



The Authority (Ofgem), the SEC Panel, SEC  
Parties, and other interested parties

22 August 2019

Dear Colleague,

**Government response to consultation on proposals regarding the Baseline Margin  
Project Performance Adjustment Scheme for Data Communications Company  
SMETS1 Services and Direction that the Scheme is made**

I refer to my letter of 11 June 2019 consulting on proposals for a SMETS1 Enrolment Project Baseline Margin Project Performance Adjustment Scheme based on the existing Project Baseline Margin conditions set out in Licence Condition 36 of the Smart Meter Communication Licence.

The consultation proposed an incentives scheme to tie the Data Communications Company (DCC) margin for delivery of its SMETS1 Service to the final quantity of Smart Metering Systems (SMSs) successfully Enrolled, and the speed at which their Enrolment takes place. The proposed scheme is intended to:

- Recognise that the outcome of meter migration is dependent on DCC's delivery of key enabling milestones (such as SMETS1 Device and User System Testing and capability live milestones) and the provision of enrolment capability that can support migration of SMETS1 meters.
- Reward the DCC for enrolling as many eligible SMETS1 SMSs that are in scope as possible, and as quickly as possible, whilst maintaining control of quality in delivery.
- Tie the incentive to matters that the DCC can be expected to control.

The scheme puts 50% of the DCC's relevant Project Baseline Margin<sup>1</sup> at risk based on the rate of enrolment of SMETS1 SMSs (that are eligible), with the share that could be retained by the DCC potentially doubling if DCC substantially exceeds the target rate and with the DCC experiencing a reduction in retained margin if it fails to meet the target. The remaining 50% of DCC's relevant Project Baseline Margin would be put at risk depending on the proportion of in scope SMETS1 SMSs that are enrolled by 31 December 2020.

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<sup>1</sup> The Project Baseline Margin is defined in the Smart Meter Communication Licence, Condition 36 Appendix 2, Paragraph A4 (c), and is then referenced in Paragraph A5 (a). At present the Project Baseline Margin for SMETS1 is expected to be over £2.3 million.

We received four written responses from EDF Energy, SSE, Electricity North West and Smart DCC.

## **Summary of Responses and Government response**

### **Question 1: Do you agree with the targets proposed for the Baseline Margin Project Performance Adjustment Scheme for SMETS1 Services?**

#### Summary of responses

Of the stakeholders who responded to this question, two agreed with the proposed targets, while two disagreed. Those who agreed with the proposals supported the targets as set out, and also welcomed BEIS's recognition of the importance of driving quality metrics for the DCC's SMETS1 service, whether through the incentives framework or more broadly. Those who disagreed tended to be concerned by timescales attached to the targets.

The primary concerns raised by respondents were:

- Two respondents considered the timescales detailed in the consultation to be no longer appropriate, in light of latest plan dates reported in the Implementation Managers Forum (IMF) compared to the LC13 plan.
- Two respondents raised concerns about external factors mitigating the DCC's ability to meet targets, notably that the migration rate for active meters is at supplier discretion within bounds set within their licences.
- Two respondents considered the proposed quality control measures to be insufficient:
  - One respondent suggested that stakeholder engagement incentives ought to be included within DCC performance measures.
  - Another respondent suggested the adoption of "Right First Time" targets, with a view to incentivising the quality and success rate of migrations.
- One respondent suggested that the testing assumptions, relating to the percentage of the metering estate covered by devices progressed through System Integration Testing and underlying the proposals are not feasible.
- One respondent raised detailed points about the Enrolment Target:
  - The respondent suggested that there are a different number of SMSs eligible for enrolment than is suggested in the consultation.
  - The respondent deemed the targets to be set too low, such that the DCC could achieve a margin in excess of 100% too easily.
- One respondent suggested that several aspects of the targets require clarification:
  - Clarification was requested on how DCC would move from testing 80% to 100% of the Device Model Combinations (DMCs) of each Operating Capability being made available, and timescales that would be involved.
  - Clarification was requested on 'Pilots' and how these relate to the pacing strategy presented at the Testing Advisory Group (TAG).

