

By email

Jacqui Russell
Head of Metering and Market Operations
Ofgem

Dear Jacqui,

Call for evidence: Review of the regulatory arrangements for the Data Communications Company

Thank you for the opportunity to contribute to your review as part of this call for evidence ('CfE').

The Retail Energy Code Company Ltd ('RECCo') was established to ensure the proper, effective, and efficient implementation and ongoing management of the Retail Energy Code ('REC'). The REC itself will facilitate the efficient and effective running of the retail energy market, including its systems and processes, in order to promote innovation, competition and positive customer outcomes. This will in due course include the new arrangements being developed as part of the Switching Programme.

Scope of the Review

We recognise that the CfE is in large part intended to inform the scope of the licence review, but the title itself may be a little ambiguous. We assume from the time-periods referenced in the CfE that the use of term DCC through the document is shorthand for the holder of the Smart Meter Communication licence ('the licensee') rather than necessarily the '*Smart DCC Ltd*', which is also commonly and interchangeably referred to as DCC.

We believe this would be a helpful clarification as the Smart Meter Communication licence ('the licence') was granted for an initial period of 12 years, ending 2025. We therefore assume that no decision has yet been made on the extension or competitive re-procurement for the grant of the licence, as referenced in the CfE¹, and that this review will in part help inform the Authority's decision in that respect. However, it would be helpful to confirm that for the avoidance of doubt. We also note that this matter could have been determined as early as March 2018. Whilst we recognise that for various reasons that may

¹ Footnote reference to Part 1 Section C of the Smart Meter Communication Licence.

have been too early to make such a decision, it would be unfortunate if an extension became a default option owing wholly or mainly to time available and/or the avoidance of disruption to over-running programmes, though that may appropriately form part of the considerations. More generally, it would be appropriate for that significant decision to be informed by a revised impact assessment, taking into account the benefit that may be realised through a competitive tender, versus those of stability and maximising the returns from previous investment. This would also allow for a reflection on changed and changing circumstances, which could not have been known or reliably assumed by government almost a decade ago.

We also consider that the practical implications of a handover to any successor licensee should take into account the wider change horizon faced by industry parties; i.e. the timing of any decision factor in programmes such as Market-Wide Half-Hourly Settlement rather than solely the Smart Meter Installation Programme. However, the wider challenges of moving towards a net-zero economy may mean that the industry change horizon intensifies rather than lessens, meaning some decisions might suitably be brought forward rather than deferred.

Switching

We note your initial view as set out in the draft Terms of Reference is that: *“the regulation and delivery of the central registration service (switching) and DCC’s activities in support of this programme should remain outside the scope of this review”*. There was no supporting rationale for this omission, though we again assume that this may be in part due to timing, and it is welcome that you invited views on this particular point.

We consider that any review must appropriately cover the Smart Meter Communication licence in its entirety. As you are aware, whilst the licence originally granted in 2013 envisaged the licensee taking on responsibility for Energy Registration Systems, this role has evolved through the Centralised Registration Service to what is now the thinner Central Switching Service. While these design decisions have been informed by operational efficiencies, they also mean that certain regulatory responsibilities have remained with network operators and continue to be discharged by third party service providers, rather than gravitating to the licensee.

Whilst the scope and design of activities undertaken by the licensee as CSS provider may continue to evolve, it would be appropriate for this review to consider whether they (and the reliance the market places upon them) are sufficiently material to warrant them being licensable activities in and of themselves. We note for instance that there are several other market critical roles governed by industry codes alone, rather than licensed. If the Authority concludes that these CSS activities should remain subject to a licence, we would welcome

consideration of it being part of a new licence type, which we understand may be provided by Secretary of State upon application of the Authority.²

Notwithstanding any changes to the scope of the licence, we would welcome early clarity of the Authority's intent to change the licensee's price control. As noted in the CfE, Ofgem currently undertakes an annual *ex-post* review of the costs that the licensee has incurred in order to ensure that they are economic and efficient, disallowing those that are not. Whilst this may be a pragmatic approach for dealing with the uncertainties of a significant change programme, this would not be appropriate for a more predictable steady-state enduring regime.

In recent discussions with the licensee, we have agreed that the operational costs of the CSS should, assuming still subject to a price control, be determined under an *ex-ante* approach. This would provide greater certainty to both the licensee and the REC Parties from whom those costs will be recovered. We also consider that this would also allow Ofgem's involvement to be more proportionate to the anticipated costs of the CSS. If changes to the switching aspects of the licence and associated price control arrangements will not be part of the Terms of Reference for this review, we would welcome early clarity on how they will be taken forward.

