



Conclusions

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. The Communications Hubs and Networks Programme

1. 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.

In delivering the CH&N Programme, DCC will be taking on new roles which have previously been undertaken by a prime service provider. 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.

1.2. DCC's consultation on changes to the SEC to support CH&N Financing

2. On 30 January 2023, DCC issued a consultation, on behalf of the Department for Energy Security and Net Zero (DESNZ), setting out changes to the SEC which would be necessary to enable DCC to manage direct finance agreements for Communications Hubs and to provide financing during the DBT Phases of the programme.
3. The consultation closed on 27 February 2023. This document summarises the responses to this consultation that were received, and DCC's conclusions in light of these responses, as well as the recommendation to the Secretary of State. We also set out what we expect to be the next steps following this conclusion, recognising that DCC is consulting on behalf of DESNZ, who will make a final decision about whether and when to implement any changes to the SEC.

2. Consultation questions and responses

4. DCC asked three consultation questions, which are set out alongside a summary of responses and DCC's conclusions in the rest of this section.
5. We received 5 responses to the consultation, made up of:
 - Three responses from Large Energy Suppliers;
 - One from a Distribution Network Operator;
 - One from the SEC Panel.

2.1. Question 1

6. DCC sought views from respondents on the overall proposals for its role in securing financing for the CH&N Programme, asking:

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.

7. Four respondents answered this question directly, all offering their support for the proposals, along with some additional comments. One Large Energy Supplier suggested that DCC should be more transparent about the costs involved and inform CH installing parties about any invoicing and contractual changes ahead of closing the finance arrangement. They also suggested that in light of the imminent DCC Licence review, the current DCC should be wary of signing the industry up to inappropriate contractual terms.
8. Another Larger Energy Supplier supported the changes, agreeing with DCC's view that acceleration events, whereby financiers would seek to recover costs directly from SEC Parties, would be unlikely given DCC's financial position and performance on this to date. The same respondents and one other Large Energy Supplier stated that they see value in smooth and forecastable costs being spread across five years, and this is beneficial compared to large, short-term costs that are unplanned. They acknowledged the financiers' lack of willingness to enter into an agreement without the change to the SEC may prevent DCC using other financing options.
9. The SEC Panel supported the principle of the change but noted their concern regarding the timing of the consultation, leaving limited time for Parties to consider any wider consequences. They suggested that the issues should have been dealt with through the SEC Modification Process.

DCC Response

10. We welcome respondents general support for the proposed changes to the SEC. Regarding additional comments raised, DCC will continue to engage with SEC Parties on financial matters at its Quarterly Finance Forum (QFF) on financial issues which will impact them, including sharing information on finance costs and benefits. It is not always possible or appropriate for DCC to share information ahead of closing financial arrangements, although we will share as much information as we can wherever possible. DCC's price control regime forms the means by which the cost-effectiveness of DCC decisions will be judged, and this provides a recourse to DCC customers if it is decided that DCC has not made the best decisions in terms of value for money.

11. On DCC's Licence expiry, DCC is required to ensure that contracts can be novated to a new Licensee on the event of a Licence handover, and novation provisions have been reflected in the contracts agreed with financiers.
12. DCC welcomes the support of the SEC Panel regarding the principle of the proposed changes. We acknowledge that the timing of the consultation was not ideal from the Panel's perspective but consider that a duration of four weeks, along with a customer webinar during the consultation window, gave interested parties adequate time to engage and respond. The timing of the consultation has been driven by the timetable of discussions with financiers and the point at which they confirmed that SEC changes were essential in order for them to provide finance. DCC engaged with SECAS ahead of this point on the possibility of utilising the SEC Modification process to deliver the necessary changes, and again at the point at which it was confirmed they were needed. It was agreed that the SEC Modification route would not be viable to make these changes given their urgency.

2.2. Question 2

13. DCC sought views on the proposed changes to the SEC to enable it to receive direct CH Financing, asking:

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.

14. All respondents either supported, or considered appropriate, the simple SEC changes to support this approach.

DCC Response

15. We welcome respondents general support for these proposed changes to the SEC.

2.3. Question 3

16. We sought views on the proposed changes to the SEC to support financing for the DBT phases of the CH&N Programme, asking:

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.

17. No respondents objected to the drafting proposed, with one Large Energy Supplier supporting the text included in the consultation, and the SEC Panel noting that it was reasonable. Other respondents were neutral regarding the legal text, but raised a number of comments regarding the processes associated with the text. These included:
 - Transparency on the contingency fund held by DCC in support of the DBT Finance Facility and a commitment to share this with SEC Parties on a regular basis;

- Suggesting that DCC should formally notify affected SEC Parties of any likelihood of a 4G DBT Finance Acceleration Event being triggered, for example drawing down on the contingency fund, and that this should be added into the SEC; and
- Concerns regarding DCC over-recovery through the contingency fund and that this should be estimated in any charging statements and at the QFF.

DCC Response

- 18.** DCC welcomes the support from some respondents regarding the drafting. On the additional points raised, DCC agrees that transparency regarding the contingency fund held by DCC, and providing information to affected SEC Parties on the likelihood of any finance acceleration event are important. We agree that we should commit to providing regular updates on both of these matters at our QFF, or directly to QFF representatives when sharing information is more urgent than the quarterly meeting cycle, and we commit to notifying affected parties if we utilise the contingency fund – which we will set as DCC’s estimate of three months of the cost relating to the 4G DBT Finance Facility – as a means of indicating the possibility of a finance acceleration event.
- 19.** We will undertake to do this and will additionally consider whether we recommend changing the SEC to codify the requirement to notify. We will consider this matter as part of the wider SEC changes for CH&N that will be concluded before the end of October 2023, and if we do propose that this change is taken forward, consultation on any supporting changes to the SEC will take place as part of the consultations on wider SEC changes.
- 20.** DCC will ensure that at QFF sessions it sets out information for participants regarding the contingency fund as suggested by one respondent.

3. Changes to the SEC

21. DCC does not propose that any changes are made to the legal text which was issued for consultation based on the responses received. However, working with DESNZ, we have identified 4 minor typographical changes that we propose are made before DESNZ takes a final decision on whether to lay the changes to the SEC before Parliament. These all relate to the changes to support 4G DBT Financing, and we have highlighted these in yellow as additional tracked changes. Final, tracked-change legal text is included in **Appendix A** to support CH Financing, and in **Appendix B** (with corrections highlighted in yellow) to support 4G DBT Financing.

4. Next Steps

22. In light of the consultation responses received, we are recommending to the Secretary of State that the changes to the SEC set out in Appendices A and B are made as soon as possible. DCC has submitted this conclusions document to DESNZ, and we understand that, should the Department decide to lay the changes to the SEC before Parliament, it intends to do so on 15 March and that, subject to the Parliamentary process, this means that the changes will come into legal effect towards the end of May 2023.

Appendix A. 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. 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>	<u>means, in respect of each 4G DBT Finance Facility, that:</u> <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 ~~is~~ 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~~ 4G DBT 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~~ 4G DBT 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.