

24 November 2011

SMIP – DCC Licensing Team
Department of Energy and Climate Change
3 Whitehall Place
London
SW1A 2AW

Dear Sir / Madam,

Consumer Focus response to „ A consultation on the detailed policy design of the regulatory
and commercial framework for DCC“

We are happy to respond to the above consultation. This submission is non-confidential and may be published on your website.

Due to resource constraints we have only been able to respond to a subset of the questions posed. A non-response to other questions should not be taken as implicit agreement (or disagreement) with the proposals in those areas.

If you have any queries in relation to this submission, please do not hesitate to get in contact,

Yours faithfully,

[Unsigned as sent via email]

Appendix: response to questions

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

The Energy Act 2004 instituted a right of appeal against Ofgem decisions to modify industry codes in defined circumstances. The enabling mechanism for designating which codes, and which decisions on those codes, are eligible for the right appeal is set out in a statutory instrument; it currently covers all the major energy codes. It appears likely that proposals to modify the Smart Energy Code (SEC) could be as material as proposals to modify the pre-existing codes – it may therefore be appropriate to modify the statutory instrument to extend the right of appeal to the SEC.

You suggest that Section 13 of the Consumers, Estate Agents and Redress Act 2007 could be amended to include an obligation on Consumer Focus to investigate complaints where the DCC disconnects a consumer without authorisation from the supplier/network operator.

We would be happy to take on such an obligation; clearly consumer detriment may result in these circumstances and we would always be willing to investigate disconnection cases. We think you should also consider whether such cases should be capable of referral to the Energy Ombudsman (EO). Currently all suppliers are subject to the EO but it has not been proposed that the DCC should be. This may mean that consumers right of redress differs depending on whether a supplier or network is at fault for a disconnection (where they could take their case to the EO, and potentially receive compensation) and where the DCC is at fault (where they could not). From a consumer perspective the loss and inconvenience associated with disconnection will be the same regardless of who is at fault, so it would be undesirable to have an inconsistency in redress rights depending on which actor is at fault.

An alternative may be to make the supplier liable in such cases, working on the principle that the DCC is acting for them as their agent. The Service Level Agreements for the DCC should include provisions that required the DCC to compensate the supplier for loss of service, such that although the consumer claim is made against the supplier the compensation is effectively paid by the DCC. This approach may have the advantages of being more consumer-friendly; consumers have a direct relationship with their supplier but are unlikely to be aware that the DCC exists.

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

The DCC objectives and the SEC objectives should fulfil separate purposes:

- The SEC objectives should set out what the smart market is intended to achieve
- The DCC objectives should set out how the DCC is intended to behave

We think there is some conflation of these purposes in the list of DCC objectives. While it will be very important for the SEC objectives to include an environmental objective, we do not think it is necessary for the DCC objectives to include one. This is because the ability of the DCC itself to have a major impact (positive or negative) on the environment is likely to be extremely limited. The wider smart programme could have a profound impact – but that will be driven by the market design, which will be governed by the SEC.

Likewise, while we think it will be very important for the SEC to have a competition objective we do not believe it is necessary for the DCC to have one – it isn't a supplier of any of the services named in the competition clause.

If the DCC is expected to act as the secretariat of the SEC, then we think it should be given an objective that covers this role. This should capture the notion that it should administer and

maintain the SEC in a non-discriminatory and efficient fashion.

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

It is probably more appropriate to put the main obligations on the DCC in its licence rather than in statute. The main reason for this is that it is considerably easier to alter licences than statute and the immature nature of the smart market in the UK may mean that there is value in maintaining this flexibility, at least in the short to medium term.

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

Yes, this is sensible. These arrangements are immature and it is highly likely that they will evolve over time. A permissive approach would provide the flexibility to allow the arrangements to grow as needed, without the need for a separate licence change on each occasion that a change of service is needed.

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

We are extremely uncomfortable with these objectives: they are badly focussed with multiple overlaps and the absence of any consumer protection objective is entirely unacceptable.

There is heavy duplication between objectives (a) and (b). It is difficult to think of any circumstances in which „ the efficient discharge by DCC of the obligations imposed upon it by its licence“ (draft objective (a)) would not by definition also result in „ the efficient, economic and co-ordinated provision of DCC services“ (draft objective (b)) – because the DCC

services referred to in the latter are likely to be driven by obligations in its licence referred to in the former. We would suggest these two objectives are collapsed in to a single DCC efficiency objective.

