



Promoting choice and value  
for all gas and electricity customers



## LCN Fund Governance Document v.4

**Document Type:** Governance Document

**Date of Publication:** 1 April 2011

---

**Target Audience:** Electricity distribution network operators (DNOs), independent distribution network operators (IDNOs), distributed generators, electricity suppliers and other interested parties

---

### Overview:

This document is version 4 of the LCN Fund Governance Document referred to at Charge Restriction Condition (CRC) 13 of the Electricity Distribution Licence.

It sets out all the regulation, governance and administration of the Low Carbon Networks (LCN) Fund.

---

**Contact name and details:** Anna Rossington, Head of Distribution Policy

**Tel:** 020 7901 7401

**Email:** [anna.rossington@ofgem.gov.uk](mailto:anna.rossington@ofgem.gov.uk)

**Team:** Local Grids and RPI-X@20, Electricity Distribution

## Context

In December 2009, we published our Final Proposals for the Distribution Price Control Review (DPCR5). One of the key proposals of the price control was to establish the Low Carbon Networks (LCN) Fund to encourage the distribution network operators (DNOs) to use the DPCR5 period (1 April 2010 to 31 March 2015) to prepare for their role in the low carbon economy. As part of the DPCR5 process we consulted on the LCN Fund proposal extensively, and included an Impact Assessment in our Initial Proposals published in August 2009.

The DPCR5 Final Proposals came into effect on 1 April 2010.

This document is version 4 of the LCN Fund Governance Document and sets out the regulation, governance and administration of all aspects of the LCN Fund.

This document is issued by the Authority under Part E (The LCN Fund Governance Document) of Charge Restriction Condition (CRC) 13 of the Electricity Distribution Licence and in accordance with Part F (Procedure for issuing the LCN Fund Governance Document) of CRC 13. This document may be revised and re-issued by the Authority in accordance with Part E of CRC 13.

The DNOs are required by CRC 13 to comply with this document as if it formed part of the licence. However we have attempted to make this document accessible and informative to parties other than the DNOs; especially those who may be looking to partner with the DNOs to use the LCN Fund to try out new technology or commercial arrangements.

## Associated Documents

- Electricity Act 1989
- Electricity Distribution Licence Standard Conditions
- Electricity Distribution Licence Charge Restriction Conditions (as applicable to each DNO)
- Electricity Distribution Price Control Review. Final Proposals - Incentives and Obligations (145/09), December 2009

## Table of Contents

<b>1. Introduction .....</b>	<b>1</b>
<b>2. Facilitation of potential Project Partners' awareness .....</b>	<b>5</b>
<b>SECTION ONE - First Tier Funding Mechanism .....</b>	<b>7</b>
1. Introduction .....	8
2. First Tier LCN Project .....	9
3. Allowable First Tier Expenditure .....	17
4. Annual regulatory reporting for First Tier LCN Projects .....	23
5. Knowledge transfer .....	24
6. First Tier LCN Project audits .....	27
<b>SECTION TWO - Second Tier Funding Mechanism .....</b>	<b>28</b>
1. Introduction .....	29
2. Initial Screening Process.....	32
3. Full Submission .....	40
<b>SECTION THREE - Discretionary Funding Mechanism.....</b>	<b>61</b>
1. Introduction .....	62
2. First Tier Portfolio Reward.....	63
3. Second Tier Reward .....	64
4. Second Tier Successful Delivery Reward .....	65
<b>SECTION FOUR - Funding Direction .....</b>	<b>66</b>
<b>SECTION FIVE - Intellectual Property Rights .....</b>	<b>67</b>
1. Introduction .....	68
2. Default IPR conditions .....	69
3. Royalties .....	72
<b>SECTION SIX - Two Year Review .....</b>	<b>73</b>
<b>SECTION SEVEN - Definitions .....</b>	<b>74</b>
<b>Appendices .....</b>	<b>84</b>
<b>Appendix 1 – The Authority’s Powers and Duties .....</b>	<b>85</b>
<b>Appendix 2 - Glossary.....</b>	<b>87</b>

## 1. Introduction

### The Low Carbon Networks Fund

1.1. In the Final Proposals of the electricity Distribution Price Control Review (DPCR5)<sup>1</sup>, we proposed a £500m Low Carbon Networks (LCN) Fund to encourage the DNOs to use the DPCR5 period (1 April 2010 to 31 March 2015) to try out new technology, operating and commercial arrangements. The objective of these trials and demonstration projects is to help all DNOs understand how they can provide security of supply at value for money as Great Britain (GB) moves to a low carbon economy, and what role they could play in facilitating the low carbon and energy saving initiatives that are underway to tackle climate change.

1.2. Our objective in designing the LCN Fund was to try to replicate the incentives on unregulated companies to innovate. Companies competing in unregulated markets that innovate successfully are able to capture the benefits of that innovation. Regulated businesses – such as the DNOs – have argued that they may incur the costs if expenditure on innovation fails (as it may not be allowed by regulators) and/or that they will not capture the full benefits of successful innovation as it will be fully or partially clawed back at subsequent price control reviews.

1.3. In the LCN Fund we will seek to use the discretionary reward to imitate the commercial benefits of innovation by rewarding DNOs for successful innovation by relating these rewards to the risks that their shareholders have borne (relative to customers) and the benefits associated with that innovation and any learning arising from it. This will not, typically, give rise to the same level of rewards that unregulated companies enjoy with successful innovation because under the LCN Fund DNOs will typically only fund 10 per cent of the expected costs with customers funding the other 90 per cent.

1.4. A key feature of the LCN Fund is the requirement that learning gained from projects can be disseminated, in order that customers gain significant return on their funding through the roll-out of successful trials and the subsequent network savings and/or carbon benefits.

1.5. The future use of the electricity distribution networks could change considerably with the increased take-up of low carbon initiatives such as distributed generation (DG), demand side management (DSM), electric space heating, electric vehicles and electricity storage. This could require significant changes to the way the networks are designed and operated, and the commercial role the DNOs play. For example, they may need to introduce more intelligence and automation onto the networks to make

---

<sup>1</sup> Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations - (Reference number: 145/09), December 2009.  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=348&refer=Networks/ElecDist/PriceCtrls/DPCR5>

sure they can adapt quickly to the changing pattern of network use and connect new users promptly without having to wait for new transformers or lines to be installed.

1.6. The DNOs may need to radically change the way they charge for access to their networks if customers (including domestic customers) change their patterns of use in response to smart metering and become customers and producers of electricity at different times of the day. DNOs' charges will need to reflect the costs (or cost savings) associated with very different patterns of use and encourage customers who have control over their demand to use more at times of the day when there is spare network capacity to avoid the need for expensive network investment in new capacity. DNOs may also increasingly enter into contracts with DG and large electricity users (or with suppliers who then aggregate demand from smaller and domestic customer) to vary their use of the network where there are constraints.

1.7. DNOs also have the opportunity to enhance the business case for low carbon technologies (such as renewable generation) by capturing the benefits on their network of DSM and active network management. Advances in information and communications technology (with dramatic reductions in the cost of these technologies) and the new data that will become available through smart meters could enable the DNOs to run the networks more efficiently and in a way that is better able to respond flexibly given that there is uncertainty over how quickly and to what extent the take-up of low carbon initiatives will happen.

