finalising the incentive mechanisms and the terms of the revenue restriction, it was proposed that the application panel would recommend to the Secretary of State that one of the preferred applicants should become the DCC licence holder and that the Secretary of State would then grant the DCC licence. It was envisaged that it will take two to three weeks to complete this stage and award the licence.

⁴⁵ Regulation 16 refers.

Views of Respondents

- 5.119. Only limited feedback was received on this section of the application process, with only two respondents making specific comment. The first respondent suggested that the Government should be prepared for “tentative responses” given the uncertainty of the service provider contracts. As such, it should prepare contingency plans in the event that service provider contracts had not been finalised or had failed, or that the preferred applicant was unable to agree all the outstanding issues and walked away or was disqualified. It further commented that the suggested timescales needed commitment to deliver and that this would be a challenge given the uncertainties which may exist.
- 5.120. The second respondent commented that any award should confirm that the applicant’s proposal would meet the needs of UK PLC and that it appeared flexible to the future needs of the DCC, as well as to the current needs.

Response and Proposed Regulations Drafting⁴⁶

- 5.121. For clarity and to ease administration, engagement during this final stage of the competitive application tender process will focus on the single preferred applicant from the previous stage of competition and in getting that preferred applicant to agree to the outstanding issues, such that the contract may be awarded.
- 5.122. Only in the event of that process failing or being highly likely to fail, would the Government consider changing the status of the first reserve (and subsequently second reserve) to be that of preferred bidder with a view to getting that party to accept the proposed terms, service provider contracts, licence conditions, Smart Energy Code, etc. Otherwise, the reserve applicants will play no active part in the preferred applicant stage of the tender exercise.
- 5.123. As soon as reasonably practicable after a preferred applicant has been determined, the competent authority would inform the applicant that it had been so selected. In so doing, the competent authority would provide the preferred applicant with a list of any remaining issues to be addressed and other conditions to be met before a licence can be granted. This would include any temporary licence obligations contained in Schedule 3 of the draft DCC Licence, which as detailed in paragraph 4.271 above, provides a framework for the inclusion of key commitments made as part of the licence application process to fully establish the organisation shortly after licence grant⁴⁷. Further details are specified in regulation 17.
- 5.124. As soon as reasonably practicable after the reserve applicants have been determined, the competent authority shall also give notice of that effect to the chosen reserve applicants.
- 5.125. A reserve applicant may be nominated by the competent authority to replace the preferred applicant in the event that:
- the preferred applicant fails to resolve the matters required to DECC’s (or the Authority’s) satisfaction by the date required;
 - the preferred applicant withdraws from the tender; or

⁴⁶ See Part 9 and Part 10 of the draft regulations.

⁴⁷ The purpose of Schedule 3 to the draft DCC licence is to ensure that certain commitments that are made by the Licensee, and accepted by the Secretary of State, during or in connection with the Licence Application Process are recorded in a form that is clear, unambiguous, and unqualified for purposes connected with the interpretation of the Licence and its application to the Licensee.

- the preferred applicant is disqualified from the tender exercise in accordance with the regulation.
- 5.126. In the event that a reserve applicant is nominated to replace a preferred applicant, this will occur in the strict order of 'first reserve' followed by 'second reserve'.
- 5.127. Where the competent authority is satisfied that the preferred applicant has resolved the matters required of it, that preferred applicant shall be the successful applicant⁴⁸ and shall be:
- issued with the licence;
 - required to accede to the SEC;
 - required to comply with its obligations with regard to financial security; and
 - required to sign the service provider contracts⁴⁹ procured on its behalf.
- 5.128. As soon as reasonably practicable after the competent authority has determined to grant the DCC licence to the successful applicant, it shall publish a notice to that effect⁵⁰. In addition, the competent authority shall as soon as reasonably practicable after its determination, give written notice to each unsuccessful applicant of its determination in relation to the successful applicant, in accordance with regulation 19.
- 5.129. The determination notice to each unsuccessful applicant shall include:
- the name of the successful applicant;
 - the evaluation criteria applied in evaluating proposals and where appropriate best and final offers;
 - the reasons for the determination, including the characteristics and relative advantages of the successful proposal or where appropriate the successful best and final offer (i.e. why successful); and
 - the score(s) of the qualifying bidder which is to receive the notice and those of the successful bidder (so that the qualifying bidder can understand how far short it fell and on what criteria).
- 5.130. In publishing notices regarding the successful applicant, the competent authority may withhold any information where it considers disclosure would:
- impede law enforcement; or
 - otherwise be contrary to law or public interest.
- 5.131. Following notification to all unsuccessful bidder-applicants of the decision on contract award, a standstill period of ten working days shall be imposed before the Secretary of State (or the Authority) shall confirm his/her determination to grant the DCC licence to the successful applicant and shall publish a notice to that effect.

