



Consultation

On Changes to the Smart Energy Code to support 4G Communications Hubs and Networks Financing arrangements

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1. Introduction and Context

1.1. Consultation on proposed changes to the Smart Energy Code on behalf of BEIS

1. The changes to the Smart Energy Code proposed in this consultation, if taken forward, will be made by the Secretary of State using powers under Section 88 of the Energy Act 2008. BEIS has asked DCC to undertake a consultation on these proposed changes on its behalf. Further information in support of this arrangement is set out in Section 4.

1.2. The Communications Hubs and Networks Programme

2. The Communications Hubs and Networks Programme (CH&N) is a Data Communications Company (DCC) initiative geared towards defining and delivering future-proof Communications Hubs & Networks with an efficient supply chain and a targeted longevity of at least 15 years. Maintaining Smart functionality over the longer term will require the introduction of new Communications Hubs (CHs) which use the 4G network. Therefore, DCC established the CH&N Programme to assess development and implementation options for a 4G solution.

1.3. Current status of the CH&N Programme

3. In October 2022, DCC signed contracts with new Service Providers to deliver a disaggregated solution to provide a service for Dual-Band 4G CHs, including sub-lots for CH device provision, WAN provision and supporting services. DCC is currently in the process of replanning the delivery of the CH&N programme now we have reached this important control point in the programme.¹

1.4. Arrangements for funding programme costs

4. As part of the disaggregated procurement model for the programme, DCC will be contracting directly with delivery partners who are providing individual components that make-up the overall solution. This is different to the approach we have followed for Communication Service Provision in the past, where DCC has contracted with a single, prime service provider, who has then arranged sub-contracts for individual components within the solution as a whole.
5. It is DCC's view that the disaggregated approach allows us to drive the best value for money for DCC customers, not only in the initial procurement, but also during its operation following implementation. However, this change in approach requires DCC to take on two roles which would have been undertaken by a prime service provider under an aggregated model. These are:
 - Managing the direct financing arrangements for Communications Hubs; and
 - Managing any necessary financing to allow DCC to smooth the costs to customers, of payments to service providers during the Design, Build and Testing (DBT) Phases of the programme.

¹ www.smartdcc.co.uk/consultations/consultation-on-the-revised-delivery-plan-for-the-communications-hubs-and-network-programme/

2. Why are we consulting?

6. DCC is able, under its Licence,² to enter into loan agreements which adhere to the following principles:
- A loan must be on an arm's length basis;
 - it must be on normal commercial terms; and
 - must be for DCC's Mandatory or Permitted Business.

2.1. Direct CH Financing between DCC and lenders

7. Section M11.5 of the SEC includes provisions which reflect the original arrangements put in place for the financing of 2G/3G SMETS2 CHs. These original arrangements involved the Communications Service Provider arranging loan finance for Communications Hubs. The SEC sets out third-party rights for a financial organisation (an **Approved Finance Party** in the SEC) who is providing Communications Hub finance (referred to as a **Communications Hub Finance Facility** in the SEC). These rights allow the Approved Finance Party to be able to recover any amounts due against a Communications Hub Finance Facility directly from Users in the event that DCC is unable to make these payments. They are recoverable from Users who currently pay for Fixed CH Charges (i.e. Import Electricity Suppliers, Export Electricity Suppliers, and Gas Suppliers). Any amount owing would be recovered in accordance with the proportions that they currently pay CH Fixed Charges. These instances are referred to as **Communications Hub Finance Acceleration Events** in the SEC.
8. An event of this nature is highly unlikely, based on the way DCC is funded, as well as the provisions that are in place for handover of DCC business to a Successor Licensee, and the Special Administration Regime that allows the appointment of a Special Administrator to take on DCC duties if the Licence Holder is unable to continue to deliver its duties under the Licence. Whilst highly unlikely to be called on, these CH Financing provisions in the SEC provide an additional level of assurance for any prospective lender and hence lower financing costs to SEC Parties.
9. Currently the definition of a Communications Hub Finance Facility in the SEC explicitly refers to finance that is arranged via a DCC Service Provider. Under DCC's disaggregated model, DCC will be securing CH Financing without the support of a prime DCC Service Provider.

