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Department of Energy and Climate Change

Formalising the relationship between
the gas and electricity markets

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Dear Rob,

Ofgem's response to DECC's government response on stage one of the Smart Energy Code and consultation on the draft legal text

We welcome the opportunity to respond to DECC's government response on stage one of the Smart Energy Code (SEC)¹ and consultation on the draft legal text. Ofgem regulates the gas and electricity markets in Great Britain. We have an important role in ensuring that the interests of consumers remain protected, both during the transition to smart metering and in the enduring framework. We will also play a key role in monitoring and, where appropriate, enforcing compliance with any new regulatory obligations relating to smart meters. This regulatory role will include approval of certain modifications to the SEC.

We recognise that DECC has made significant progress since its April 2012 consultation on the SEC². DECC has produced detailed legal drafting to provide a framework for the operation of smart metering. We welcome the explicit references to Ofgem's ongoing Code Governance Review³. We welcome the constructive engagement to date and recognise the challenge DECC has in balancing the views of a diverse range of stakeholders.

We set out below our response on some of the key issues in DECC's publication.

SEC objectives

The General Objectives of the SEC are set out in Part C of condition 22 of the Data and Communications Company (DCC) licence. The SEC objectives also appear in the SEC. Whilst we recognise that the intention is to help the reader understand the provisions and purposes of the SEC, we consider that this duplication is unnecessary. Further, we are concerned that this will add administrative complexity to the governance of the SEC, as any licence modification would require the SEC to also be modified. There is a risk of confusion if the objectives set out in the licence and the SEC are not identical at all times. We therefore urge the removal of the objectives from the SEC, but consider you should include appropriate references in the SEC to the objectives set out in the DCC licence. Also, we would expect the SEC objectives to be readily available on the Code Administrator's website.

¹ The SEC will be a new industry code setting out the detailed provisions governing the relationship between the Data and Communications Company (DCC) and its users, and other issues related to smart metering.

² <http://www.decc.gov.uk/assets/decc/11/consultation/smart-metering-imp-prog/4896-smart-energy-code-con-doc.pdf>

³ A review into how energy industry codes are governed

<http://www.ofgem.gov.uk/licensing/indCodes/CGR/Pages/GCR.aspx>

Code governance and modifications

It is important that the governance structure and change process for modifying the SEC are robust and efficient to ensure the SEC is dynamic and able to evolve over time to meet the challenges of a fast moving industry. It is essential that modifications are administered impartially and objectively and that the reports that come to Ofgem for decision are supported by rigorous and high quality analysis. This will be important for Ofgem to be able to reach a timely decision on whether to approve a proposed code modification.

The governance arrangements for the SEC include a number of the elements that are important for ensuring robust and flexible governance arrangements. For example, in line with the Code Governance Review the Panel Chair will be independent and certain modifications can be progressed through self-governance. We consider that the oversight role of the Panel during the change proposal process should ensure they are accountable for the overall quality and robustness of the final change report.

DECC proposes differing roles of the SEC Panel and the Change Board⁴. The Change Board is not directly involved in developing modifications, yet it decides on the recommendation that is presented to the Authority⁵. Given this approach, we welcome that the Change Board has the ability to recommend that the Panel return a modification report to the working group for further clarification or analysis. However, given the Panel's oversight role, there will hopefully be little need for the Change Board to exercise this power, in particular as the Panel can send a modification report back to the working group even without this recommendation. We encourage DECC to work through modification scenarios with industry to ensure the framework is robust and workable.

Change Board recommendations and Competition Commission appeals

Change Board recommendations to Ofgem will be to accept or reject a modification proposal. We strongly agree with DECC's proposal that the recommendation would be based on the majority view of party categories that are affected by the proposed change. Given the diverse range of parties that will be party to the SEC, it is not clear that a consensus view would be possible in the vast majority of circumstances. Majority voting should ensure that the SEC can evolve appropriately and prevent an unnecessary administrative burden. DECC also decided not to allow SEC parties to appeal Authority decisions to the Competition Commission where the Authority's decision aligns with the recommendation made by the Change Board. Again, we strongly support this position, which is consistent with existing industry codes.

Temporary Panel Chair

It is not ideal that the Panel chair will initially be a Panel member given the importance (as recognised by DECC) of the Chair being independent and impartial. However, we appreciate that it is a temporary, pragmatic approach. DECC should however ensure that appropriate checks and balances are in place until a permanent Chair is appointed. For example, we welcome that the SEC explicitly requires a permanent Chair to be appointed within five months of SEC designation.

Urgent modifications

It is proposed that the Authority would determine whether a modification proposal should be considered urgent (SEC D4.5 - 4.8). This aligns with existing industry codes. The SEC goes on to list examples of when a modification may be given the status of an urgent proposal, which differs from existing codes. These examples have been taken from Ofgem

⁴ The Panel will delegate certain activities to the Change Board.