#### Government response

In relation to enrolment timescales, targets and incentives are to be based on the DCC's own SMETS1 delivery plan as approved by BEIS in February under DCC Licence Condition 13 and further to industry consultation. In the case of any deviation from this plan, the DCC would be required to provide evidence confirming that delays were not within its control for the incentives regime to be considered for re-baselining. BEIS has not yet received such evidence from DCC. Any re-baselining would be consulted on by BEIS.

As regards concerns raised that the scheme does not account for the fact that active meter migrations are only under energy supplier control, we consider that DCC could seek to utilise

available levers, in terms of engagement, guidance, clear communications and support, in order to facilitate timely migration. Ultimately all suppliers are required to take all reasonable steps to migrate their active meters, once eligible for enrolment, within 12 months.

In relation to quality control, we are pleased that some respondents recognise the approach that has been outlined on managing quality through migration controls, industry backed governance and the Ofgem-led Operational Performance Regime (OPR). In revising the OPR to incorporate further consideration of SMETS1, we suggest that industry participants discuss proposals on quality in migration with Ofgem. Furthermore, as is detailed in the response to Question 2, the BMPPA framework is not specifically designed to incentivise cost management; rather, costs are managed by Ofgem-managed price control frameworks.

Responding to broader points made by individual respondents:

- With regard to the Enrolment Target, any targets will be based on the number of enrolled Smart Metering Systems, and not the quantity of individual Smart Metering devices as migrations will happen at the installation level.<sup>2</sup> It is the view of the Government that the target shape of the 12-month migration curve is based on a reasonable expectation of migration across the cohort of meters, and it is expected that the DCC will work to facilitate this.
- The number of Smart Metering Systems that form the Enrolment Target will only be available once statistics for all of 2019 have been collected and published. The scheme has been updated to reflect that the number is to be defined at this point. This scheme will be remade once this number is available and relevant consultation conducted. This is seen as preferable to waiting for these numbers before setting the scheme as it will give clarity on the incentive regime for the DCC and wider industry.
- As is detailed in LC13 plan DCC had aimed to complete testing and have eligible for enrolment 80% of IOC DMCs at the first capability release, so this is the basis on which the target for migration has been based. The actual release strategy has changed and DCC will be driving meters to be eligible for enrolment through the Device Model Combination Testing (DMCT) process.
- The 'piloting' assumption is a high-level view of energy suppliers' ramp-up rates expected in initial months. This was based on supplier responses to the BEIS maximising interoperability consultation which concluded in October 2018 where the time for enrolment was extended from 6 to 12 months in part to accommodate slow initial ramp up rates.
- Regarding the suggestion of DCC customer engagement-related incentives, the Government notes that the DCC has the ability to engage with DCC customers and provide all relevant information to facilitate enrolment and this is key to influencing the rate of enrolment.

**Question 2: Do you agree with the structure of the Baseline Margin Project Performance Adjustment Scheme for delivery of SMETS1 Services as set out in Annex B?**

Summary of responses

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<sup>2</sup> However, installations may be constituted by more than one Smart Metering System, for example, both an electricity and gas SMS.

Of the stakeholders who responded to this question, two agreed with the proposals, while two disagreed. Those who agreed with the proposed structure supported it without qualification. Support was also expressed for BEIS' decision to take on board concerns about the assessment of the materiality of events raised by the DCC as well as concerns about the independent verification of the data by which the DCC's performance will be measured against the targets.

Those who disagreed with the proposed structure mainly considered the structuring of the loss/gain of the margin to be suboptimal, though for differing reasons:

- One respondent considered the structuring of the loss/gain of the margin to unfairly favour the DCC over energy suppliers, and deemed both the minimum performance level required for a margin and the performance level required for the maximum allowable margin to be too low.
- Another respondent suggested that the proposed migration curve moves at a rate which is too challenging for the DCC to achieve.

More broadly, one respondent was concerned that compliance with the incentives regime would be unduly costly for the DCC and suggested it was unclear how cost management was incentivised by the scheme's structuring

One respondent raised concerns in relation to the scheme's definition of what constitutes a 'successful enrolment'. Consequently, one respondent suggested an alternative structure for the incentives scheme, in light of the changing nature of the circumstances and plans regarding migration and enrolment. This structure would be based on several potential reopener points, at which targets and proposed migration curves would be reassessed and redefined.