2.2. Financing for programme delivery

10. DCC will also be financing the costs of the DBT arrangements for the programme without using the services of a prime DCC service provider. DBT costs are those incurred by DCC in design, build and test of the 4G solution until the solution goes live in the production environment, (which is the start of the Initial Pallet Validation phase in the CH&N plan). Current regulatory arrangements for the recovery of DCC costs means that payments for DBT would be directly recovered by DCC customers who pay DCC Fixed Charges – i.e. Energy Supplier Parties and Distribution Network Operators. However, costs for DBT for the CH&N Programme are not expected to be smooth, which would lead to high variation in the annual charges that we would need to pass on to our customers.
11. In discussions with customers at our Quarterly Finance Forum, we have flagged this risk, and our plan to mitigate it through the use of a finance facility. This would allow DCC to smooth the costs of the DBT phase for customers, extend repayment over a longer period of time and allowing for less variability of costs year on year.

² In Condition 27.3 of the DCC Licence

2.3. Aligning debt recovery arrangements in the SEC to reflect 4G CH&N Programme financing approach

12. DCC has now concluded its negotiations with lenders to arrange financing for DBT. As part of the negotiations, lenders stipulated that in order to secure financing, the SEC should be updated so that the provisions for debt-recovery that cover CH Financing via a DCC Service Provider are extended in scope so that they include funding for DBT of 4G CH&N. As part of the final agreement, which will allow DCC to recover the costs of DBT over five years, we have agreed to seek to introduce these changes into the SEC.
13. Whilst negotiations with lenders for CH Financing are at an earlier stage, we expect that they will require the same change to be made to the SEC to cover CH Financing arranged directly with DCC (as opposed to via a DCC Service Provider). DCC is therefore proposing changes to the SEC to meet both of these requirements. We have drafted amendments to the SEC which are explained in Section 3 of this consultation.
14. If implemented, these changes will make clear that, under the SEC, lenders will have the right to recover debt directly from SEC Parties, in a scenario where DCC was unable to make payments. Any amount owing would be recovered in accordance with the proportions that costs are allocated to SEC Parties, which for programme delivery costs is via the Fixed Charge. This means that those who currently pay DCC Fixed Charges would be liable to for any cost recovery arrangements relating to DBT Financing.
15. As previously stated, DCC considers this scenario to be very unlikely. DCC's cost-recovery provisions in the SEC allow it to recover costs for its Authorised Business, which would include CH Financing and DBT costs, subject to Ofgem price control decisions. There is historical evidence to justify this scenario as unlikely: in the six years in which finance (arranged through DCC's 2G/3G Service Providers) has been used to procure and provide CHs for the roll-out to date, it has never been necessary for lenders to call on the rights they have under the SEC to recover debt.

Implications for not changing the SEC

16. If these changes to the SEC are not introduced, DCC's arrangements for DBT financing of the 4G Programme would be put at risk, with a likely scenario that DCC's chosen lenders would end the agreement. DCC's extensive market engagement with other lenders ahead of selecting a lender has indicated that they too would require similar provisions in the SEC, meaning it would not be possible for DCC to simply select another lender.
17. This would mean that DCC would need to recover costs for DBT directly from SEC Parties, along with any funding initially drawn down under the financing arrangement. This would in turn mean that recovery of these costs would not be smoothed over a five year period but would instead be recovered over the period (of approximately two years) in which they were incurred, leading to higher and more variable regulatory charges for that period than would be seen over an equivalent five-year period, which we would like to avoid.
18. We would expect similar issues when securing the CH Financing outlined in Section 2.1, with DCC either unable to secure financing for the millions of 4G CHs that will need to be procured, or securing financing at unfavourable rates due to the absence of such cost-recovery provisions in the SEC.
19. It is our view that these SEC changes are necessary, due to the financial benefit that they bring DCC customers.

Question 1

Do you support DCC's proposal that the SEC should be amended to support direct CH Financing between DCC and lenders? Please provide a rationale for your views.

Consultation Timetable

Date	Activity
31 January 2023	Consultation Opens
27 February 2023	Consultation Closes

Table 1 – Consultation Timetable

3. Proposed changes to the SEC to enable programme financing

20. The proposed SEC changes to enable the changes described in Section 2 of this document, are set out below. Section 3.1 sets out the change needed to support direct CH Financing between DCC and lender. Section 3.2 sets out the changes needed to support financing for 4G programme delivery, as well as the rationale for its approach to the drafting changes. These changes have been reviewed by BEIS prior to their inclusion in this consultation.