⁵ For Path 3 (ie self governance) modifications, as no Authority decision is required the outcome of the vote will determine whether the modification is implemented, but this decision may be appealed to the Authority.

guidance⁶. The Ofgem guidance is non-binding and we reserve the right to update it if we consider it appropriate. We do not consider it appropriate for our urgency criteria to sit within the SEC and strongly recommend that these examples should be removed from the SEC.

Security modifications

Regarding overall system security, DECC is currently considering the appropriate governance arrangements for the enduring security arrangements. This will include considering whether additional steps will be required when developing and approving modifications. Ofgem strongly supports DECC in ensuring that robust arrangements are in place. We are keen to ensure that any role undertaken by Ofgem in respect of security is appropriate and in accordance with our Principal Objective and general statutory duties. In our view security arrangements for meters that are not enrolled in the DCC should also be set out within the SEC as soon as practicably possible, rather than via an enduring licence condition or alternative arrangements. This is to ensure that all consumers are protected by the robust certification and technical assurance arrangements which will sit within the SEC.

DCC charging

We consider that the charging proposals broadly support DECC's policy aims. However, some aspects of charging are still unclear, such as:

- how costs will be split between fixed and variable charges, which to an extent depends on the service provider procurement
- how fixed costs will be split between licence groups (based on "charging group weighting factors"), prior to it being subdivided based on market share
- the approach to charging in relation to adoption and enrolment of meters installed during the foundation period⁷
- the final form of the charging statement, as required under the DCC licence.

As the charging arrangements are finalised, DECC should strive to maintain an appropriate balance between minimising complexity and ensuring costs are allocated in a cost reflective manner. DECC will be responsible for finalising the content of the charging statement, with the Secretary of State approving it in the first instance. We encourage DECC to ensure the charging statement is drafted in a very clear manner, such that it forms a user friendly document that helps SEC parties to understand how they will be charged. This is important for transparency and to ensure that the charging arrangements, which are unavoidably complex, are clearly understood by all parties affected.

DCC services

We welcome the definition of core and elective services within the SEC. Also, we support the progressive implementation of DCC services over time, with a flexible approach that will enable services to evolve.

Confidentiality of elective services

Where a party takes an elective service, we understand the rationale for keeping some details confidential. However, we feel there is currently a lack of evidence to justify keeping all details confidential for six months. We would be interested in seeing what evidence there is, including the views from industry, regarding:

- the level of insight that can be gained from seeing certain details regarding that service

⁶<http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Ofgem%20Guidance%20on%20Code%20Modification%20Urgency%20Criteria.pdf>

⁷ Discussed in DECC's "Foundation Smart Market" consultation

- the appropriate length of time that details should remain confidential.

In terms of the final approach DECC takes, what is key is that the arrangements can be easily modified if the approach turns out to be unwarranted. Also, the arrangements should have inbuilt flexibility, so that if a SEC user consents to the details of its request being made available, it can be published in a transparent manner.

Timing of availability of elective services

DECC proposes that elective (as well as core) services should be available from go-live. There are advantages and disadvantages with elective services being available from go-live. To an extent, the importance of this issue depends on a number of factors. For example, if the core service offering is very narrow, it will be more important to provide elective services earlier. Also, if DECC mandates suppliers to enrol their existing smart meters from go-live, then there is a more pressing need for elective services to be available from go-live, to prevent consumers losing pre-existing services.

Party categories – National Electricity Transmission System Operator

DECC questioned whether the National Electricity Transmission System Operator (NETSO) should constitute a Party category under the SEC. Becoming a party category would presumably give the NETSO a right to obtain certain information from smart meters via DCC. DECC suggested that this information may be more efficiently obtained at an aggregate level through Distribution Network Operators (DNOs).

We consider there are two key questions, the answers to which should inform any action that DECC takes in terms of NETSO accessing data. Firstly, is it clear that there is a net consumer benefit from NETSO accessing smart meter data? We consider that NETSO should only have a right to access data where there is a clear consumer benefit. If there is evidence for a consumer benefit, then the next consideration should be which route is more efficient. Both routes would have costs associated with them. The DNO route would increase the costs on DNOs, as they would presumably need to build in some functionality to their systems to allow them to pass on the data. Also, it may require additional licence provisions to obligate DNOs to provide such information. The DCC route would have costs associated with NETSO acceding to the SEC. Also, NETSO would likely require a licence condition similar to that proposed for distribution and supply companies to give them a right to certain data.

We appreciate the constructive engagement with DECC thus far and look forward to this continuing in the coming months. If you would like to discuss this response in the meantime, please contact

Yours sincerely