### Government response

In relation to the structuring of the loss/gain margin, the Government firstly notes that this specific consultation was not related to the margin level, which is governed by Ofgem-managed price control frameworks. Furthermore, Government is not of the view that the migration curve is unduly challenging or lenient. It is expected that the DCC would be planning rollout against a variety of scenarios and building capacity appropriately, as well as working closely with energy suppliers to understand their plans. Although forecasts of migrations are now available from DCC, these are still incomplete due to the lack of data for MOC and FOC either provided by energy suppliers or assumed by the DCC.

The DCC should work to understand a full picture of migration forecasts and estimates for those installs that have yet to be forecast by energy suppliers. Equally, the earlier energy suppliers can provide indicative plans to DCC the sooner DCC can plan to accommodate them.

As concerns the cost of compliance with the incentives regime, given that the measure of SMSs enrolled is one that will be reported on by the DCC regardless of the regime, there should be no additional overhead to monitor progress. It is also expected that good industry practice for programme management should be observed. Hence, risks, assumptions, issues and dependencies ought to be consistently tracked and managed in any event.

Within the scheme there is provision for an independent audit of the final report that will support the review of the DCC evidence and be used to confirm any unsuccessful enrolments being reported in these numbers.

Regarding the suggestion of alternative structures to the scheme, and specifically that of 'reopener points', the DCC is invited to request changes to the Scheme if it feels that there is

sufficient evidence to do so, and is able to clearly articulate both the factors outside of its control, and how it has worked through the possible mitigating actions.

### **Conclusion**

Following consideration of stakeholder responses, we believe that the proposed targets and structure of the SMETS1 Enrolment DCC incentive scheme remain appropriate.

### **Direction**

The document at the Annex constitutes both (i) a direction to the DCC identifying the SMETS1 Enrolment & Adoption Project, and (ii) a Baseline Margin Project Performance Adjustment Scheme made by the Secretary of State in relation to that Project. The direction is given, and the scheme made, on and with effect from the date of this letter.

Yours faithfully,



**Duncan Stone**

**Deputy Director Delivery, Smart Metering Implementation Programme**

(an official of the Department for Business, Energy & Industrial Strategy authorised to act on behalf of the Secretary of State)

**ANNEX**  
**BASELINE MARGIN PROJECT PERFORMANCE ADJUSTMENT SCHEME**  
**RELEASE 3.0 PROJECT**

**Introduction**

This document is issued for the purposes of the smart meter communication licences granted under the Electricity Act 1989 and the Gas Act 1986 (together, the **DCC Licence**).

This document constitutes –

- (A) a direction issued by the Secretary of State under paragraph 35.5 of Condition 35 of the DCC Licence (The Chapter 9 Particular Definitions) identifying a 'Project'; and
- (B) the terms of a Baseline Margin Project Performance Adjustment Scheme (a **Scheme**) made by the Secretary of State in accordance with paragraph A2 of Appendix 1 to Condition 38 of the DCC Licence (Baseline Margin Project Performance Adjustment Scheme),

and has effect for the purposes of the Price Control Conditions of the DCC Licence, and in particular Part D of Condition 38 (Calculation of the value of the BMPPA term).

In this Scheme, in accordance with the provisions of paragraph A4 of Appendix 1 to Condition 38 of the DCC Licence –

- Section 1 identifies the project to which the Scheme relates (the **Project**).
- Section 2 describes a number of activities carried out by the DCC for the purposes of the Project (the **Project Activities**).
- Section 3 specifies a weighting factor in relation to each Project Activity (the **Project Activity Weighting Factors**).
- Section 4 describes a performance target in relation to each Project Activity (the **Project Activity Milestones**).
- Section 5 specifies a performance factor in relation to each Project Activity Milestone (the **Project Activity Performance Factors**).

The DCC shall be required to record, report on, and procure the audit of information in accordance with Section 6.

Words and phrases used in this Scheme shall be interpreted in accordance with, and have any meanings given to them in, Section 7.