Likewise it is not clear that draft environmental objective (e) is necessary given that energy efficiency and energy services are already covered by draft objective (f). Can you give an example of something that could be considered under the umbrella of draft objective (e) that could not already be considered under draft objective (f)? We are struggling to think of one, and would suggest that the two objectives could be collapsed in to a single environmental impact objective.

It is possible that parties may periodically wish to bring forward changes to the code that will only affect a single fuel – for example, changes to the data flows to and from „ smart“ household goods, or micro-generation, are likely to only affect electricity and not gas supply. Equally, there are a number of industrial and commercial suppliers who only operate in the gas market. We therefore suggest that the competition clause needs to refer to „ gas and/or electricity“ rather than its current additive drafting („ gas and electricity“). This would avoid the perverse situation where a pro-competition change could not be considered under this objective because it only promoted competition in one of the two fuels.

The code needs a consumer protection objective, we explain our reasons for this in depth in our answer to the next question so do not do so here to avoid repetition.

In summary, we suggest a better set of objectives incorporating these changes would be

- (a) An objective to protect and/or empower consumers
- (b) An objective to deliver efficient, economic and co-ordinated DCC services
- (c) An objective to promote effective competition in the supply of gas and/or electricity

- (d) An objective relating to promoting energy efficiency and/or carbon savings
- (e) An objective related to maintaining data privacy and security

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

No – definitely not.

The applicable code objectives create the framework for assessing whether proposed changes to the code should be made or not – and therefore, what falls within the scope of the assessment of these changes. They also create the cultural framework within which the code panel operates – what it can, and cannot, consider in its role administering the code.

Failing to have a consumer protection objective effectively rules concerns in this area outside the scope of the Panel's discussions, and those of the modification groups considering any changes to the code. This is irrational given that the major reason behind the mandatory roll-out of smart metering is to improve consumers understanding of and engagement with their energy usage.

Adopting a set of code objectives that are entirely business-focussed and ignore the consumer would create undue discrimination between different stakeholder groups by enfranchising market participants and disenfranchising consumer representatives.

Ultimately consumers will pay for the smart meter programme and live with the consequences of any decisions to alter the design of the market through the SEC. The code needs an objective that recognises the impact it may have upon them.

We would be extremely reluctant to take a consumer seat on the SEC Panel if the code has no consumer protection objective. Representation without remit is rather pointless, and we see little value in humouring a box-ticking exercise.

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

We think the approach should differ between the two.

We consider that the terms and conditions for elective services should be set out within the SEC. We think this is necessary to ensure transparency, so that those signatories (and potential signatories) who are not currently taking these services have clear sight of what their rights and obligations would be if this should change. It should also make change management easier and reduce the risks of inconsistencies between the terms and conditions set for different parties. It was for similar reasons that Ofgem decided to amalgamate the many hundreds of distribution connection agreements into a single Distribution Connection and Use of System Agreement (DCUSA).

For value-added services, we think it is more appropriate that these be set out in bilateral agreements. We think this is justified because we understand that you envisage that these kinds of services may have nothing to do with the energy, or energy services, sector. If this is the case, it would appear unreasonable to make them subject to the SEC governance regime, or to reveal their terms within the code.

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

Yes, it seems sensible both that the DCC should test the market in order to deliver value for money services, and that it should be bound by clear, robust, procurement principles.

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

This seems like a sensible division of obligations, and would be broadly consistent with the approach taken on other industry codes.

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

Depending on the design of the SEC, it should be possible to include dispute resolution processes that limit the need for a third party to be called in to adjudicate on disputes. For example, the Balancing and Settlement Code includes a “ Trading Disputes” process that allows signatories to seek remedy where they believe that the code has been incorrectly applied. These cases are ordinarily heard by a neutral committee, or, in extremis, the code “ s

governing panel. The code company ELEXON is bound by their decisions.

More broadly, the code modification process itself can provide a means through which parties can seek to alter or clarify the nature of their rights and obligations when dealing with the operator of central systems.

The inclusion of a robust performance assurance regime in the code should help to mitigate the risk of disputes by providing early diagnosis of, and response to, operational problems.

