

LCNF SECOND TIER REWARD

REPORT AND RECOMMENDATION

Prepared by the Independent Expert Panel for Ofgem

November 2022

INTRODUCTION

- 1 This report, prepared by the Independent Expert Panel (the Panel), sets out the Panel's recommendations to the Gas and Electricity Markets Authority (the Authority) on the allocation of Second Tier Reward (STR) payments to Low Carbon Networks Fund (LCNF) projects.
- 2 Members of the LCNF STR Panel are:
 - Maxine Frerk (Chair)
 - David Newbery
 - Mike Kay
 - Jiggy Lloyd
 - Stuart Bailey
- 3 Three submissions were made to the LCNF STR bidding round, as follows:
 - ENWL: Smart Street
 - ENWL: Customer Load Active System Services (CLASS)
 - SP Energy Networks: Accelerating Renewable Connections (ARC)
- 4 These STR submissions will be available on the Ofgem website.
- 5 The Panel wishes to acknowledge and reaffirm the wide and significant benefits the LCNF-supported innovation projects have delivered and will continue to deliver for GB network customers. The Panel also commends the efforts, enthusiasm and determination of the DNOs and project partners in delivering project outcomes.

EVALUATION METHODOLOGY

- 6 The role of the Panel is to make a recommendation to the Authority as to which, if any, of the three LCNF STR submissions the Panel considers is eligible for an STR reward. To make this recommendation, the Panel followed the evaluation process as set out in Ofgem's LCNF Governance Document (v7)¹ and Ofgem's LCNF STR Guidance Note, dated 28th June 2022.²
- 7 To form its opinion for each project, the Panel relied primarily on the evidence from the STR submissions. The Panel could have requested further information if needed but it did not consider this necessary.
- 8 To be eligible for the STR, the DNOs had to provide compelling evidence of exceptionality. The responsibility for providing robust evidence to make this case lay with the DNO. The default position is that no STR reward recommendation would be made unless the Panel were convinced by the evidence submitted by the DNO that the threshold for exceptionality had been met.

¹ https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/lcnf_gov_doc_v7_-_final_clean_0.pdf

² <https://www.ofgem.gov.uk/publications/guidance-note-low-carbon-networks-fund-second-tier-reward-2022>

- 9 The Panel considered the discretionary reward criteria contained in the Guidance Note (see summary in attached Annex), together with the formulation that the 2018 Panel³ had adopted to assess whether or not a project was deemed eligible to be classed as exceptional:
- i. Has the project delivered above and beyond what was originally expected as stated in the original Project Direction?
 - ii. Is this ‘additionality’ due to the efforts of the DNO (and/or its project partners), rather than simply because wider macro-factors over which the project has no influence went in the project’s favour?
 - iii. Has this ‘additionality’ brought significant benefits for GB network customers?
- 10 The Panel’s counterfactual for assessing exceptionality was the projected outputs and GB-wide benefits in the project’s original Full Submission document – these were what the project was funded to deliver. Therefore, simply achieving these outputs is not in itself evidence of exceptionality.
- 11 Adopting this approach meant that the burden of proof was on the DNOs to provide the Panel with evidence of going the extra mile to deliver more than was originally proposed. The Panel is clear that this is a challenging set of criteria to meet but, if met, demonstrates that a project has delivered above and beyond the expected outcomes.
- 12 This report sets out the results of the Panel’s deliberations and its recommendations to the Authority. This report should be read together with the DNOs’ STR and original LCNF Full Submissions and other relevant information published concurrently with these documents on the Ofgem website.

EVALUATION OF SUBMISSIONS

- 13 The Panel considers that one of the three submissions meets the threshold for exceptionality. This is ENWL - CLASS. The reasons for this are set out below.
- 14 ENWL’s CLASS project was awarded LCNF funding in 2012. The original aims of the project were to test voltage reduction and the use of CLASS for frequency response and reactive power absorption. The funding awarded was £7.2m with a compulsory licensee contribution of £810k.
- 15 ENWL claimed exceptionality for CLASS based on it having fundamentally shifted industry attitudes regarding deployment of the voltage-demand relationship. Although originally intended as a way to reduce peak demand and defer network reinforcement, during the trial ENWL identified a greater opportunity to provide demand response services to the ESO as part of the balancing services market. Ofgem agreed an extension to the project (within the original budget envelope) to prove this opportunity. The robustness of the methodology and ENWL’s significant efforts provided Ofgem with the confidence to change the regulatory framework and assured the ESO that it met the performance requirements for the relevant balancing services. CLASS is the first balancing service to be provided by a DNO. In the Panel’s view it is this

³ <https://www.ofgem.gov.uk/publications/decision-low-carbon-network-funds-second-tier-reward-2018>

evolution of the thinking behind CLASS and the efforts required to establish it as a balancing service delivering very significant benefits to GB customers (as it displaces alternative more costly and higher carbon balancing services) that make CLASS exceptional.