1.8. The LCN Fund will enable the DNOs to run trials to explore which technologies, charging, commercial and operating arrangements are likely to provide best value for money for network users while helping to tackle climate change. We anticipate that the projects may highlight the regulatory and legal changes that may be needed to ensure that the networks can meet the needs of users into the future. We expect that these trials will help to inform the business plans that the DNOs submit to us at the time of the next price control review.

1.9. The LCN Fund consists of two tiers. DNOs are able to use First Tier Funding to recover a proportion of expenditure incurred on small scale projects and to recover expenditure incurred to put in place the people, resources and processes to progress innovative projects. The total expenditure that a DNO can recover from First Tier Funding is subject to an annual limit.

1.10. The Second Tier Funding Mechanism provides total funding of up to £320m over the five years for a small number of significant 'flagship' projects. Ofgem will hold an annual competition for project funding and the DNOs will compete against each other for an allocation of the funds. The annual process will start with DNOs putting forward outline project proposals in the Initial Screening Process (ISP) for Ofgem to assess whether they meet the Eligibility Requirements. This will be followed by the annual call for, and submission of, full proposals.

1.11. A Discretionary Funding Mechanism worth £100m over the five year period enables Ofgem to reward successful delivery and 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.

1.12. We have modified the standard conditions and the charge restriction conditions (CRCs) of the Electricity Distribution Licence in order to enable the creation of the LCN Fund. CRC 13 relates specifically to the LCN Fund, and sets out the arrangements for how it is funded through the DNO use of system charges and also other matters relating to the LCN Fund arrangements.

## **The LCN Fund Governance Document**

1.13. This document is the LCN Fund Governance Document and sets out the regulation, governance and administration of the LCN Fund.

1.14. This is the fourth version of the LCN Governance Fund Document and has been issued following a review of the first year LCN Fund operation.

1.15. In this document we use the term DNO to refer to entities that are termed distribution service providers (DSPs) in the Electricity Distribution Licence. We have used the term DNO here in order to make the document easier to read. We also use the term Electricity Distributors to refer collectively to DNOs and independent DNOs.

1.16. In this document we use the terms Ofgem and the Authority interchangeably. Ofgem is the Office of the Gas and Electricity Markets Authority.

1.17. Defined terms are capitalised throughout the text, with the definitions set out in Section Seven.

1.18. Throughout this document we use the terms Project, Trial, Method, Problem and Solution.

- Problem: means the issue that needs to be resolved in order to facilitate the low carbon future,
- Method: means the way of solving the Problem,
- Trial: means a limited, controlled and monitored test to demonstrate/prove that the Method works,
- Project: means the Trial or group of Trials being proposed or undertaken, and
- Solution: means the outcome if the Problem is solved.

1.19. A Project could involve multiple Trials, where each Trial is testing a different Method.

1.20. A hypothetical example could be the challenge of multiple electric vehicles (EV) connecting in one street. The Problem would be insufficient capacity network

capacity to allow all the EVs to be charged at times of high demand. The Solution would be the connection of multiple neighbouring EVs without network reinforcement. A Method could be using time of use tariffs to stagger the charging times of the EVs. There might be a number of Trials to test the responsiveness of customers to different tariffs, and whether sufficient offset could be achieved to prevent the need for reinforcement. The Project would be the combination of the separate Trials.

1.21. All paragraph and chapter references contained in this document refer to the paragraphs and chapters contained within the same section unless it is explicitly stated otherwise.

## **Compliance**

1.22. The LCN Fund and this LCN Fund Governance Document in no way relieves affected parties, including DNOs and Project Partners, from their responsibility to ensure ongoing compliance with legislation including competition, environment and consumer protection laws.

1.23. Any DNO and Project Partners may use the LCN Fund logo (as provided by Ofgem) for purposes associated with a Project funded through the LCN Fund, but must not use the Ofgem or Ofgem E-Serve logo in any circumstances..

---

## 2. Facilitation of potential Project Partners' awareness

2.1. We expect DNOs to collaborate with each other and non-DNO parties (Project Partners) on many of the projects supported by the LCN Fund. DNOs are likely to have to work closely with other parties in the electricity supply chain (from generators to suppliers) to explore what technology or commercial arrangements best address changes in network use and what role they can play in facilitating low carbon and energy saving initiatives such as DSM and DG. Similarly, DNOs may benefit from the technologies used and lessons learned in other industries, including the telecoms and information technology sectors, in which case partnerships with technology providers and others outside the energy industry will be valuable. Other parties such as local authorities may be carrying out pilot studies (for example into electric vehicles or zero carbon homes) and these could offer opportunities for DNOs to get a better understanding of how to respond to these developments.

2.2. The DNOs have established an area on the website of the Energy Networks Association (ENA) through which external parties can bring forward ideas to the DNOs for LCN Fund projects<sup>2</sup>. We expect the DNOs to work collaboratively to maintain this website so that it includes the following minimum functionalities at all times.

- Links to the Ofgem website to allow direct access to this LCN Fund Governance Document and published information from First Tier and Second Tier projects. A place where potential Project Partners can record their name, contact details and a brief summary of their business so that DNOs can look for potential Project Partners for LCN Projects.
- A contact point for potential Project Partners to submit Project ideas that conform to the eligibility criteria for a First Tier LCN Project or the Eligibility Requirements or a Second Tier project. The contact point must ensure that the Project idea is sent to a nominated party at each DNO group that is responsible for reviewing each Project idea. A copy will also be submitted to Ofgem.
- A place where a DNO can also record its suggested Projects if it wishes to attract potential Project Partners.

2.3. We expect DNOs to work collaboratively to annually review this website and make appropriate changes to improve its accessibility and content. We expect this review to be informed by stakeholder consultation on the quality of information provided and the usability of the website.

2.4. Expenditure incurred in complying with this condition can form part of the First Tier Allowable Set-up Expenditure (which is detailed further in paragraph 3.5 in Section One).

---

<sup>2</sup> <http://www.ena-eng.org/lcn/Home.aspx>



2.5. This service is not intended to provide any constraint on, or specify the mechanism as to how a DNO will select Project Partners, nor should it be used as the sole basis upon which an award of a contract for services provided by a Project Partner in return for consideration should be made. It is for the DNO to ensure that its actions, in this regard, comply with any applicable procurement rules.

---

## SECTION ONE - First Tier Funding Mechanism

<b>1. Introduction .....</b>	<b>8</b>
<b>2. First Tier LCN Project.....</b>	<b>9</b>
Background.....	9
Specific Requirements .....	9
Registration process.....	12
<b>3. Allowable First Tier Expenditure.....</b>	<b>17</b>
Allowable Set-up Expenditure .....	17
Allowable First Tier Project Expenditure .....	18
<b>4. Annual regulatory reporting for First Tier LCN Projects.....</b>	<b>23</b>
<b>5. Knowledge transfer .....</b>	<b>24</b>
Close-Down Report .....	24
Annual conference .....	26
<b>6. First Tier LCN Project audits .....</b>	<b>27</b>

## 1. Introduction

1.1. The First Tier Funding Mechanism provides limited funding to each DNO to use for two purposes:

- To put in place the people, resources and processes to design, develop and implement innovative projects (whether funded under the First Tier or the Second Tier of the LCN Fund or through other means), and/or
- To fund small scale projects which meet the criteria set out in this Governance Document.