In extremis, where disputes relate to compliance (or not) with licence conditions then it would be appropriate for Ofgem to arbitrate, as the day-to-day manager of the energy licensing regime.

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

No, we think it should be based on MPANs and MPRNs that *have received*, rather than are *mandated to receive*, smart metering systems.

Basing it on the mandate, rather than the actuality, of roll-out would mean the introduction of a cross-subsidy flowing to „ go early” suppliers from „ go late” ones – and by implication from

their consumers. Effectively it would mean that customers without smart meters are subsidising those with them; paying towards a service they are not receiving.

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

Upfront its worth highlighting that from a consumer perspective, the cost recovery mechanism is probably only really of great interest in so far as it affects the outcomes that customers see - for example: if it is likely to result in differential charging between different type of consumers; would create a (meaningful) incentive that encourages faster or slower rollout; or has an impact on the quality or value of service that consumers receive (for example, by encouraging meter rollout faster than the DCC could cope with, or DCC investment that is larger or sooner than is actually needed).

We are not particularly inclined to believe that any of the three options on the table would materially alter incentives on supplier roll out strategies. While the monies involved are significant in aggregate, the inferred cost to serve per household of ~£7 per WAN per year is likely to be dwarfed by other considerations; the capital cost of the meter, installation visit costs, supply chain constraints on both equipment and human capital etc. So, although a

theoretical case can be made that the recovery mechanism will drive rollout behaviours we suspect any incentives here will be weak rather than pronounced.

Of the three options on the table, we have a (very marginal) preference for Option 2 over Option 1 but think there's little to choose between those two options. The choice between those two options appears to me highly dependent on where you see the trade-off lying between precision in cost targeting (which is best facilitated by Option 1) and stability / predictability in charges (which is best facilitated by Option 2). We are considerably less keen on Option 3 because it creates windfalls in a situation where there's no obvious public interest reason to justify those windfalls. We will set out our thinking in more detail below.

Option 1 is most cost reflective and would most clearly allocate costs to serve on those being served. But the incremental benefit of the precision cost targeting of Option 1 over the sculpted cost targeting of Option 2 is somewhat undermined by the fact that while suppliers can have control over how many smart meters they roll-out, they don't have any control over how many meters their rivals have rolled out. If you insulate suppliers from this volatility by applying a fixed menu of charges then inevitably the DCC will over or under-recover in any given year and there will be opportunity and financing costs associated with this over/under recovery. If you don't insulate suppliers from this volatility, by making the DCC whole each year, then you create a forecasting risk associated with unpredictable charges. Indeed, you appear to acknowledge this in paragraph 4.41 where you highlight that a scaling factor or end of month/year reconciliation period would be needed.

Option 2 dampens down the cost reflectivity of option 1 but does nonetheless try to apply costs to suppliers in a way that is broadly reflective of the demands they make on the DCC systems. It should provide a more stable charging regime for suppliers which should mitigate the cost of risk that consumers ultimately face. The biggest deficiency in this approach is the risk that a supplier's actual rollout delivery may deviate significantly from their rollout plans, resulting in it incurring/avoiding costs as a result of this deviation. But sensible scheme design could mitigate this, for example automatic adjusters if a supplier over / under shoots its plan by a set amount.

While there's not much to choose between Options 1 and 2, we are much less keen on Option 3. This is because, unlike Options 1 & 2, it appears to effectively smear the cost of the DCC over non-smart meter points as well as smart meter points. It seems fairly questionable whether there's a reasonable rationale for consumers who don't get smart meters until 2019 starting to pay for the costs to serve them in 2014 (and indeed, that's assuming 100% rollout is technically possible anyway). Linking attribution of costs to market share rather than meters served would also create a cross-subsidy flowing from „go late“ suppliers to „go early“ suppliers; it's questionable whether there's net consumer benefit in

creating this kind of competitive distortion.

There's a broader policy question that DECC will need to grapple with on whether it wants to impose any constraints on suppliers ability to differentially charge consumers if the DCC

costs to serve different sites is significant. If the spread of DCC costs between hard to serve, and easy to serve, sites is minimal, perhaps a couple of pounds annually, then I suspect this is a non-issue for consumers – because I would expect suppliers would simply net this out in their tariffs such that consumers saw no difference. But if the spread of DCC costs is significant – tens of pounds per year – then it could create consumer detriment. The most obvious way would be through the introduction of “ smart surcharges” for some sites, which may leave some consumers worse off than they would be without a smart meter, create consumer reluctance to let a smart meter be installed if they were aware of this risk, and could create perverse incentives on suppliers not to install smart meters at sites that they expect to churn before 2019.