3.1. Proposed changes to support direct CH Financing between DCC and lenders

21. Communications Hub Financing is described across various Sections of the SEC. Section J1 sets out how Communications Hub Finance Charges are invoiced, and that Charges for Communication Hub Financing Charges may be required to be paid directly to an Approved Finance Party.
22. Section K3 sets out how DCC must hold three months' contingency for Communication Hub Financing Charges, and Section K9 includes the arrangements to be followed in the unlikely event that Communication Hub Financing Acceleration Event takes place. Section M11 sets out the third-party rights for lenders classified as an Approved Finance Party (as they are not SEC Parties themselves).
23. We do not propose to amend any of this legal text. Instead, we propose amending the definition of a Communications Hub Finance Facility so that it can be arranged by DCC directly, as well as a DCC Service Provider, as is currently the case. We have also amended the definition so that it enables DCC to acquire 'and/or make available CHs'. DCC is continuing its engagement with Communications Hubs Asset Providers to secure financing for 4G CHs, and we consider amending this drafting now reduces the risk of further amendments in the next few months as DCC finalises arrangements with Communications Hubs Asset Providers.
24. The draft legal text for this change is set out in **Appendix A**.

Question 2

Do you have any comments on the proposed legal drafting changes to the SEC to support direct CH Financing between DCC and lenders? Please provide a rationale for your views.

3.2. Proposed changes to support financing for DBT for CH&N

25. The changes to set out rights for lenders financing the 4G programme delivery are more extensive than the changes to support direct CH Financing between DCC and lenders but are not complex. The drafting replicates the provisions already in the SEC, but instead of referring to a Communications Hub Finance Facility, a new '4G DBT Finance Facility' is introduced. This is defined as enabling the funding of the costs for designing, building, manufacturing and delivering 4G Communications Hubs and any solutions or services necessary for the provision and/or operation of 4G Communications Hubs. As the 4G DBT Finance Facility is required for the initial implementation of the CH&N Programme, we have limited the availability of this facility by linking it to the point at which DCC reaches the volume manufacture milestone in its 4G Programme plan (by which time the CH&N programme will have concluded).
26. The remaining changes to the SEC introduce the same provisions which apply to the Communications Hub Finance Facility, but for the '4G DBT Finance Facility'. These comprise:
- New definitions for '4G DBT Finance Charges', '4G DBT Finance Costs', and a '4G DBT Finance Acceleration Event', to replicate those for CH Financing
 - A new Section K3.15A to replicate the requirement for DCC to hold a contingency fund for 4G DBT Finance Costs
 - Updates to Section K9.7 so that this refers to both Communications Hub Finance and 4G DBT Finance.
 - Replicated provisions in Section M11 providing third-party rights to a 4G DBT Finance Provider, as well as CH Finance Providers.
27. To support the changes, the definition of 'Approved Finance Party' is updated to relate to the provider of both a Communications Hub Finance Facility, or a 4G DBT Finance Facility. A new definition of 'DCC Finance Facility' has been introduced to cover both the Communications Hub Finance Facility and the 4G DBT Finance Facility – and is included in the updated definition of 'Approved Finance Party'. Finally, we have added a new definition for a 4G Communications Hub, which is used in the definition of the 4G DBT Finance Facility.
28. All of the drafting for the changes described in Section 3.2 are set out in **Appendix B**.

Question 3

Do you have any comments on the proposed legal text changes to the SEC to support financing for DBT? Please provide a rationale for your views.

4. Consultation Approach and Next Steps

29. BEIS has indicated to DCC that, subject to the consultation responses received, any changes to the SEC described above would be made using powers under Section 88 of the Energy Act 2008, which allows the Secretary of State to direct changes to energy regulation, including energy codes.
30. **This document therefore constitutes a consultation on behalf of BEIS**, and will seek views from all SEC Parties, as well as the Authority. BEIS will make a final decision on whether to lay such changes before Parliament, based on consultation responses and a published conclusions report from DCC, with its recommendations as to what (if any) changes to the SEC should be made. Consultation responses will be shared with BEIS on that basis.
31. Respondents are able, if they wish, to send the consultation responses only to BEIS (as opposed to DCC who will share it with BEIS). If you wish to do this, please send your consultation response to smartmetering@beis.gov.uk.
32. Otherwise, we request that you email your response to consultations@smartdcc.co.uk.