⁴⁸ Regulation 18(1) refers.

⁴⁹ Communications Service Provider (CSP) and Data Services Provider (CSP) contracts.

⁵⁰ Regulations 18(2) and 18(3) refer.

- 5.132. As detailed in regulation 19(7), once this notice confirming the competent authority's determination to grant electricity and gas smart meter communication licences to the successful applicant has been published in accordance with paragraph 5.131, the licence competition shall be deemed to have finished.

J. Fast Track Process

September Consultation Paper

- 5.133. In the September consultation, it was proposed that a fast-track application process be considered, covering the appointment of an interim DCC licensee in the event that the incumbent DCC has its licence revoked.
- 5.134. At that time, the Government stated that it considered that it would be important to have the ability to appoint a company to step in as DCC as soon as possible given the consequences of withdrawal of DCC services. It was feared that completion of a full competitive application process, which would take a minimum of at least six months, would expose end users to too great a risk of having an inadequate service during the interim.
- 5.135. Thus, it was proposed that the DCC licence application regulations should include the provision for the Authority to competitively appoint a "temporary" DCC licence holder through a fast track process in the event that the incumbent has its licence revoked. The appointment would be for a period of, say, up to eighteen months, which would provide sufficient time to appoint a successor DCC through a full competitive process in a timely and effective manner.
- 5.136. The consultation asked stakeholders whether they agreed that, in the event of the DCC losing its licence, the Authority should have the power to fast track the appointment of a temporary DCC. If so, it was questioned if eighteen months is an appropriate maximum time period for the temporary DCC to hold a licence before a new DCC can be appointed via a full competitive process? It was further questioned which elements of the licence application process could be accelerated or eliminated to ensure rapid appointment of a temporary DCC?

Views of Respondents

- 5.137. All but one of the respondents agreed with the proposal for a fast track process. Although the proposal for a fast track application process received general support, it also received criticism for being cumbersome. One party claimed that it was "unnecessary", as the implementation of a special administrative regime (or alternative arrangements as currently included in the draft DCC licence) could avoid the need for a rushed fast-track process.
- 5.138. The general concern, which is shared by the Government, was that it would difficult to run a sufficiently rigorous selection process to support a full (twelve year) DCC licence award in any less time than in the proposed normal process. Therefore, a licence awarded under a fast-track process would have to be for a shorter period, and as such it would be unlikely to be attractive to potential bidders.
- 5.139. Alternative suggestions were offered to reduce the standard competitive process and associated timeline. One party suggested that the pre-qualification stage could be eliminated. A similar thought by another party recommended that the PQ and ITA stages were combined to reduce timescales. Another respondent suggested that the BAFO stage could be eliminated. In contrast another respondent commented that no steps should be eliminated, but that the

timescales could be shortened. Two respondents suggested that the runner-up or first reserve from the first process should be considered.

- 5.140. Only four respondents commented on the proposed time period for a temporary DCC to be appointed via a fast-track process. Two thought that 18 months was appropriate and would allow sufficient time to complete a full scale application process. However, the other two respondents both commented that the proposed time period of 18 months was too long and should be shortened. One suggested that a period of 6 to 12 months was more appropriate.