## **1 The Project**

1.1 The **Project** means the activities carried out (or to be carried out) by the DCC:

- (a) in accordance with the implementation plan produced by the DCC in compliance with a direction issued by the Secretary of State on 18 January 2017 under Condition 13 of the DCC Licence (Arrangements relating to the Transition Objective) as subsequently amended pursuant to a direction issued on 26 July 2018 under that Condition;
- (b) during the period up to and including the Final Scheme Month;
- (c) in order to support a change in the nature and scope of the Services by facilitating the effective delivery of Service Release 3.0 (Services to Support SMETS1 Meters).

## **2 The Project Activities**

2.1 Each of the following activities being carried out by the DCC for the purposes of the Project shall be a Project Activity under the Scheme.

### *Project Activity 1*

2.2 **Project Activity 1** constitutes the activities undertaken by the DCC, in each month during the period from the start of the First Scheme Month to the end of the Final Scheme Month, to Enrol SMETS1 Smart Metering Systems.

### *Project Activity 2*

2.3 **Project Activity 2** constitutes all the activities undertaken by the DCC, in the period up to and including the end of the Final Scheme Month, to Enrol SMETS1 Smart Metering Systems.

## **3 The Project Activity Weighting Factors**

- 3.1 The Project Activity Weighting Factor in respect of each of the Project Activities shall be that which is set out in the table immediately below.

<u>Project Activity</u>	<u>Project Activity Weighting Factor</u>
1	0.5
2	0.5

#### 4 The Project Activity Milestones

- 4.1 Each of the following performance targets relating to the DCC's undertaking of a Project Activity shall be a Project Activity Milestone under the Scheme in respect of the specified Project Activity to which it relates.

##### *Project Activity Milestones - General*

- 4.2 For the purpose of each Project Activity Milestone:
- (a) the **Enrolled Total** means, in respect of any specified date, the aggregate number of SMETS1 Smart Metering Systems that have been Enrolled as at that date; and
  - (b) the **Enrolment Target** means the total number of SMETS1 Smart Metering Systems that are eligible for Enrolment in the period up to and including the end of the Final Scheme Month, and shall be equal to *[number to provided following availability of 2019 statistics]*.

##### *Project Activity Milestone 1*

- 4.3 The Project Activity Milestone which applies to Project Activity 1 is that the Enrolment Quotient should be equal to the Target Enrolment Quotient, where:
- (a) the **Enrolment Quotient** is a number calculated in accordance with paragraph 4.4, representing the rate at which the Enrolment of SMETS1 Smart Metering Systems takes place; and
  - (b) the **Target Enrolment Quotient** is a number representing the minimum rate at which the Enrolment of SMETS1 Smart Metering Systems is expected to take place, and shall be equal to 0.40.



- 4.4 For this purpose, the Enrolment Quotient is calculated in accordance with the following formula:

$$Enrolment\ Quotient = \left( \sum_{n=1}^{n=20} \frac{ET_n}{ETG} \right) \div 20$$

- 4.5 where

- (a)  $n$  represents each month falling in the period between the First Scheme Month and the Final Scheme Month (inclusive), such that  $n=1$  means the First Scheme Month and  $n=20$  means the Final Scheme Month;
- (b)  $ET_n$  means the Enrolled Total on the last day of each month  $n$ ;
- (c)  $ETG$  means the Enrolment Target.

*Project Activity Milestone 2*

- 4.6 The Project Activity Milestone which applies to Project Activity 2 is that, at the end of the Final Scheme Month, the Enrolled Total shall be equal to the Enrolment Target.

## 5 The Project Activity Performance Factors

*Project Activity 1*

- 5.1 In respect of Project Activity 1, the Project Activity Performance Factor shall be determined in accordance with the table immediately below, in which:
- (a)  $R$  is a number representing the ratio of the Enrolment Quotient to the Target Enrolment Quotient;
  - (b) the first column specifies the range of values within which  $R$  lies;
  - (c) the second column specifies, or sets out a formula for calculating, the Project Activity Performance Factor for the range of values within which  $R$  lies.