- 16 The Panel also welcomes the fact that other DNOs are planning deployment in ED2 pending a decision from Ofgem on its regulatory treatment. In their original submissions for LCNF (and subsequently NIC) funding the DNOs all present forecasts of GB-wide benefits (to justify the costs being borne by GB customers). Absent clear evidence of a project being widely adopted by other DNOs the Panel does not consider that it can meet the criteria for exceptional performance.
- 17 ENWL presented evidence that the carbon savings and capacity released were significantly greater than originally anticipated. While this is welcome, the Panel's view is that this was not the result of any particular action by ENWL rather it was just a case of the technology being more effective than anticipated. On its own this would not be sufficient to merit a reward.
- 18 ENWL also argued that the Engaged Customer Panel methodology they used for CLASS was exceptional. The Panel acknowledges the important role of customer engagement on projects such as this – and the effort that ENWL put into it - but does not consider that aspect met the threshold for exceptionality.
- 19 In summary, whilst producing learning and achieving effective knowledge dissemination should be key parts of every innovation project, the Panel considers that the impact of the learning from this project has gone beyond what could have been reasonably expected at the time of the submission. The Panel is of the view that this increased impact was due to the project team's sustained efforts to engage with Ofgem to reform the regulatory regime and to raise visibility of the opportunity with the ESO and other DNOs. This increased impact is to the benefit of GB consumers.
- 20 Based on this, the Panel concludes that ENWL's CLASS project has met the threshold for exceptionality.
- 21 The Panel unanimously agrees that neither of the other two projects meet the exceptionality criteria. While the benefits in each of the DNO's licence area have generally been higher than the DNO had originally anticipated this could be attributed to external factors with some outperformance being expected on average across innovation projects. Evidence on GB benefits was typically weak and as noted above the Panel does not consider a project could be considered exceptional unless the learning is clearly being adopted by others and hence benefitting GB consumers at large.
- 22 The SPEN ARC project submission highlighted that significantly more renewables had been connected than originally anticipated. While ARC clearly facilitated this uptake, insufficient evidence was provided that the higher than anticipated outturn was the result of exceptional efforts on SPEN's part rather than simply reflecting demand growth as a result of wider policy developments. The Panel also notes that while Active Network Management has become a vital and established part of the DNO toolkit there were other innovation projects that preceded ARC which arguably broke the mould. Thus, while SPEN's ARC project clearly made a valuable contribution to industry learning, required significant effort by SPEN and its partners and

delivered higher than anticipated benefits in the SPEN area, the Panel considers that it does not meet the criteria to be considered exceptional.

- 23 The ENWL Smart Street project further explored the opportunity originally tested in CLASS to reduce customer bills through voltage management. ENWL claimed that the financial savings for customers were greater than anticipated and that this idea was being adopted by other DNOs. The Panel's view is that the level of savings delivered is the sort of upside that one might expect to see in an innovation project and was not the result of particular efforts on ENWL's part. The Panel also questions whether the "similar" approaches being pursued by other DNOs really did build on the ENWL work or were more cost-effective approaches that drew on wider industry understanding of voltage management. As such the Panel is not persuaded that Smart Street meets the criteria for exceptional performance.

RECOMMENDATIONS

- 24 As set out above, the Panel recommends an STR reward be made to ENWL for its CLASS project.
- 25 In considering the quantum of the reward, the Panel notes that the original financial contribution made by ENWL was £810k. However, ENWL have since recovered this through Successful Delivery Reward payments of £760k in 2016 and a further £50k in 2017.
- 26 The Panel also notes that under the Ofgem methodology (Directly Remunerated Service 8) ENWL shares the benefits of participation in the balancing market with its customers and has returned £5.22m to customers up to June 2022. The revenues it has retained will have helped fund the BAU rollout of the technology to 78% of its primary substations but can also contribute to additional returns for the company.
- 27 The Panel views the CLASS project as having GB-wide benefits that are, in its view, exceptional. Ofgem in its impact assessment anticipates CLASS delivering net savings across industry of between £0.9bn and £1.2bn over the next 30 years. It also helps accelerate the development of a low carbon energy sector.
- 28 The Panel notes that in 2018 SSEN were awarded an STR reward of £300k for My Electric Avenue. In the Panel's view, CLASS has had a more significant GB impact having shaped DNO involvement in ancillary services but, on the other hand, the structure of those services does already allow ENWL to benefit financially from providing them. On balance the Panel's view is that the same level of reward would be appropriate for ENWL as was awarded to SSEN.
- 29 The Panel therefore recommends an STR reward of £300k to ENWL for CLASS.

Annex: Summary of criteria from Ofgem's Guidance

Criterion A is about exceptional performance of a project against one or more of the following Detailed Criteria:

- i. Accelerated the development of a low carbon energy sector and has delivered net financial benefits to future and/or existing customers, and/or
- ii. Value for money provided to distribution customers in the delivery of the Project, and/or
- iii. Sharing of knowledge amongst all DNOs, and/or
- iv. Relevance and timing of the project, and/or
- v. Demonstration of a robust methodology and that the Project is ready to implement.

Criterion B is "To invest the DNO's own money (over and above any compulsory funding) to enable the project to be successfully delivered".

Criterion C is "To undertake exceptional effort to ensure the projects exceeds the expected delivery outcomes and the learning from the project is maximised for the good of all DNO customers".

The guidance places a particularly strong weight on criterion A.