Response and Proposed Regulations Drafting

- 5.141. After due consideration, the Government believes that a special administrative regime (delivered through primary legislation) or an intervention regime (as provided for in the draft DCC licence) to address failings in an incumbent DCC would offer advantages in comparison to a fast track application process.
- 5.142. These regimes would keep an existing DCC operational and delivering the principal services to users, while a full licensing application process could be undertaken within normal timescales in order to appoint a successor DCC on an enduring basis hopefully for a full licence term. On balance, the Government believes that a fast track process would be difficult to manage in a sufficiently short period of time and remain a robust assessment of potential DCC licensees. Moreover, the Government is concerned about the attractiveness of a very short-term DCC licence and the impact on competitive pressure that could be exerted through such a process.
- 5.143. As such, no provision has been included in the regulations for a fast track appointment process for a temporary DCC. Further details of the proposed arrangements for intervention and continuity of the DCC's service are detailed in paragraphs 4.255-4.262 above.

Consultation Question

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| 16. | Do you agree with the proposal not now to include a fast-track process to appoint a temporary DCC, but instead to rely upon the provisions for intervention to keep the DCC's service functioning whilst a standard licensing application process is conducted to appoint an enduring successor DCC? |
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K. Other

- 5.144. A number of other issues have been considered and addressed within the draft regulations, with additional detail to be specified in the application documentation as appropriate. These issues were not explicitly considered as part of the September consultation, but are discussed below for information and stakeholder comment.

Restrictions

- 5.145. The Government will place participation limits on bidders and service users to:
- ensure the independence of the DCC from its service users to avoid situations where any service user could use the supply chain to advantage their own position at the expense of other users; and

- prevent conflicts of interest between DCC and the suppliers it manages on behalf of its service users.

5.146. The table below summarises the limits on participation which will be imposed on potential bidders from applying for the DCC licence:

Participation Limit	Rationale	Enforcement Mechanism
The DCC should be materially independent of energy suppliers.	<ul style="list-style-type: none"> • Protection of equitable delivery to SEC members. 	<ul style="list-style-type: none"> • DCC Licence. • Smart Energy Code. • DCC Licence application process.
The DCC licensee may not also be the Data Services Provider (DSP) or Communications Service Provider (CSP).	<ul style="list-style-type: none"> • Prevention of over-dependency on a service provider. • Maintain DCC's independence from key service providers. • Removal of potential conflict of interest in contracting with service providers and managing contractual obligations. 	<ul style="list-style-type: none"> • DCC Licence. • Smart Energy Code. • CSP and DSP tender requirements and contracts. • DCC Licence application process.
A subcontractor to the DSP or CSP may not be the DCC licensee.	<ul style="list-style-type: none"> • Maintain DCC's independence from key service providers. • Removal of potential conflict of interest in contracting with service providers and managing contractual obligations. • Ensuring that subcontractors do not exert undue influence on the DSP and DCC. 	<ul style="list-style-type: none"> • DCC Licence. • Smart Energy Code. • CSP and DSP tender requirements and contracts. • DCC Licence application process.

5.147. These participation limits have been embodied in the DCC licence application regulations, where they are not otherwise embodied in the DCC licence. Checks at the qualification stage will confirm that the participation limits detailed above have not been breached. These will need to be re-checked when a consortium's membership changes and prior to any selection being made, including prior to the grant of licence.

*Withdrawal*⁵¹

- 5.148. A bidder may withdraw from the licence competition at any stage in the process, by giving written notice. A bidder who withdraws may only be re-admitted to the licence competition in the event that that bidder joins another qualifying bidder's consortium.
- 5.149. A preferred applicant, reserve applicant, or successful applicant who withdraws from the licence competition shall not be re-admitted to that licence competition – except in the event that the competition is cancelled and re-run.
- 5.150. Regulation 20 provides further details.