<u>Ratio (<math>R</math>) of the Enrolment Quotient to the Target Enrolment Quotient</u>	<u>Project Activity Performance Factor</u>

$R \leq 0.4$	1
$0.4 < R \leq 0.7$	$\frac{6.2 - (8 \times R)}{3}$
$0.7 < R \leq 1.3$	$\frac{2 - (2 \times R)}{3}$
$1.3 < R \leq 1.6$	$\frac{9.8 - (8 \times R)}{3}$
$R > 1.6$	-1

*Project Activity 2*

5.2 In respect of Project Activity 2, the Project Activity Performance Factor shall be determined in accordance with the table immediately below, in which:

- (a)  $R$  is a number representing the ratio of the Enrolled Total as at the end of the Final Scheme Month to the Enrolment Target;
- (b) the first column specifies the range of values within which  $R$  lies;
- (c) the second column specifies, or sets out a formula for calculating, the Project Activity Performance Factor for the range of values within which  $R$  lies.

<b><u>Ratio (<math>R</math>) of the Enrolled Total at 31 December 2020 to the Enrolment Target</u></b>	<b><u>Project Activity Performance Factor</u></b>
$R \leq 0.6$	1
$0.6 < R \leq 0.8$	$3.4 - (4 \times R)$
$0.8 < R < 1.0$	$1 - R$
$R \geq 1.0$	0

## **6 BMPPA Scheme Principles**

### *Recording and Reporting*

6.1 For the purposes of paragraphs 5.1 to 5.2, the DCC shall:

- (a) maintain accurate records, supported by documentary evidence, sufficient to establish the Project Activity Performance Factors for Project Activities 1 and 2;
- (b) whenever requested by the Secretary of State to do so, promptly provide a report to him, the Authority and to the SEC Panel containing such up-to-date information and evidence relating to those records as he may request; and
- (c) by no later than the end of the first month immediately following the Final Scheme Month:
  - (i) submit a report to the Secretary of State (copied to the Authority and the SEC Panel) setting out the values of the Project Activity Performance Factors for Project Activities 1 and 2; and
  - (ii) provide together with that report such supporting information and evidence as is reasonably required to support the conclusion set out in it.

### *Independent Audit*

6.2 The DCC shall ensure that the report and supporting information and evidence referred to in paragraph 6.1(c) is accompanied by a statement from an independent auditor confirming that the overall set of information is correct in all material respects and that the values of the Project Activity Performance Factors contained within the report accurately reflect the performance that the DCC has achieved in relation to this Scheme.

## **7 Definitions and Interpretation**

7.1 Except to the extent to which an alternative definition is set out in paragraph 7.3:

- (a) words and phrases defined in either the DCC Licence or in the Smart Energy Code shall have the same meaning in this Scheme as in that document;

- (b) if the same word or phrase is defined in both such documents and the definitions are not consistent, the definition in the Smart Energy Code shall take precedence for the purposes of this Scheme.

7.2 The rules of interpretation set out at Condition 2 of the DCC Licence shall apply as if they formed part of this Scheme.

7.3 For the purposes of this Scheme, unless the context otherwise requires –

<b>DCC Licence</b>	means the smart meter communication licences granted under the Electricity Act 1989 and the Gas Act 1986, taken together.
<b>Enrolled Total</b>	has the meaning given to that expression in paragraph 4.2(a).
<b>Enrolment Quotient</b>	has the meaning given to that expression in paragraph 4.3(a).
<b>Enrolment Target</b>	has the meaning given to that expression in paragraph 4.2(b).
<b>Final Scheme Month</b>	means December 2020.
<b>First Scheme Month</b>	means May 2019.
<b>Project</b>	has the meaning given to that expression in paragraph 1.1.
<b>Project Activity 1</b>	has the meaning given to that expression in paragraph 2.2.
<b>Project Activity 2</b>	has the meaning given to that expression in paragraph 2.3.
<b>Scheme</b>	means this Baseline Margin Project Performance Adjustment Scheme.
<b>Service Release 3.0</b>	has the meaning given to the expression “Services to support SMETS1 Meters” in the direction issued by the Secretary of State on 18 January 2017 under

Condition 13 of the DCC Licence (Arrangements relating to the Transition Objective).

**Target Enrolment Quotient** has the meaning given to that expression in paragraph 4.3(b).