

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

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

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

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

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

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

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

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

Chapter 9: Competitive licence application process

Design of Process

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

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

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

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

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

Financial Security

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

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

Changes to an applicant's consortium

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

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

within the timescales the Government has committed to.

Confidentiality agreement

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

Yes.

Clarifications

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

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

Pre-qualification Stage

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

The approach is fully consistent with what we would expect given the nature and size of the contract.

In the spirit of transparency, we would expect that applicants have visibility of the weightings associated with Part 2 PQQ criteria within the PQQ.

ITA Documentation

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

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

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

Applicant's Responses

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

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

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

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

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

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

Best and final offer (BAFO) stage

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

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

Preferred applicants and licence grant

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

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

governance services.

Fast track process

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

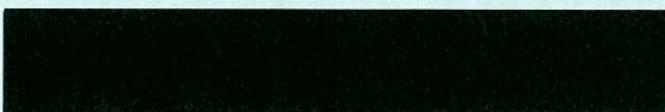
Given the importance of the DCC service and the regulatory scrutiny to which it will be exposed we would expect that in all, bar the most catastrophic failures, poor performance would be identified promptly and remedial action taken, to allow the failing service to be rectified.

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

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

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

For more information on our response, please contact:



Ref: URN 11D/868

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

DCC Incentivisation

1. DCC incentives

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

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

2. How Incentives should be applied

Outputs not inputs:

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

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

Simplicity:

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

Limit on risk:

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

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

The best candidates for incentivisation

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

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

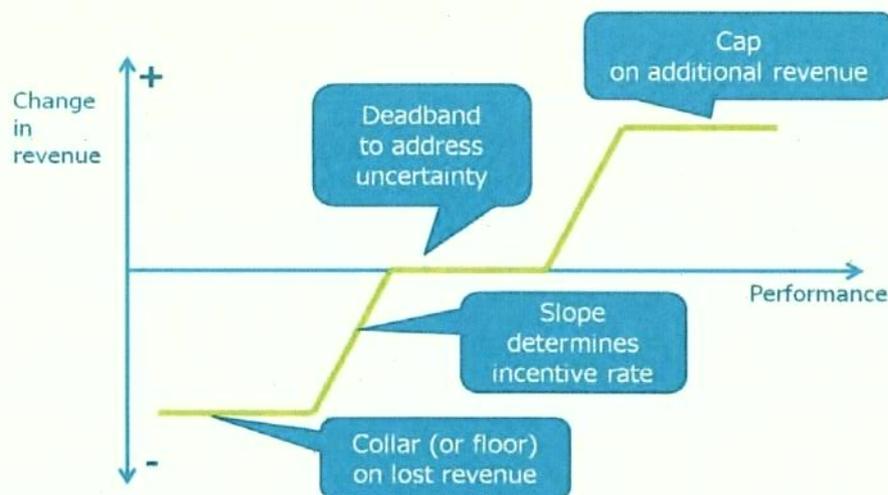


The use of Caps and Collars

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

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

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



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

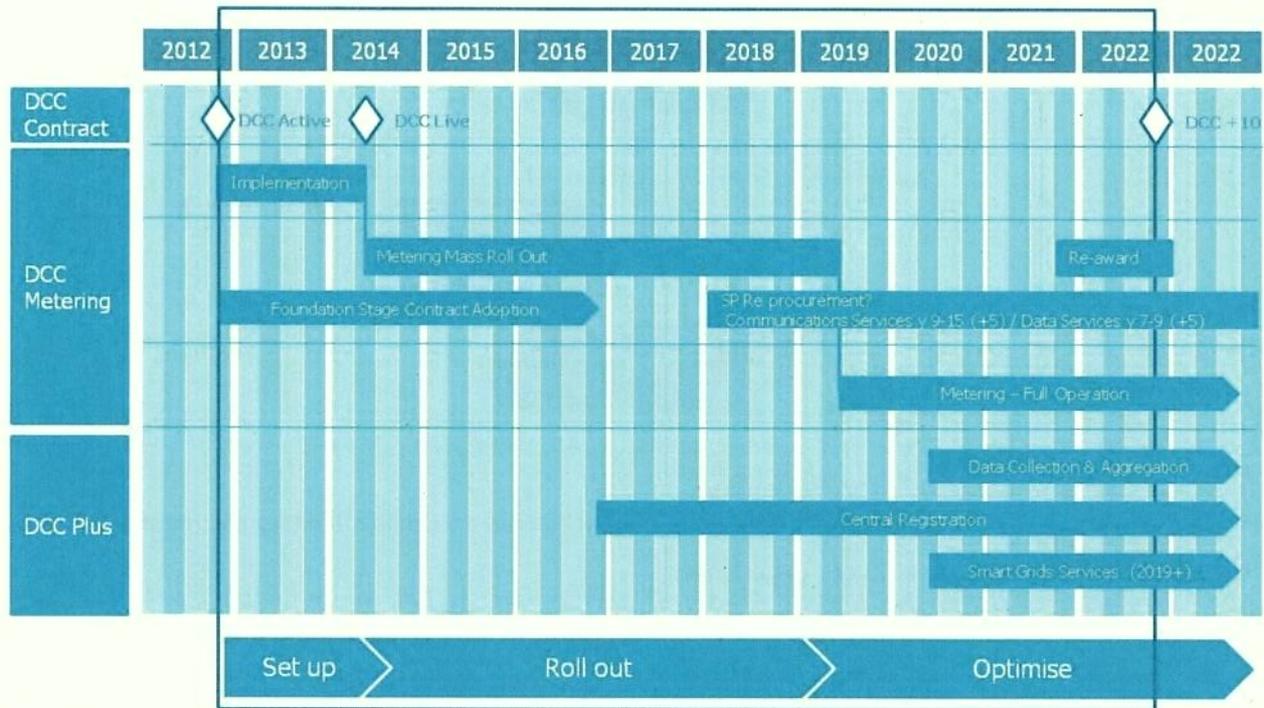
The aggregate levels of exposure under such mechanisms need not be the summation of all the individual regimes – as the probability of all occurring simultaneously is quite low – we would suggest that caps and collars should be based on reasonable best and worst case scenarios across all areas of incentivisation.

3. How might the incentives be structured

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

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

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



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

4. What are the appropriate candidates for incentivisation

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

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

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

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

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

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

5. Conclusions

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