*Cancellation*⁵²

- 5.151. As detailed in regulation 21, for a set of cancellation events defined in Schedule 24 of the regulations, the competent authority may give notice of its intention to cancel the licence competition. The notice period shall be of limited duration, but sufficient to allow representations to be made. Any representations made during the notice period must be considered by the competent authority before the licence competition is declared cancelled or failed. The intention behind such cancellation provisions is to provide the flexibility to the competent authority to avoid being locked into a licence application process that they believe will not result in a competitively appointed and capable DCC.
- 5.152. The competent authority may later re-run a licence competition which it has cancelled – either from the beginning or the start of a particular stage of that tender exercise. In the event that no preferred applicant, reserve applicants, or successful applicant is determined, the competent authority may re-run the licence competition or determine that the competition has failed. The competent authority will not be liable for any costs incurred by applicants or other external parties resulting from a licence competition which has been cancelled; nor shall the competent authority consider such costs when making its decision.
- 5.153. The cancellation events detailed in Schedule 4 of the regulations are in summary:
- No completed and compliant qualification questionnaires are received.
 - The competent authority determines that there are no bidders or qualifying bidders;
 - No completed and compliant proposals are received to the invitation to submit a proposal.
 - If a best and final offer stage is conducted, no completed and compliant applications are received to this best and final offer stage of the tender exercise.
 - A preferred applicant withdraws from the process or is disqualified and there are no reserve applicants remaining.
 - There is no successful conclusion to the preferred applicant stage of the competition (i.e. the matters to be completed are not satisfied by any of the remaining applicants), such that no 'successful applicant' can be declared and granted the licence.

⁵¹ See Part 11 of the draft regulations.

⁵² See Part 12 of the draft regulations.

- The competent authority determines that the dialogue phase of the BAFO stage of the tender process has gone on for too long and that is unlikely to reach a successful conclusion.
- A successful applicant withdraws from the DCC licence application tender process before the licence is granted and there are no remaining reserve applicants.
- The competent authority determines that the tender process has been corrupted or otherwise compromised, such that it would not be in the public interest to continue, as a competitive outcome could not be assured.
- The successful applicant fails to make a payment in accordance with regulation 18.
- The competent authority determines that the regulated business information has varied from that provided at an earlier stage of the tender exercise, such that continuing with the tender would not be fair and equitable to any other bidder.
- The competent authority determines that it would not be appropriate to grant a DCC licence to any qualifying bidder.
- The competent authority determines that the participation limits (originally checked at the qualification stage) have subsequently been breached in the event that a consortium's membership changes and prior to any selection being made, including prior to the grant of licence.

Disqualification

- 5.154. For reasons of probity, the Government is proposing a number of provisions relating to the disqualification of bidders. Regulation 22 states that where the competent authority is satisfied that one or more disqualification events are occurring or have occurred and they would materially affect the outcome of the licence competition, the competent authority shall disqualify the bidder-applicant by giving notice to that effect.
- 5.155. The disqualification events are specified in Schedule 5 of the regulations. These disqualification events in relation to any applicant, qualifying applicant, preferred applicant, or successful applicant – or member of a consortium – are summarised below:
- causing or inducing any person or organisation to enter into an agreement to collude or to inform the applicant of any information within a competitor's rival application.
 - submitting any information to the competent authority which is false or misleading unless the provision of further information is acceptable to the competent authority.
 - engaging in, attempting to engage in, allowing or encouraging any anti-competitive behaviour by or between any person participating in the tender exercise;
 - doing anything which would constitute the commission of an offence under section 1, 2 or 6 of the Bribery Act 2010.
 - fixing or adjusting the detail of a document to be submitted by or in accordance with any agreement or arrangement with any other tender participant or by improperly using insider information.

- entering into any agreement or arrangement with any other tender participant that it shall refrain from submitting a tender.
- communicating to any person other than the competent authority the details of its proposed tender, except where this disclosure is made in confidence in order to obtain information necessary for the preparation of that tender.
- any change to the membership of a bidder group other than a change which has been approved by the competent authority.
- contacting any relevant person other than in a manner permitted by any rules particular to the qualification, proposal, and best and final offer stages of a tender exercise or any requirements specified in the regulations. This includes, but is not limited to, contact for the purposes of discussing the possible transfer of such person to the employment of bidder-applicant.