1.2. The limit of funding available to each DNO under the First Tier Funding Mechanism is set out in Appendix 1 of CRC 13. It is intended that this value is large enough to fund a reasonable number of smaller projects, but small enough to allow less intrusive, 'arms length' Ofgem review.

---

## 2. First Tier LCN Project

2.1. This chapter sets out the requirements for a Project to qualify as a First Tier LCN Project.

### Background

2.2. The First Tier Funding Mechanism should be used to explore technologies, commercial and Distribution System operating arrangements that will facilitate GB's transition to a low carbon economy. There will be no initial requirement for a DNO's First Tier Project portfolio to contain a specific percentage split between different types of Method and Solutions. However, it is likely that we will achieve the maximum learning for the industry if the Projects funded across all DNOs cover a broad range of Methods and Solutions. Therefore, if at the Two Year Review (explained further in Section Six) there is a strong bias towards one type of Method and Solution, Ofgem may decide to specify the balance between types of Projects to be funded through the First Tier Funding Mechanism for the remainder of DPCR5.

2.3. There is no minimum or maximum size for a First Tier LCN Project<sup>3</sup>. First Tier LCN Projects should not last more than three years. Therefore, a DNO cannot recover any expenditure that is incurred more than three years after Registration from the First Tier Funding Mechanism.

### Specific Requirements

2.4. There are two sets of criteria (Specific Requirements) that a Project must meet if it is to qualify as a First Tier LCN Project. DNOs must demonstrate within their Project Eligibility Assessment (PEA) how their First Tier LCN Fund Project meets these criteria (as set out in paragraph 2.23).

#### Specific Requirements set 1

2.5. A First Tier LCN Project must involve the trialling on the Distribution System of at least one of the following:

- A specific piece of new (i.e. unproven in GB) equipment (including control and communications systems and software) that has a Direct Impact on the Distribution System,
- A novel arrangement or application of existing Distribution System equipment (including control and communications systems and software),
- A novel operational practice directly related to the operation of the Distribution System, or
- A novel commercial arrangement with a Distribution System User.

---

<sup>3</sup> Although First Tier Funding is subject to each DNO's First Tier LCN Allowance, as explained in Chapter 3.

**Specific Requirements set 2**

2.6. In addition, a First Tier LCN Project must meet all of the requirements described below.

**(a) Accelerates the development of a low carbon energy sector**

2.7. The Solution associated with the First Tier LCN Project must make a contribution to the UK's current strategy to reduce greenhouse gas emissions as set out in the document entitled "The Low Carbon Transition Plan", as published by the Department of Energy and Climate Change (DECC)<sup>4</sup>. Where this document is amended or replaced by the Government, Ofgem will notify the DNOs of any changes in writing.

2.8. In outlining the expected contribution of the Project, DNOs must provide a description of the following:

- The aspect(s) of the Low Carbon Transition Plan which the Solution(s) facilitate,
- The contribution the roll out of the Method(s) across GB can play in facilitating this aspect(s) of the Low Carbon Transition Plan,
- How the roll out of the Method(s) across GB will deliver the Solution(s) more quickly than the most efficient method currently in use on the GB Distribution System,
- The potential for replication of the Method across GB in terms of the number of sites, or the percentage of the GB Distribution System where it could be rolled out. The DNO should use this to outline the potential carbon contribution the roll out of the Method(s) can make.

2.9. To reduce carbon in the energy sector, the Low Carbon Transition Plan considers that electricity use may increase. A Solution may involve facilitating the use of electricity instead of an alternative higher carbon energy source.

**(b) Has the potential to deliver net financial benefits to existing and/or future customers**

2.10. There must be a clear expectation and evidence that the Method being trialled has the potential to deliver the Solution at a lower cost than the most efficient Method currently in use on GB Distribution Systems.

2.11. A DNO must estimate the costs of delivering the Solution (at the scale being tested within the Project) through the most efficient Method currently in use on GB Distribution Systems - the Base Case Costs. DNOs must compare the Base Case Costs to the costs of replicating the Method, at the scale being tested in the Project,

---

<sup>4</sup> The UK Low Carbon Transition Plan: National Strategy for Climate & Energy July 2009. [http://www.decc.gov.uk/en/content/cms/publications/lc\\_trans\\_plan/lc\\_trans\\_plan.aspx](http://www.decc.gov.uk/en/content/cms/publications/lc_trans_plan/lc_trans_plan.aspx)

once it has been proven successful - the Method Costs. The difference between the Base Case Cost and the Method Costs is the financial benefit of the Project.

2.12. DNOs must also detail how replicable the Method is across GB in terms of the number of sites, or the percentage of GB Distribution Systems, where it could be rolled out. In addition DNOs must provide an outline of the costs of rolling out the Method across GB.

**(c) Has a Direct Impact on the operation of a DNO's Distribution System**

2.13. The Project Method that a First Tier LCN Project is trialling must have a Direct Impact on the operation of a DNO's Distribution System. If a First Tier LCN Project is halted, then Allowable First Tier Project Expenditure (described in paragraphs 3.6 to 3.20) incurred to date will still be eligible for LCN funding even if the Project has not yet had a Direct Impact on the operation of a DNO's Distribution System.

**(d) Generates new knowledge that can be shared amongst all DNOs**

2.14. One of the main purposes of the LCN Fund is to allow learning to be shared amongst the DNOs. The First Tier LCN Project must therefore be expected to generate new knowledge that can be shared amongst all DNOs. This will be assisted by each DNO's knowledge transfer strategies (see chapter 5).

2.15. We recognise that a Project may generate intellectual property rights (IPR), either for the DNO or for any Project Partners (whether for both or jointly) and have set out the default treatment for IPR in Section Five.

2.16. If, for a specific First Tier LCN Project, a DNO wishes to deviate from the default IPR conditions, it will have to get approval from Ofgem at Registration (set out in paragraphs 2.23 to 2.30). For the request to be approved the DNO will have to demonstrate that: a) where a Project Partner does not accept the default requirement for IPR, the Project requires a Project Partner, and that despite using reasonable endeavours the DNO has not been able to find an alternative Project Partner that is willing to accept the default conditions; and b) the Method has a sufficiently large expected net financial benefit that it will still be expected to deliver value to existing and/or future customers, even if IPR are not shared.

**(e) Focuses on network Methods that are at the trialling stage**

2.17. The LCN Fund is specifically targeted at Projects that a DNO would not perform in its normal course of business. The First Tier LCN Project must have a Technology Readiness Level (TRL)<sup>5</sup> of between 5 and 8. TRL 9 is excluded, as it offers limited

---

<sup>5</sup> TRL is a measure used to assess the maturity of evolving technologies. It is graded on a scale from 1 to 9 where TRL 1 is where scientific research begins to be translated into applied research and development and TRL 9 is a proven technology. In this document we use the TRL to refer to the total Project, or combination of technologies being trialled, rather than the TRL

scope for new knowledge to be generated and is too low risk. This also prevents the widespread deployment of a technology being funded under the First Tier Funding Mechanism. It should be noted that Projects that have a TRL of 4 and below are considered research and development (R&D), which will often be eligible for funding under the existing Innovation Funding Incentive (IFI).

2.18. For Projects that involve a commercial or contractual Method, it may not be possible to identify the TRL of the Project. In such cases, the Project is exempt from meeting this requirement.

