



All Electricity Distributors

*Promoting choice and value for
all gas and electricity customers*

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Date: 28 April 2010

Dear Colleague,

Low Carbon Networks (LCN) Fund: Notice under Charge Restriction Condition (CRC) 13 of the Electricity Distribution Licence with respect to the LCN Fund Governance Document.

This letter constitutes formal notice under CRC 13 of the Electricity Distribution Licence of Ofgem's intent to issue version 2 of the LCN Fund Governance Document for purposes connected with the regulation, governance and administration of the LCN Fund. A draft of the document is appended to this letter. **Representations or objections to this Notice should be made to Ofgem on or before Friday 28 May 2010. Representations or objections that are received and not withdrawn will be considered by Ofgem prior to the document coming into effect on 4 June 2010.**

On 1 April 2010 we published version 1 of the LCN Fund Governance Document, which covered the arrangements relating to the First Tier Funding Mechanism. Version 2 incorporates the following changes:

- we have added a new section covering the Initial Screening Process (ISP) for the Second Tier Funding Mechanism;
- we have amended the default position on intellectual property rights (IPRs) so that royalty free licences for IPRs developed as a result of an LCN Fund project must be provided to all other electricity distributors for use on their distribution systems¹; and
- we have made minor modifications to the First Tier Funding Mechanism text to reflect comments received following the Notice to publish version 1 of the document; to extend the confidentiality clause to cover the distribution network operator (DNO) or its external collaborators facing commercial harm, and to extend the definition of First Tier Project Expenditure to cover maintenance costs and equipment that is licensed to the DNO.

Through the Second Tier of the LCN Fund we will be making up to £320m available to fund large flagship projects over the 2010 to 2015 period. Funding will be awarded to DNO sponsored projects that are successful in an annual competition. The first stage of the Second Tier Funding process is the ISP in which Ofgem will review summary project proposals to judge whether the projects are eligible for funding, and therefore can be considered in the second stage of the process. Only projects that pass the ISP can be submitted for the next stage which involves an Expert Panel evaluating full project submissions. The Expert Panel will make recommendations to the Authority on which projects should be awarded funding, and the Authority will then decide which projects will be funded.

¹ Our rationale for this is set out in Appendix 1 of this Notice.

The purpose of ISP is to reduce the risk DNOs face when developing projects by providing an early indication of which projects are eligible for funding, thereby limiting the costs a DNO might incur in developing and proposing an "ineligible" project. The design of the ISP has been informed by the responses we received to our consultation dated 24 February 2010; a summary of which is included as Appendix 2 to this Notice. We have also found valuable the comments made by participants at the LCN Fund stakeholder workshop we held at our offices on 30 March 2010².

The third version of the LCN Governance Document will be published in June, and will cover the remainder of the arrangements for the Second Tier and Discretionary Funding Mechanisms³.

Representations or objections to this Notice should be made to anna.rossington@ofgem.gov.uk on or before Friday 28 May 2010. Responses will be published on Ofgem's website unless marked as confidential.

Yours faithfully,



**Rachel Fletcher
Partner, Distribution
For and on behalf of the Gas and Electricity Markets Authority**

² A summary of the workshop discussions is available on the Ofgem website at: <http://www.ofgem.gov.uk/Networks/ElecDist/lcnf/Documents1/Low%20Carbon%20Networks%20Fund%20Workshop%20Notes.pdf>

³ The Discretionary Funding Mechanism enables Ofgem to reward up to £100m over the five year period for successful delivery and to projects that bring particular value in helping the DNOs understand what investment, commercial arrangements and operating strategies they should be putting in place to provide security of supply at value for money for future network users, while doing all they can to tackle climate change

Appendix 1: Reasons for expanding the default option for IPRs

One of the main purposes of the LCN Fund is to generate new learning that can be shared across the GB distribution networks so that all customers can benefit from these trials. It is therefore important that customers of independent network operators (IDNOs) are not excluded.