Treatment of Bidder Costs

- 5.156. All bidder-applicants will be responsible for their own costs. The competent authority will be under no obligation and shall not accept any liability for any costs, expenses, damages or losses incurred by any bidder-applicant - whether successful or otherwise - in connection with the tender exercise.
- 5.157. If a bidder-applicant withdraws or is disqualified, or the competent authority cancels the licence competition, the competent authority shall not incur any liability for any losses whatsoever towards any applicant, member of the consortium, or any of their related parties.

Cost Recovery

- 5.158. The draft regulations make no provision for the competent authority to recover its costs in relation to administering the licence application process, as for the initial DCC licence application, the Government has indicated that it will be responsible for its own costs.
- 5.159. For subsequent DCC licence applications which may be conducted by the Authority, there could be merit in having a discretionary power in the regulations (as provided for by s56FC(4)(a) of the Electricity Act 1989 and s41HC of the Gas Act 1986, both inserted through schedule 4 of the Energy Act 2008) which would allow the Authority to recover its costs in relation to administering the licence application process, in accordance with a published cost recovery methodology.
- 5.160. Further work is required to consider what kind of cost recovery model would be most appropriate in the circumstances, and best fit with the DCC licence application process. As such, no such cost recovery provision is included in the draft regulations detailed in Annex 4 to this consultation. Instead, the Government and Ofgem will explore this issue, and as appropriate bring forward any amendments to the regulations to allow for such a scenario.

Consultation Question	
17.	Do you have any comments on the proposed competitive application process for the DCC licence and, in particular, on the Government's stated intention to operate an extensive 'best and final offer' stage for the first licence competition?
18.	Do you have any comments on the draft DCC licence application regulations and, in particular, whether they effectively implement the proposed competitive application process described in this consultation document?

Annex 1 Summary of Consultation Questions

1.	Do you agree with the structure and content of parts 1 and 2 of the licence?
2.	<p>Do you agree with the proposed list of licence revocation events, in particular do you agree with the inclusion of revocation triggers linked to:</p> <ul style="list-style-type: none"> i) A failure of the DCC to comply with an enforcement notice issued under Section 40 of the Data Protection Act; ii) A contravention of the licence condition or statutory requirement in a manner so serious as to make it inappropriate for the licensee to continue to hold the licence; iii) A contravention of the independence Condition 9; and iv) The licensee no longer being, or never having been, a fit and proper person to carry out the Authorised Activity?
3.	Do you agree that the DCC licence should be issued for a fixed-term only?
4.	Do you have any comments on Chapter 1 of the licence conditions, in particular do you have any comments on the drafting of the definitions?
5.	<p>Do you have any comments on Chapter 2 of the licence conditions, in particular do you have any views on:</p> <ul style="list-style-type: none"> i) The general objectives of the DCC; ii) The way in which the Mandatory and Permitted businesses of the DCC have been constructed; iii) The interaction between the mandatory and permitted businesses; iv) The proposed general and security controls for the DCC?
6.	<p>Do you have any comments on Chapter 3 of the licence conditions, in particular do you have any comments on:</p> <ul style="list-style-type: none"> i) the independence requirements of the DCC and the interaction with the revocation provisions; ii) the broad condition on protection of confidential information; iii) the scope and nature of the role of the compliance officer?
7.	<p>Do you have any comments on Chapter 4 of the licence conditions, in particular do you have any comments on the drafting of:</p> <ul style="list-style-type: none"> i) the transitional obligations on the DCC, possibly as part of a wider transition scheme; ii) the proposals for how the DCC would set out its future business development objectives; iii) the proposed inclusion of a licence condition that would facilitate future transfer of registration to the DCC?