#### **(f) Does not lead to unnecessary duplication**

2.19. A First Tier LCN Project must not unnecessarily duplicate other First Tier and Second Tier LCN Projects already Registered by the DNO group.

2.20. Unnecessary duplication is likely to occur if the new First Tier LCN Project is not expected to lead to recognised new learning. Projects that address the same Problem, but use a different Method, will not be considered as unnecessary duplicates. Projects that are at different TRLs will not be considered as unnecessary duplicates.

2.21. Ofgem will monitor the degree of First Tier LCN Project duplication across the DNOs. If, at the Two Year Review, Ofgem deems that there has been excessive unnecessary duplication across the DNOs, then Ofgem may set up a process for disallowing such duplication in future years.

#### **Documentation**

2.22. Before Registration of a First Tier LCN Project with Ofgem, a DNO must produce a PEA, demonstrating that the Project meets the Specific Requirements set out in paragraphs 3.5 to 3.22. This assessment does not need to be submitted to Ofgem at Registration, but it should be made available to Ofgem upon request.

#### **Registration process**

2.23. In order for a Project to be eligible for funding it must be Registered with Ofgem.

---

of any individual component. This means that existing technology (with a TRL of 9) could be employed in a novel way, thereby giving a TRL of the trial of less than 9. The definitions of the TRLs are set out in UK Low Carbon Energy Technology Strategy: September 2008 available at [http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/lc\\_uk/lc\\_business/env\\_trans\\_fund/env\\_trans\\_fund.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/lc_business/env_trans_fund/env_trans_fund.aspx)

---

2.24. The Registration process does not involve Ofgem approving Projects. However, we have identified three circumstances where a DNO must seek approval from Ofgem to Register a Project if:

- It is requesting a derogation from the default conditions for IPR set out in Section Five;
- It intends to make payments to itself or to Related Undertakings as set out in paragraph 3.10; or
- It wishes any of the information required to be included in the LCN First Tier Project Registration Pro-forma to be withheld from the Ofgem website for reasons of commercial confidentiality and can demonstrate that it (or Project Partners) will face commercial harm from disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

2.25. Ofgem will review these submissions and only provide approval where it judges that a satisfactory justification has been supplied. Ofgem will undertake this review and respond to the request within twenty Working Days of receipt of the properly completed First Tier LCN Project Registration Pro-forma. This period may be extended for Projects that require IPR approval.

2.26. If the DNO is not seeking approval to Register a Project for one of the reasons identified above, the Project will be Registered on confirmation by Ofgem of receipt of the properly completed LCN First Tier Project Registration Pro-forma. Ofgem will use reasonable endeavours to confirm receipt of the submission within five Working Days.

2.27. A Project can be submitted for registration with Ofgem at any time during the Regulatory Year. Projects must start in the same Regulatory Year that they are registered, except where Ofgem has confirmed Registration within twenty Working Days of the end of the Regulatory Year, in which case the Project may start in the subsequent year.

2.28. Projects must not be started until Ofgem has confirmed Registration.

2.29. A DNO can still register a First Tier LCN Project even if it does not expect to incur any Allowable First Tier Project Expenditure. In doing so, it will still be eligible to receive Allowable First Tier Project Expenditure if the outturn costs and benefits are different from expectation.

2.30. A DNO will provide the information required for Registration set out in Table 2.1 below by completing the First Tier LCN Project Registration Pro-forma as provided by Ofgem.



**Table 2.1: Information required for the Registration of First Tier LCN Projects**

<b>Information required</b>	<b>Description</b>
Project title	
Participant DNOs	Where the Project is a collaboration between DNOs, the collaborating DNOs should be identified here, along with the Lead DNO
Problem(s)	This should outline the Problem(s) which is being addressed by the Project.
Method(s)	This section should set out the Method or Methods that will be trialled in order to solve the Problem. The type of Method should be identified where possible e.g. technical or commercial.
Scope and objectives	The scope and objectives of the Project should be clearly defined including the benefits which should directly accrue to the Distribution System.
Success criteria	Details of how the DNO will evaluate whether the Project has been successful.
TRL(s)	The TRL(s) of the Method(s) should be stated.
Predicted end date	DNOs should provide an estimate of the expected completion date for the Project.
Project Partners and external funding	Details of actual or potential Project Partners and External Funding support as appropriate.
Potential for new learning	Detail what the parties hope to learn and how the learning will be disseminated.
Risks	The DNO should highlight any material, known risks that could impact the Project's cost and/or programme.
Scale of Project	A DNO should justify the scale of the Project. In particular, it should explain why there would be less potential for new learning if the Project were of a smaller scale.
Geographical area	Details of where the Trial(s) will take place. If the Project is a collaboration, the DNO area(s) in which the Trial(s) takes place should be identified.
Revenue allowed for in the DPCR5 settlement	An indication of the revenue allowed for within the DPCR5 settlement <sup>6</sup> that is likely to be saved as a result of the Project.
Indicative total Allowable First Tier Project Expenditure	An indication of the total Allowable First Tier Project Expenditure that the DNO expects to reclaim for the whole of the Project.
Related Undertakings	The DNO must set out all payments that it proposes to make to itself or any Related Undertaking. Further, if a payment is to be made to any Related Undertaking that is a Distribution System User, the DNO must demonstrate that it

<sup>6</sup> This is the revenue included in the DNOs' Full Business Plan Questionnaire (FBPQ) for DPCR5

Information required	Description
	has offered the same terms to similar Distribution System Users on the part of the network that is within the Project boundary and has used reasonable endeavours to identify such Users.
IPR arrangements	The DNO should indicate if the Project does not conform to the default IPR conditions. A justification for alternative arrangements and why the Project should still be approved must be provided, in accordance with paragraph 2.18.

### **Publication of the First Tier LCN Project Registration Pro-forma**

2.31. The DNO must identify any information in the completed First Tier LCN Project Registration Pro-forma that it does not consent to being published in full. It must demonstrate that it (or its Project Partners) will face commercial harm from its disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

2.32. All information submitted within the First Tier LCN Project Registration Pro-forma will be made available on the Ofgem website, unless Ofgem has agreed otherwise as part of the Registration process set out above.

### **First Tier LCN Project Changes**

2.33. Once a First Tier LCN Project has been Registered, a DNO will not be able to change the following aspects of the Registered Project, as identified in the First Tier LCN Project Registration Pro-forma:

- Project title,
- Project background,
- Scope and objectives,
- Success criteria, and
- The IPR arrangements.

2.34. Further, although a DNO can reduce the level of payment that was registered to be made to a Related Undertaking, it cannot either increase the payment nor make a payment to an additional Related Undertaking without receiving approval from Ofgem.

2.35. However, if a DNO can demonstrate that there will be a benefit to changing other aspects of the Project (not listed in paragraph 2.33) based on learning once the Project has been started, it may make these changes once it has submitted a revision to the First Tier LCN Project Registration Pro-forma to Ofgem. This must

include an explanation of why the change has been made. For the avoidance of doubt, this change could include prematurely terminating the Project.