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

Yes, we do; as a mandated piece of technology to support an essential utility (energy) it should be subject to a universal service obligation.

As you highlight, the cost to serve “ difficult to reach” premises could be a significant multiple of the cost of a typical install. Likewise, regional differences in population density and topography could mean that some locations are considerably higher cost to serve than the national average.

If core services were subject to regional and/or technology pricing it could therefore mean that consumers in “ difficult to reach” premises or locations find that they are considerably worse off after having a smart meter installed, even if, on average, most consumers were better off. This would be likely to frustrate the objectives of the smart metering programme in several ways.

Firstly, because it may make 100% roll-out considerably less achievable. Consumers will have the right to refuse to have a smart meter installed, and it would appear naive to expect that they will not exercise that right in significant numbers if they become aware that the fabric of their home, or location, means that they are likely to attract a significant surcharge. If (near) 100% roll-out cannot be achieved, this is likely to considerably weaken the overall cost / benefit case for smart metering because of the need to maintain parallel industry systems to serve legacy (i.e. non-smart) meters.

Secondly, because it would undermine the intention of the programme to help consumers cut their energy bills. Consumers who are subject to regional and/or technology surcharges may find that these eat into any cost savings they could make by reducing their consumption, perhaps even to the point where they are worse off having a smart meter than not having one.

There are also wider public policy considerations that make such surcharges inadvisable. For example, technology-specific pricing may make the price comparison process harder or more unreliable by adding another piece to the jigsaw of information that consumers need to know in order to get an accurate price comparison quote. Switching rates in the UK are currently declining, with tariff complexity a probable contributory factor; it would be prudent not to facilitate the introduction of new surcharges that could make this worse.

Question 80) Please indicate whether the Minimum Core Service Requirements [...] can be modified to reduce the potential impact on the WAN cost without compromising the corresponding benefits?

We are a little surprised that you envisage a minimum number of meter reads as high as 6 per day (electricity) and one per day (gas). It is unlikely that many consumers will check their meter reads this frequently, and if they need to do so, would they not be able to use their In Home Display to get this information? Why do suppliers need to remotely read the meter with such high frequency? It does not appear to be necessary for billing purposes (too frequent) and it would not appear to provide them with significant assistance in managing their imbalance exposures (because imbalance Gate Closure will already have passed by the time they receive this information). Such continuous contact with the meter is likely to ramp up communication and data processing costs; we would like to see further detail on the cost/benefit consequences of this minimum standard. We think the minimum core service requirement could well be significantly lower than this.

Such frequent read contacts may also be undesirable for wider policy reasons. It may well infringe the right to privacy granted by the Human Rights Act; smart meter roll-out in the Netherlands fell foul of equivalent privacy legislation with a less frequent regime of meter reads (one every 15 hours) than the one you are proposing. The Data Protection Act requires there to be a legitimate commercial reason for a company to hold personal data; we have yet to hear one that justifies suppliers' desire for such frequent retrieval of data.

Given the ongoing scientific uncertainty around the potential long-term health effects of exposure to electromagnetic fields (EMF), we recommend that there should not be unnecessarily high levels of interactions between the DCC and smart metering systems. Where possible, the DCC licensing team should avoid building unnecessary broadcasts in to the core services.

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

Because the DCC itself is largely a contract management body, rather than a service provider in its own right, the bulk of its costs will be external rather than internal (to be confirmed, but we suspect probably of the order of 95% vs 5%). It is therefore vital that any incentive regime put in place on the DCC places greater weight on managing external costs than managing internal costs – because the former will hit consumers' wallets much harder.

The Government decision to parallel procure the DCC and its service providers creates risks in this area, because potential DCC candidates will naturally be worried about the prospect of taking on significant risk in relation to contracts they did not strike. This is likely to create pressure to concentrate the incentive regime on internal, rather than external costs. Government needs to manage this tension; given the scale of DCC agent costs (~£3bn over ten years) it is vital that proper incentives exist to keep external costs down.