8.	<p>Do you have any comments on Chapter 5 of the licence conditions, in particular do you have any comments on:</p> <ul style="list-style-type: none"> i) The procurement obligations, including the balance between what the DCC must competitively procure and what it may self provide; ii) The most appropriate role, if any, for the Authority in influencing how the DCC should balance various competing public interests, when preparing for future procurements of Fundamental Service Capability; iii) Do you have any evidence from other sectors about how the public interest is taken into account by regulated bodies when making major procurement decisions; iv) The obligations on the DCC in relation to provision of services, recognising that these conditions will need to be reviewed in light of a more detailed definition of services; and v) The charging methodology provisions, particularly the objectives of the methodology?
9.	<p>Do you have any comments on Chapter 6 of the licence conditions, in particular do you have any comments on :</p> <ul style="list-style-type: none"> v) The scope of the SEC as set out in the SEC condition and the SEC objectives; vi) Whether the DCC should have a licence obligation to maintain and keep in force the SEC; vii) The proposal to allow the Secretary of State to block SEC modifications in the period up to 31 October 2018; and viii) The way in which interoperability should be addressed through the SEC objectives?
10.	<p>Do you have particular comments on how best to ensure the consumer interest is met in the SEC Objectives, in particular:</p> <ul style="list-style-type: none"> iii) Can you identify any potential scenarios where a modification might be proposed which would be in the interests of consumers but which would not be supported by the objectives set out for the code; and iv) If you think the objectives could be set out to better capture the interests of consumers, as opposed to the proposed approach for SEC objectives to be balanced in the round with due regard for energy consumers' interests, how do you think this could be done?
11.	<p>Do you have comments on the proposed condition allowing the Authority to put forward code modifications and for this power to be limited to specific areas defined in the SEC?</p>
12.	<p>Do you have any comments on Chapter 7 of the licence conditions, in</p>

	<p>particular do you have any comments on:</p> <ul style="list-style-type: none"> i) The proposals in relation to financial security, in particular the requirement to provide a performance bond in addition to financial security?
13.	<p>Do you have any comments on Chapter 9 of the licence conditions, in particular do you have comments on:</p> <ul style="list-style-type: none"> i) The need for the revenue restriction conditions in the DCC licence to evolve as the DCC's role changes; ii) The need to incentivise the DCC to concentrate on achieving programme milestones at the beginning; iii) The proposal that the DCC's internal costs should be passed through with a (£/annum margin applied; iv) That incentives on reduction in the DCC's internal costs and on output measures should be applied later; v) That the DCC should be subject to an element of bad debt risk unless it takes reasonable measures to recover such debt; and vi) Particular KPIs that could be applied to the DCC after it starts to deliver services?
14.	<p>Do you have any comments on Chapter 10 of the licence conditions, in particular do you have any comments on:</p> <ul style="list-style-type: none"> i) The proposed arrangements applying to Management Orders, including the scope of the powers of the Authority in such circumstances; ii) The arrangements proposed in relation to the Business Handover Plan and the process for resolution of matters between the outgoing and incoming DCC; iii) The scope of matters that the Business Handover Plan should provide for; iv) The scope of the matters that may need to survive for a period of time to continue to ensure a smooth handover to the DCC's successor and whether the two year timeframe is appropriate; and v) The proposed approach to Intellectual Property Rights?
15.	<p>For the initial licence application, do you agree with the Government's intention to apply the BAFO stage in all circumstances, so as to mitigate the risks associated with the changing requirements and improve the competitive outcomes?</p>
16.	<p>Do you agree with the proposal not now to include a fast-track process to appoint a temporary DCC, but instead to rely upon the provisions for intervention to keep the DCC's service functioning whilst a standard licensing application process is conducted to appoint an enduring successor DCC?</p>

17.	Do you have any comments on the proposed competitive application process for the DCC licence and, in particular, on the Government’s stated intention to operate an extensive ‘best and final offer’ stage for the first licence competition?
18.	Do you have any comments on the draft DCC licence application regulations and, in particular, whether they effectively implement the proposed competitive application process described in this consultation document?

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Annex 3 Draft DCC Licence (published separately)

Published alongside this consultation at

http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx

Annex 4 Draft DCC Licence Application Regulations (published separately)

Published alongside this consultation at

http://www.decc.gov.uk/en/content/cms/consultations/cons_smip/cons_smip.aspx

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