2.36. This information will be published unless Ofgem approves otherwise based on the DNO demonstrating that it (or its Project Partners) will face commercial harm from disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

### 3. Allowable First Tier Expenditure

3.1. There are two categories of expenditure that can be recovered from the First Tier Funding Mechanism of the LCN Fund. The first category is expenditure to put in place the people, resources and processes to progress innovative projects. This is set out in paragraph 3.5 below and is called Allowable Set-up Expenditure. The second category is to recover expenditure associated with undertaking First Tier LCN Projects. This is set out in paragraphs 3.6 to 3.22 below and is called Allowable First Tier Project Expenditure.

3.2. The sum of Allowable Set-up Expenditure and Allowable First Tier Project Expenditure is equal to Allowable First Tier Expenditure, as set out in CRC 13 and the formulae below. Allowable First Tier Expenditure that can be claimed from the First Tier Funding Mechanism must not exceed the overall limit set out in Appendix 1 of CRC 13 and is offered on a 'use it or lose it' basis in any individual year.

3.3. This is set out in the formulae below,

$$AE_t = \sum_{i=1}^n APE_{it} + ASE_t$$

subject to  $AE_t \leq L_{DNO}$

where

$AE_t$  is the Allowable First Tier Expenditure in Regulatory Year  $t$ .

$APE_{it}$  is the Allowable First Tier Project Expenditure for Project  $i$  in Regulatory Year  $t$ .

$ASE_t$  is the Allowable Set-up Expenditure in Regulatory Year  $t$ .

$L_{DNO}$  is the First Tier LCN Allowance for the given DNO as set out in Appendix 1 of CRC 13.

3.4. Funding is not provided on an upfront basis. Instead the DNO will adjust its Combined Allowed Distribution Network Revenue by the Allowable First Tier Expenditure incurred by it in that Regulatory Year. This calculation is undertaken each year on an ex post basis based on outturn expenditure.

#### Allowable Set-up Expenditure

3.5. A DNO can use up to a maximum of 20 per cent of its First Tier LCN Allowance (as set out in CRC 13) in any Regulatory Year to cover expenditure it incurs to put in

place the people, resources and processes to progress innovative Projects. This may include the costs of putting together bids for the Second Tier Funding Mechanism. This is called Allowable Set-up Expenditure. A DNO must be able to demonstrate that it has used the amount claimed under Allowable Set-up Expenditure for the purposes listed above.

## Allowable First Tier Project Expenditure

3.6. Expenditure incurred by the DNO as part of a Registered First Tier LCN Project can be recovered from the First Tier Funding Mechanism if it is Allowable First Tier Project Expenditure.

3.7. A DNO is required to fund a minimum of 10 per cent of the Project itself, meaning that a maximum of 90 per cent of Eligible First Tier DNO Expenditure can be recovered.

3.8. Allowable First Tier Project Expenditure is derived from the following formulae.

$$APE_{it} = \min(EDE_{it} - DPCR5_{it}, 0.9 \times EDE_{it})$$

where

$APE_{it}$  is the Allowable First Tier Project Expenditure for Project i in Regulatory Year t.

$DPCR5_{it}$  is the Revenue Allowed for in the DPCR5 Settlement for Project i in Regulatory Year t.

$EDE_{it}$  is the Eligible First Tier DNO Expenditure for Project i in Regulatory Year t, and is derived from the following formula:  $EDE_{it} = EPE_{it} - UPE_{it} - EF_{it}$

$$EDE_{it} = EPE_{it} - UPE_{it} - EF_{it}$$

where

$EPE_{it}$  is the Eligible First Tier Project Expenditure for Project i in Regulatory Year t.

$UPE_{it}$  is the Unrecoverable First Tier Project Expenditure for Project i in Regulatory Year t (as explained in paragraph 3.17).

$EF_{it}$  is the External First Tier Funding for Project  $i$  in Regulatory Year  $t$  (as explained in paragraph 3.21).

3.9. For expenditure on a First Tier LCN Project to be deemed to be Allowable First Tier Project Expenditure it must be incurred within three years of the date of Registration of the Project (since a First Tier LCN Project should not last longer than three years). A DNO undertaking a multi-year Project must claim Allowable First Tier Expenditure each year in the Regulatory Year in which it was incurred. However, for First Tier LCN Projects starting after 31 March 2012, the LCN Fund only provides guaranteed funding until 31 March 2015.

### **Eligible First Tier Project Expenditure**

3.10. Eligible First Tier Project Expenditure is expenditure on a First Tier LCN Project that is directly related to the distribution of electricity through the licensee's Distribution System, including the purchase of ancillary services that facilitate the distribution of electricity, subject to the restrictions set out in the rest of this condition.

1. If the expenditure relates to equipment (including control and communications systems and software) then:
  - It must be incurred in relation to the procurement, installation, operation, maintenance and decommissioning of equipment (including control and communications systems and software) owned solely by or licensed to the DNO,
  - It must be connected to and form part of the existing Distribution System assets owned or licensed to and operated by the DNO. Equipment (including control and communications systems and software) that is installed and owned by or licensed to the DNO solely for the purpose of gathering and analyzing data or sending or receiving control signals to assist in the control of the Distribution System will be deemed to be connected to and form part of the Distribution System where such equipment has a communications path to the Distribution System or analyzes data gathered from the Distribution System, and
  - It must not be related to the procurement, installation, operation and decommissioning of any device on any customer's premises that measures the consumption of electrical energy and provides such measurement data to a licensed electricity supplier.
2. If the expenditure involves payments to a Distribution System User to remunerate that User for the actions it takes as part of the First Tier LCN Project then:
  - All payments that are proposed to be made to any Related Undertaking must be declared at the time of Project Registration and will require approval from Ofgem before the Project can be Registered,
  - If a payment is made to any Related Undertaking that is a Distribution System User, the DNO must simultaneously offer the same terms to similar Distribution System Users of the part of the network that is within the Project boundary, and

have used reasonable endeavours to identify similar Distribution System Users, and

- The payment cannot be made directly to the DNO or affiliated DNOs undertaking the First Tier LCN Project, except to cover the marginal operating costs of running existing DNO owned generation or storage plants that are solely necessary for the purposes of the Project. Such marginal operating costs must be declared at the time of Project Registration and will require approval from Ofgem before the Project can be registered.

#### *Engagement with Customers*

3.11. It is recognised that access to a Customer's premises and the installation of DNO equipment at a Customer's premises may be required as part of a First Tier LCN Project.

3.12. Such access and installation of equipment will only be permissible if the DNO first notifies the customer's Electricity Supplier and then obtains the prior consent of the Customer, such consent needs to be formally recorded.

3.13. We expect DNOs to have regard to the smart meter roll-out in their area and to ensure that their First Tier LCN Projects do not interfere with the roll-out in any way. The DNOs must seek to coordinate with current or future roll-out plans and avoid any Customer confusion.

3.14. If the Project involves any interaction with a Customer (including contractual or charging arrangements) or Customer premises, the DNO must submit to Ofgem, at least two Calendar Months prior to initiating any Customer engagement, a plan of how it, or its Project Partners, will engage with, or impact upon, Customers as part of the Project. The DNO and its Project Partners cannot initiate any form of Customer engagement until the plan has been approved by the Authority, and must comply with the approved plan at all times. The plan must include:

- i. a communications strategy which set out inter alia:
  - any proposed interaction with a Customer or premises of a Customer; any proposed interruption to the supply of a Customer for the purposes of the Project, and how the Customer will be notified in advance;
  - ongoing communications with the Customers involved in the Project; and
  - arrangements for responding to Customer queries or complaints relating to the Project.
- ii. identification of any Priority Services Register Customers who will be involved in the Project and how they will be appropriately treated (including providing information to any person acting on behalf of a Priority Services Register Customer in accordance with condition 26 of the Electricity Supply Licence, where applicable);
- iii. details of any safety information that may be relevant to the Project; and

- iv. how the Customer will be provided with information (which should be identified as part of the Communications strategy) on how the equipment will be installed, how long it will be installed for and how it will be decommissioned.