This consultation closes at **17:00 on Monday 27 February 2023**.

33. DCC reserves the right not to publish, or to delay publication of, referenced material or documents and/or respondent feedback for confidentiality, commercial, compliance and/or legal reasons.
34. Consultation responses may be published on our website www.smartdcc.co.uk. Please state clearly in writing whether you want all or any part, of your consultation to be treated as confidential. It would be helpful if you could explain to us why you regard the information you have provided as confidential.
35. Please note that responses in their entirety (including any text marked confidential) will be made available to the Department of Business, Energy and Industrial Strategy (BEIS) and may be made available to the Gas and Electricity Markets Authority (the Authority), who are subject to public law duties and obligations as regards such information and its publication, entirely separate to DCC.

If you have any questions in relation to this consultation, please contact DCC via consultations@smartdcc.co.uk

Appendix A. Proposed SEC changes to support direct CH Financing by DCC

Communications Hub Finance Facility

means a facility arranged **by the DCC or** a DCC Service Provider with an Approved Finance Party relating exclusively to the funding of the costs associated with, acquiring **and/or making available** a tranche of Communications Hubs, including by way of a loan facility, an equity subscription, or an assignment or sale of receivables.

Appendix B. Proposed SEC changes to explicitly enable debt recovery for DBT costs

Changes to Section A

Approved Finance Party	means, in respect of each Communications Hub DCC Finance Facility, the person <u>with whom the DCC arranges the facility, or</u> to whom the DCC accepts payment obligations under the Direct Agreement relating to that facility, <u>as the case may be</u> , and which has (from time to time) been notified by the DCC to the Authority and the Panel as meeting the requirements of this definition
<u>4G Communications Hub</u>	means a Communications Hub which is capable of using 4G mobile cellular radio technology to connect to the SM WAN
<u>DCC Finance Facility</u>	<u>means a Communications Hub Finance Facility or a 4G DBT Finance Facility.</u>
<u>4G DBT Finance Acceleration Event</u>	means, in respect of each 4G DBT Finance Facility, that: <ul style="list-style-type: none"> <u>(a) an acceleration of repayment of the indebtedness thereunder occurs such that it is immediately due and payable by the borrower in circumstances where the DCC is liable for the same under the Direct Agreement; or</u> <u>(b) the DCC becomes liable under the Direct Agreement to immediately pay the unamortised asset value (and any associated finance costs in respect) of any assets to which that facility relates.</u>
<u>4G DBT Finance Facility</u>	<u>means a facility, other than a Communications Hub Finance Facility, arranged by the DCC or a DCC Service Provider with an Approved Finance Party for the funding of the development costs (including design, build and testing costs) of any solutions or services which DCC procures in order to enable or facilitate its provision and/or operation of 4G Communications Hubs, such costs being incurred in respect of activities undertaken up to the point of volume manufacture of the 4G Communications Hubs (such point as further described in the plan produced pursuant to condition 13B of the DCC Licence), and being costs which DCC is entitled to recover via the Fixed Charges under this Code, including by way of a loan facility, an equity subscription, or an assignment or sale of receivables.</u>
<u>4G DBT Finance Charges</u>	<u>means, in respect of each 4G DBT Finance Facility, the DCC's charge to recover the applicable 4G DBT Finance Costs (being a subset of the Fixed Charges), in an amount each month determined by the DCC at the time it produces an Invoice for that month (having regard to the requirements of Condition 36.5 of the DCC Licence)</u>
<u>4G DBT Finance Costs</u>	<u>means, in respect of each 4G DBT Finance Facility, the costs the DCC incurs in respect of that facility</u>

Direct Agreement means, in respect of each Communications Hub Finance Facility or 4G DBT Finance Facility, any agreement entered into by the DCC in relation to that facility under which the DCC owes direct payment obligations

Updates to Section K

Determining the Fixed Charges

K3.15A In determining the Fixed Charges, the DCC shall have regard to the need, for the purposes of making a prudent estimate in accordance with Condition 36.5 of the DCC Licence, to provide for the availability at all times of a contingency fund in respect of the 4G DBT Finance Charges relating to each Communications Hub Finance Facility that is equal to the DCC's estimate of [three] months of the 4G DBT Finance Costs relating to that facility

K9.7 For the purposes of Section K9.6:

- (a) a Communications Hub Finance Acceleration Event and a 4G DBT Finance Acceleration Event are each a Liability Event;
- (b) the amount due and payable by the DCC as a result of a Communications Hub Finance Acceleration Event and/or a 4G DBT Finance Acceleration Event is a Liability Sum to the extent the DCC estimates that such amount will be recoverable by the DCC as Allowed Revenue;
- (c) the references to “Charges” in the definition of ^{LS}pl shall (in the case of a Communications Hub Finance Acceleration Event) be interpreted as a reference to “Communications Hub Charges” and in the case of a 4G DBT Finance Acceleration Event be interpreted as a reference to “Fixed Charges”; and
- (d) the amount payable by each Party in respect of such Liability Event shall (for the purposes of invoicing and payment under Section J (Charges) or Section M11.5(b) (Third Party Rights)) be treated as an amount due by way of Communications Hub Finance Charges relating to the Communications Hub Finance Facility in respect of which the Communications Hub Finance Acceleration Event has occurred and/or as an amount due by way of 4G DBT Finance Acceleration Charges in respect of which the 4G DBT Finance Acceleration Event has occurred (as the case may be).

Updates to Section M

M11.5 The following persons shall be entitled to enforce the following rights in accordance with the Contracts (Rights of Third Parties) Act 1999:

- (a) the person referred to in Sections C3.12 (Protections for Panel Members and Others) and M2.13(a) (Other Matters) shall be entitled to enforce the respective rights referred to in those Sections;
- (b) the Approved Finance Party for each Communications Hub Finance Facility shall be entitled to exercise and/or enforce the following rights of the DCC in respect of the Communications Hub Finance Charges relating to that facility where a Communications Hub Finance Acceleration Event has occurred in respect of that Communications Hub Finance Facility and the Authority has determined that the DCC is unwilling or unable to do so:

- (i) the right to calculate the amount of the Communications Hub Finance Charges arising as a result of that event (provided in such circumstances that the Approved Finance Party must demonstrate to the satisfaction of the Authority that the amount of the charges so calculated will in aggregate be no more than the amount contractually due and payable (but unpaid) by the DCC to the Approved Finance Party in respect of that event);
- (ii) the right to invoice the Users in respect of the Communications Hub Finance Charges arising as a result of the Communications Hub Finance Acceleration Event (whether in the amount calculated by the DCC in accordance with this Code, or in the amount calculated by the Approved Finance Party and approved by the Authority under Section M11.5(b)); and/or
- (iii) the right to enforce payment by the Users in accordance with this Code of the amount of Communications Hub Finance Charges invoiced in accordance with this Code,

and the payment of any amount by a User to an Approved Finance Party pursuant to this Section M11.5(b) shall satisfy that User's obligation to pay that amount to the DCC;
and

(c) the Approved Finance Party for each 4G DBT Finance Facility shall be entitled to exercise and/or enforce the following rights of the DCC in respect of the Other DCC Finance Charges relating to that facility where a 4G DBT Finance Acceleration Event has occurred in respect of that 4G DBT Finance Facility and the Authority has determined that the DCC is unwilling or unable to do so:

- (i) the right to calculate the amount of the 4G DBT Finance Charges arising as a result of that event (provided in such circumstances that the Approved Finance Party must demonstrate to the satisfaction of the Authority that the amount of the charges so calculated will in aggregate be no more than the amount contractually due and payable (but unpaid) by the DCC to the Approved Finance Party in respect of that event);
- (ii) the right to invoice the Users in respect of the 4G DBT Finance Charges arising as a result of the Other DCC Finance Acceleration Event (whether in the amount calculated by the DCC in accordance with this Code, or in the amount calculated by the Approved Finance Party and approved by the Authority under Section M11.5(c)); and/or
- (iii) the right to enforce payment by the Users in accordance with this Code of the amount of 4G DBT Finance Charges invoiced in accordance with this Code,

and the payment of any amount by a User to an Approved Finance Party pursuant to this Section M11.5(c) shall satisfy that User's obligation to pay that amount to the DCC.

(e)(d) AltHANCo (as defined in Section Z (Alt HAN Arrangements)) shall be entitled to enforce all rights which are conferred upon it under Section Z4 (Alt HAN Costs and Budgets), and shall (notwithstanding Section M11.8) be entitled to assign the benefit of these rights.