Additional services

We agree that the licensee should be able to offer additional services, whether to the broader energy sector or more widely. We agree that this could fulfil the original intent of reducing the cost burden to obligated funding parties to the extent those additional revenues make a contribution to the licensee's fixed costs. We also consider that this should allow the licensee and its customers to benefit from the realisation of non-financial synergies, such as shared learning and best practices from other sectors. This will become increasingly important as the provision on energy related services moves away from the traditional models. However, it is also important to recognise that the licensee is a price-controlled monopoly.

We would be concerned if the licensee was able to use revenues from its provision of monopoly services to subsidise business development in contestable sectors, to the detriment of competition. Ofgem has previously recognised and addressed similar issues in respect of the role by Elexon as the Balancing and Settlement Code Company.

Following a review of Elexon's governance and consideration on BSC modification P284,³ the Authority concluded that:

² Electricity Act 1989 (as amended) Section 56B, and Gas Act 1986 (as amended) Section 41D

³ P284: https://www.ofgem.gov.uk/sites/default/files/docs/2012/09/p284d_0.pdf

“whilst there might be benefits of diversification, robust arrangements had to be put in place to mitigate any additional risk to the BSC and BSC Parties. In order to ensure that this was the case, we stated that our consent would be required and that we would need our pre-requisite conditions to have been met, as follows:

- *BSC Parties should benefit from any diversification;*
- *the arrangements should not place disproportionate risk on BSC Parties;*
- *standards of service under the BSC should be maintained; and*
- *Elexon’s BSC role should not give it any undue competitive advantage in a contestable activity.”*

These principles were again referenced in the Authority’s decisions to accept BSC modification P330⁴ and more recently P390⁵. We consider that these simple principles could be readily applied to the licensee, ensuring that any additional services it may provide are undertaken in a manner that protects and potentially benefits its existing stakeholders, namely the Parties to the Smart Energy Code and/or the Retail Energy Code.

If the huge investment being made in smart meters is to deliver the benefits originally cited in the government’s decision to mandate the Smart Meter Implementation Programme are to be realised, then it is vitally important that the data obtained from those meters is utilised to the maximum effect. We consider that facilitating open access to that data is the single biggest contribution the licensee can make towards the industry’s transition to net-zero. That data may be leveraged by multiple parties including non-traditional innovators and disruptors throughout the energy supply chain. The licensee should therefore be applauded for the welcome announcement of its intention that access to data via its systems will be made available at cost and not for profit.⁶

However, we also recognise that unlike Elexon, which operates to a not-for profit model under the arm’s length ownership of Network Grid ESO, Smart DCC Ltd is a wholly owned subsidiary of Capita PLC, which should be able make a reasonable return on its investment. One challenge of the review may therefore be to determine what a reasonable return for the licensee’s activities should be from 2025 onwards, given the lack of obvious comparators.

We note that the Terms of Reference for the review will consider the extent to which the licensee should deliver its services through contracted service providers or directly itself. We agree that this is a key consideration, though external procurement does not always

⁴ P330: <https://www.ofgem.gov.uk/system/files/docs/2016/05/p330d.pdf>

⁵ P390: <https://www.elexon.co.uk/mod-proposal/p390/>

⁶ See: https://www.smartdcc.co.uk/media/4699/21037-dcc-data-for-good-paper_v8-final.pdf

lead to greater efficiency than in house provisions, so such decisions may be best left to the management of the company to make on a case-by-case basis, rather than skewed by prescription towards one model or the other. However, it may be appropriate for the review to consider benchmarking the proportion of contracts by value awarded, and/or charges paid to the licensee's parent company.⁷ Such transparency may further mitigate one of the emerging risks identified in the Smart DCC Annual Report 2020.⁸

Conclusion

We welcome the review and are broadly happy that the draft Terms of Reference will address the right areas. We will be happy to support you in whatever we can and look forward to hearing about the next steps and/or any feedback on the specific points raised within this letter.

Yours sincerely

Sid Cox
CEO, RECCo Ltd

⁷ Smart DCC Limited is a wholly-owned subsidiary of Capita PLC, whose 2020 Annual Report shows that in 2020, Capita received £113.1m (2019: £83.4m) of revenue for administrative services it provided to Smart DCC Ltd.

⁸ See: Smart DCC Annual report, page 43 -

https://www.smartdcc.co.uk/media/4098/20204_dcc_report_and_accounts_9.pdf