3.15. The DNO and its Project Partners must not visit a premises of a Customer for sales or marketing activities in connection with, in the context of or otherwise under the guise of the Project.

#### *Data Protection*

3.16. If the Project involves the use of personal data (as defined in the Data Protection Act 1988) the DNO must submit a strategy for dealing with personal data to Ofgem at least two Calendar Months prior to collecting or using any personal data. The DNO and its Project Partners cannot collect or use any personal data until the strategy has been approved by the Authority. The strategy must set out the following:

- what personal data will be collected for the purposes of the Project;
- how this personal data will be used;
- how consent for use of the personal data will be obtained;
- what information will be provided to the Customer prior to consent being sought;
- if Priority Services Register Customers are included in the Project, how their personal data will be obtained;
- who owns the personal data;
- how long the personal data will be retained; and
- how this personal data will be managed (which should be based on a 'privacy by design' approach, as advocated by the Information Commissioner's Office<sup>7</sup>).

#### **Unrecoverable First Tier Project Expenditure**

3.17. Unrecoverable First Tier Project Expenditure cannot be recovered from Allowable First Tier Project Expenditure. Unrecoverable First Tier Project Expenditure is any Eligible First Tier Project Expenditure incurred in undertaking R&D activities, arising from a failure to conform to technical requirements or arising from an increase in payments associated with a reduction in standards of performance.

#### *R&D activities*

3.18. R&D expenditure incurred as part of a First Tier LCN Project is an Unrecoverable First Tier Project Expenditure as a) it is not trialling and b) it can potentially be recovered through the IFI. Any Projects which have a TRL of 4 or below will be considered R&D.

3.19. IFI funding does not place conditions on any IPR generated, whereas a First Tier LCN Project must conform to the default IPR conditions or any alternative

---

<sup>7</sup> See [http://www.ico.gov.uk/news/current\\_topics/privacy\\_by\\_design\\_conference.aspx](http://www.ico.gov.uk/news/current_topics/privacy_by_design_conference.aspx)



arrangements approved at Registration. If a mixture of the First Tier Funding Mechanism and IFI funding is used for a First Tier LCN Project, a DNO must still seek approval from Ofgem if it does not propose to conform to the requirements of paragraphs 2.15 to 2.16.

#### *Technical requirements and standards of performance*

3.20. Meeting the criteria for First Tier LCN Projects does not exempt a DNO from complying with its obligation to conform to all technical requirements or standards of performance. If a DNO wishes to seek a derogation from technical requirements or incentive schemes it must do so through the relevant existing mechanisms. Absent such derogation any increase in payments resulting from a reduction in performance that occurs through undertaking a First Tier LCN Project is deemed an Unrecoverable First Tier Project Expenditure.

#### **External First Tier Funding**

3.21. If a DNO receives funding from a Project Partner or External Funder that covers Eligible First Tier Project Expenditure that is not Unrecoverable First Tier Project Expenditure, it cannot be recovered from Allowable First Tier Project Expenditure.

#### **Revenue Allowed for within the DPCR5 settlement**

3.22. If revenue allowed for within the DPCR5 settlement<sup>8</sup> has been saved through undertaking the First Tier LCN Project, this must be used to cover the expenditure incurred on the First Tier LCN Project and so must be deducted from the Eligible First Tier DNO Expenditure.

---

<sup>8</sup> This is revenue included in the DNO's Full Business Plan Questionnaire (FBPQ) for DPCR5.

## 4. Annual regulatory reporting for First Tier LCN Projects

4.1. A DNO must report the required details for its First Tier LCN Projects as set out in Standard Licence Condition (SLC) 44C and the LCN Fund reporting instructions and guidance (RIGs).

---

## 5. Knowledge transfer

5.1. Facilitating knowledge transfer is one of the key aims of the LCN Fund. Learning should be shared among all DNOs.

5.2. There are three requirements relating to knowledge transfer set out in this document: the Close-Down Report and the annual conference described in this chapter and the treatment of IPR (as described in Section Five). A DNO should also seek other mechanisms to ensure effective dissemination of information and this may be subject to further incentives through the payment of discretionary rewards.

### Close-Down Report

#### Content

5.3. The DNO must provide a Close-Down Report for each First Tier LCN Fund Project that it registers. It needs to provide sufficient information for third parties to understand what has been learnt from the Project and should be sufficient to minimise the likelihood that other DNOs will unnecessarily duplicate the Project using the First Tier Funding Mechanism in future. If the First Tier LCN Project generates IPR that Ofgem has agreed at Registration do not need to be shared, the Close-Down Report must provide sufficient information for other DNOs to determine whether the IPR would be of value.

5.4. The DNO must submit its Close-Down Report to Ofgem within three Calendar Months of the expected Project completion date shown on the First Tier LCN Project Registration Pro-forma. If the Project is delayed, the DNO must inform Ofgem and provide the revised date for the submission of the Close-Down Report.

5.5. If a First Tier LCN Fund Project is halted, a Close-Down Report must be submitted for it within three Calendar Months.

5.6. If a First Tier LCN Fund Project extends beyond three years, a Close-Down Report must be provided three years after the date of Registration, even if the Project has not been completed unless Ofgem agrees otherwise. A further Close-Down Report will need to be submitted once the Project is completed.

5.7. For the avoidance of doubt, a Close-Down Report must still be provided even if the First Tier LCN Fund Project has not delivered its expected benefits.

5.8. A DNO must clearly identify any information contained in the Close-Down Report that it does not consent to being published in full. If Ofgem agrees that it has demonstrated that it (or its Project Partners) will face commercial harm from disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or the Environmental Information Regulations

2004, then the DNO must provide a non-confidential version of the Close-Down Report which will be published by Ofgem.

5.9. The Close-Down Report should include the following sections in the order that they appear below.

**Table 5.1: Information required in First Tier LCN Project Close-Down Reports**

<b>Section</b>	<b>Description</b>
Project Title	As per Registration
Project Background	As per Registration
Scope and objectives	As per Registration
Success criteria	As per Registration
Details of the work carried out	Details of what Methods the DNO trialled. The DNO should also describe the trialling methodology that it used.
The outcomes of the Project	Comprehensive details of the project's outcomes are to be reported. Where quantitative data is available to describe these outcomes it should be included in the report. Wherever possible, the performance improvement attributable to the Project should be described. If the TRL of the Method has changed as a result of the Trial this should be reported.
Performance compared to the original Project aims, objectives and success criteria	Details of whether and how the Project helped solve the distribution issue described in the First Tier LCN Project Registration Pro-forma. Details of how the Project performed relative to its aims, objectives and success criteria.
Required modifications to the planned approach during the course of the Project	The DNO should state any changes to its planned methodology and describe why the planned approach proved to be inappropriate.
Significant variance in expected costs and benefits	The DNO should describe if any parts of the Project ended up costing more or less than expected (+/- 10 per cent). In relevant cases, the DNO can link the cost changes to the section on required modifications to the planned approach. If costs were different to what the DNO expected, the DNO should provide details of why this was the case. The DNO should discuss whether the benefits of the Project matched the DNO's expectations. This should include any changes to incentive payments and any changes to expected savings in revenue allowed for in the DPCR5 settlement.
Lessons learnt for future Projects	Recommendations on how the outcome of the Project could be exploited further.