IDNOs are not subject to the price control arrangements under which the LCN Fund was established, and therefore cannot submit projects for funding. However they can partner with a DNO on a project funded through the LCN Fund, and should also be able to implement learning generated from LCN Fund projects. It is therefore important that the IPR arrangements do not restrict this.

In version 2 of the LCN Fund Governance Document we have therefore amended the First Tier Funding Mechanism text so that the default option for IPRs developed as a result of a project funded through the LCN Fund is that royalty free licences for the IPRs must be provided to all other electricity distributors (which includes both DNOs and IDNOs) for use on their distribution systems.

We have used the same default option in the new ISP section.

Appendix 2: Responses to the consultation in relation to aspects of the LCN Fund

On 24 February 2010, we invited views on four questions relating to aspects of the LCN Fund:

1. The criteria we might use in screening projects for inclusion in the annual competition for Second Tier funding;
2. The evaluation criteria we might use in assessing which project proposals receive Second Tier Funding;
3. The arrangements we should put in place regarding the treatment of Intellectual Property Rights (IPRs); and
4. The criteria we might use to allocate the Discretionary Reward.

We received 12 responses in total, which included seven from DNOs and five from other interested parties. The non confidential responses are appended to this letter. The responses are summarised below, by question.

1) The criteria we might use in screening projects for inclusion in the annual competition for second criteria

Generally, most respondents felt that the criteria used for screening should be broad, transparent and inclusive, therefore supporting the criteria suggested at the LCN workshop held by Ofgem on 30 March 2010. One respondent stated the criteria should not be absolute in nature another requested projects that are very strong in one or two areas are not precluded.

An additional criterion of "additionality" was suggested by one respondent who felt it was essential to ensure only projects which would not occur without additional funding are awarded money.

Two respondents asked for feedback to be incorporated into the screening process to improve future submissions.

2) The evaluation criteria we might use in assessing which project proposals receive second tier funding

Most DNO responses requested that the evaluation criteria set to assess projects are broad and relaxed and allow the Expert Panel/Authority to make informed judgements on the most suitable projects. One respondent felt a question and answer session between the DNO and the Expert Panel/Authority would benefit the evaluation process.

One respondent disagreed with evaluating projects based on its "formulaic carbon benefit" and another noted that the evaluation of any project should recognise the societal benefits in addition to the tangible carbon savings.

One response asked if funding from subsequent years could be utilised if there were more suitable projects than funds available in the first year.

3) The arrangements we should put in place regarding the treatment of IPRs

Most of the respondents (both DNOs and other parties) felt that IPRs did not constitute a significant problem and stressed time should not unduly be spent on the issue. Of these, three respondents felt that Ofgem should produce a standard "preferred" document for IPRs and allow the Expert Panel/Authority to judge the merits of any non-standard agreement. Others stressed that any approach outlined should refrain from being too onerous as this may hamper innovation.

One respondent suggested the Innovation Funding Incentive (IFI) approach to IPR was appropriate and should be adopted for the Second Tier.

4) The criteria we might use to allocate the Discretionary Reward

There were generally high levels of support for the Discretionary Reward mechanism, although one respondent felt it was not a useful way of utilising consumer funds as ample projects would be proposed in spite of a reward. Most felt that the criteria for the reward should be broad and most importantly transparent.

Four respondents felt the Discretionary Reward should reward two separate aspects of the projects. Firstly, projects that have successfully delivered against set project milestones should recover the funding spent by the DNO and secondly a "best in class project/s" should be rewarded for providing exceptional learning dissemination.

Three respondents felt that projects which had "failed" but have provided valuable learning opportunities should not be discounted from the Discretionary Reward. Two respondents felt that the Discretionary Reward should only apply to Second Tier projects and another felt that rewards should be larger for projects that began at the start of the Second Tier process, as these are likely to be riskier.

One respondent questioned whether the reward would be received at the end of the entire process or on a yearly basis.