Section	Description
	<p>This may include recommendations of what form of trialling will be required to move the Method to the next TRL.</p> <p>The DNO should also state if the Project discovered significant problems with the trialled Methods.</p> <p>The DNO should comment on the likelihood that the Method will be deployed on a large scale in future.</p> <p>The DNO should discuss the effectiveness of any contractual Methods that formed part of the Project.</p>
Planned implementation	<p>Details on whether and how the DNO plans to modify its Distribution System based on learning from the Project.</p> <p>If the Method is not ready to be implemented, the DNO should explain what needs to happen before the Method can be implemented. The DNO can break down the requirements into actions required by DNOs and actions required by non-DNO parties.</p>
Other comments	

## Compliance

5.10. In the event that Ofgem considers that a Close-Down Report is of an unacceptable standard, it may ask the DNO to resubmit the Close-Down Report. If Ofgem considers that the resubmitted report is still of an unacceptable standard, Ofgem may reduce the DNO's Combined Allowed Distribution Network Revenue by an amount up to the level of funding allowed for the Project concerned.

## Publication

5.11. The Close-Down Reports will be made available on the Ofgem website.

## Annual conference

5.12. The DNO must work collectively with such other DNOs as are subject to this Governance Document to organise an annual conference. The annual conference will be held every Regulatory Year for DNOs, Project Partners and interested third parties. Expenditure incurred in organising this annual conference can form part of Allowable Set-up Expenditure. The DNO must (subject to any confidentiality or IPR arrangements approved in Registration) deliver presentations and answer questions on all First Tier LCN Projects that have been completed since the previous annual conference as well as provide updates on those First Tier LCN Projects that are still ongoing.

## 6. First Tier LCN Project audits

6.1. Ofgem does not intend to monitor or review every First Tier LCN Project. However we reserve the right to conduct audits on selected Projects. This audit may be undertaken by Ofgem or a third party appointed at the discretion of Ofgem.

6.2. For each First Tier LCN Project that is selected for audit, it will be necessary for the DNO to demonstrate that:

- the Project is compliant with the appropriate conditions in the relevant Electricity Distribution Licence and the RIGs,
- Allowable First Tier Project Expenditure has been calculated in accordance with the rules set out in paragraphs 3.6 to 3.20,
- the Project has been well managed, and
- the reporting requirements have been met.

6.3. If Ofgem does not consider that the DNO has met these requirements for a First Tier LCN Fund Project, the DNO's Combined Allowed Distribution Network Revenue may be reduced up to the level of funding for the Project concerned.

6.4. It is good practice for the DNO to formally record the processes and criteria, which are used to assess, select, initiate and close First Tier LCN Projects. This record should be made available for audit on request by Ofgem. The level of documentation can be proportionate to the level of expenditure claimed by the DNO.

## SECTION TWO - Second Tier Funding Mechanism

<b>1. Introduction .....</b>	<b>29</b>
Background.....	29
Differences between First and Second Tier Funding Mechanism.....	29
Second Tier Funding Mechanism .....	30
Evaluation of Second Tier Projects .....	30
<b>2. Initial Screening Process .....</b>	<b>32</b>
Introduction .....	32
Eligibility Requirements .....	33
Screening process.....	35
Screening Submission .....	36
Publication .....	38
Project Changes.....	38
<b>3. Full Submission .....</b>	<b>40</b>
Introduction .....	40
Project ownership .....	40
Eligible submissions .....	40
Derogations and requests to change regulatory arrangements.....	40
Second Tier Funding Request .....	42
Successful Delivery Reward Criteria.....	44
Submission process.....	44
Full Submission Pro-forma .....	45
Evaluation Process .....	46
Evaluation Criteria .....	48
Award notification and Project Direction.....	52
Project Implementation .....	53
Application for Discretionary Funding for cost overruns or shortfalls in Direct Benefits .....	57
Halting Projects .....	58
Close-Down Report .....	59
Second Tier Project audits.....	60
Disallowed Expenditure.....	60

## 1. Introduction

### Background

1.1. The Second Tier Funding Mechanism provides total funding of up to £320m during the five years of the DPCR5 period for a small number of significant 'flagship' projects. A total of £64m may be awarded in a single year. These projects are likely to differ in their scope and value from First Tier LCN Projects and consequently are subject to separate governance arrangements which are detailed in this section of the document.

1.2. DNOs will compete against each other to obtain Second Tier Funding for projects they have designed. Ofgem will hold an annual call for submissions and will allocate up to £64m in each of the five years between 2010 and 2015.

1.3. Projects must first pass through an Initial Screening Process (ISP) to demonstrate that they are eligible to be considered for funding. Each DNO Group can submit up to five projects to ISP and can then develop up to two projects which have passed through ISP into Full Submissions. Full Submissions will be evaluated against a set of criteria – Evaluation Criteria – by an independent Expert Panel. The Expert Panel will make a recommendation to the Authority on which Projects should be awarded funding. The Authority will then decide which Projects will be funded.

1.4. There is no minimum value of funding that may be applied for under the Second Tier Funding Mechanism, although it is expected that in most cases projects costing less than the LCN First Tier Allowance will be progressed through the First Tier Funding Mechanism. The maximum lifetime funding that a project may apply for (and receive) from the LCN Fund in respect of a Second Tier Project is the maximum that will be allocated in any year – £64m.

### Differences between First and Second Tier Funding Mechanism

1.5. The level of funding under the First Tier Funding Mechanism is relatively small<sup>9</sup> and we have established the governance arrangements so that Ofgem has a proportionate level of direct involvement in approving First Tier LCN Projects. We have set tight criteria for the First Tier Funding Mechanism so that DNOs can self certify compliance in most circumstances.

1.6. In contrast, the level of funding under the Second Tier Funding Mechanism is substantially greater and therefore requires a much higher degree of Ofgem involvement and oversight. The annual competitive process for the Second Tier Funding involves a detailed scrutiny of projects by an Expert Panel ahead of the Authority's decision to award and release funding for projects.

---

<sup>9</sup> The amount of First Tier Funding which each DNO can recover each year is set out in Appendix 1 of Charge Restriction Condition (CRC) 13.



1.7. Unlike the First Tier Funding Mechanism there will be no defined funding boundary<sup>10</sup> for Second Tier Projects. The competitive process and detailed evaluation is designed to ensure that they deliver value for money. For instance projects which are similar in nature and which are likely to deliver similar learning can be evaluated according to the value for money they deliver. DNOs have an incentive to develop projects which deliver the maximum benefits for the funding they request if they want to stand the best chance of receiving funding.

## **Second Tier Funding Mechanism**

1.8. The general principles and allowed revenues associated with the Second Tier Funding Mechanism are set out in CRC 13. Each year, the Authority will specify the total value of Second Tier Funding awarded for that Regulatory Year. This value will be the aggregate of the Approved Amounts by the Authority for individual projects under the Second Tier for the year and will cover the approved costs for the life of the project. We will annualise any multi-year project costs and allow them to be expensed in the first year of the Project.

1.9. This funding will be recovered from all DNOs (according to their customer numbers) through their distribution use of system (DUoS) charges to customers and transferred to the DNO(s) implementing the winning project(s). The Authority reserves the right to disallow, in accordance with the provisions set out in CRC 13, any funding awarded (or part thereof) which has not been spent in accordance with the provisions of this Governance Document or relevant Project Direction. Further details of the procedures relating to Halted Project Revenues and Disallowed Expenditure (as defined in CRC 13) are set out in Chapter 3.

## **Evaluation of Second Tier Projects**

1.10. A DNO Group will be able to develop up to two projects which have passed through the ISP for Full Submission. The Full Submissions will be scrutinised by the Expert Panel and the Authority on the basis of how they perform against the Evaluation Criteria. The Authority will decide the winning project(s), if any, considering the recommendations of the Expert Panel.

1.11. Each Second Tier Project will be judged by the Expert Panel and the Authority on its merits according to how it performs against a set of Evaluation Criteria including the new learning which will emerge<sup>11</sup>. Consequently, we consider it appropriate to have more flexible criteria for the Second Tier Funding Mechanism in comparison to the First Tier Funding Mechanism. Second Tier Projects provide an opportunity for DNOs to engage with generators, end users, Electricity Suppliers and other parties (such as Local Authorities or property developers) to explore the

---

<sup>10</sup> By funding boundary we refer to the defined set of principles applied to First Tier projects in order to calculate the Eligible First Tier Project Funding.

<sup>11</sup> The Authority and the Expert Panel can also consider the impact on the Project of the overall portfolio of Second Tier Projects that have either been awarded funding in the past, or are seeking funding as part of the same Full Submission process.

interactions required with them in order to facilitate the transition to a low carbon economy. The onus is on the DNO to demonstrate that their project is worthy of funding according to the Second Tier Evaluation Criteria.

---

## 2. Initial Screening Process

### Introduction

2.1. All proposed Second Tier Projects must pass the ISP before they are eligible to be developed into Full Submissions to be evaluated by the Expert Panel and considered by the Authority for funding.

2.2. The purpose of the 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.

2.3. Furthermore, the ISP provides DNOs and Ofgem with an early view of the projects which DNOs are developing in a given year and are considering for Full Submission. It will provide an indication of the funding which will be requested and the Project Partners or External Funders who intend to invest (i.e. commit time, resources and/or funding) in the Project. This information will be useful in informing DNOs' decisions over which projects to progress to Full Submission and will also help Ofgem avoid any conflict of interest amongst members of the Expert Panel or any external consultants used by Ofgem to review Full Submissions. The ISP also provides an opportunity for DNOs to identify opportunities to collaborate on Projects.

2.4. If DNOs collaborate on a Second Tier Project, they must appoint a Lead DNO who will act as the single point of contact with Ofgem. The Lead DNO is the DNO that applies for funding in respect of the Project and submits the Screening Submission. References to DNO or DNO Group in this section refer to this Lead DNO where there is DNO collaboration.

2.5. Those Projects which do not meet the Eligibility Requirements will be 'screened out' and not permitted to proceed to Full Submission. Ofgem will announce a Screening Submission deadline by which DNOs must submit a summary proposal – the Screening Submission - of any project they wish to be considered for Second Tier Funding that year. A DNO Group will not be permitted to submit more than five Screening Submissions to Ofgem for consideration in any given year. Ofgem will assess Screening Submissions against the Eligibility Requirements and notify the DNO where a Project fails to meet them. This means that Projects are deemed to have passed ISP unless a DNO is informed otherwise.

2.6. The Eligibility Requirements which Second Tier Projects must meet are similar to the Specific Requirements set out for First Tier Projects. It should be noted that there are a separate set of criteria (which are similar but not the same as the Eligibility Requirements) which the Expert Panel and the Authority will use to evaluate which Full Submissions should be awarded funding. These are known as the Evaluation Criteria.

---

## Eligibility Requirements

2.7. In order to pass the ISP, a Project must meet the Eligibility Requirements. Under the Eligibility Requirements a Second Tier Project must meet one of the specific requirements set out in paragraph 2.8 and each of the five criteria detailed in paragraphs 2.9 to 2.22 below in order to pass the ISP. Once a Project proposal has passed the ISP, it can be developed into a Full Submission to be evaluated by the Expert Panel and the Authority.

### Specific requirements

2.8. A Second Tier LCN Project must involve the trialling on the Distribution System of at least one of the following:

- A specific piece of new (i.e. unproven in GB) equipment (including control and communications systems and software) that has a Direct Impact on the Distribution System,
- A novel arrangement or application of existing Distribution System equipment (including control and communications systems software),
- A novel operational practice directly related to the operation of the Distribution System, or
- A novel commercial arrangement.

### Criteria

2.9. In addition to meeting one or more of the requirements set out in paragraph 2.8, in order to pass ISP, a DNO must also demonstrate in its completed Screening Submission that the Project also meets all the following criteria.

#### **(a) Accelerates the development of a low carbon energy sector**

2.10. The Second Tier Project must demonstrate how the Solution(s) associated with the Project makes a contribution to the UK Government's current strategy for reducing greenhouse gas emissions, as set out in the document entitled "The UK Low Carbon Transition Plan", as published by DECC<sup>12</sup>. This may be amended from time to time or replaced by the Government. Any such changes will be notified to DNOs in writing by Ofgem.

2.11. In outlining the expected contribution of the Project, DNOs must identify the aspect(s) of the Low Carbon Transition Plan which the Solution(s) facilitate. They must also outline how the roll out of the Method(s) across GB will deliver the

---

<sup>12</sup> The UK Low Carbon Transition Plan: National Strategy for Climate & Energy July 2009: [http://www.decc.gov.uk/en/content/cms/publications/lc\\_trans\\_plan/lc\\_trans\\_plan.aspx](http://www.decc.gov.uk/en/content/cms/publications/lc_trans_plan/lc_trans_plan.aspx)

Solution(s) more quickly than the most efficient method currently in use of the GB Distribution System.

**(b) Have the potential to deliver net financial benefits to existing and/or future customers**

2.12. There must be a clear expectation and evidence that the Method(s) being trialled has the potential to deliver the Solution(s) at a lower cost than the most efficient Method currently in use on the GB Distribution System.

2.13. A DNO must estimate the costs of delivering the Solution(s) (at the scale being tested within the Project) through the most efficient method currently in use on the GB Distribution Systems - the Base Case Costs. DNOs must compare the Base Case Costs to the costs of replicating the Method, at the scale being tested in the Project, once it has been proven successful - the Method Costs. The difference between the Base Case Cost and the Method Costs is the financial benefit of the Project.

**(c) Has a Direct Impact on the operation of the distribution network**

2.14. A Second Tier Project must demonstrate that the Method(s) being trialled will have a Direct Impact on the operation of a DNO's Distribution System.

2.15. This does not confine Projects to trialling a Method which only impacts the Distribution System. However, the LCN Fund is focussed on the role that DNOs can play as GB moves towards a low carbon economy. Therefore, the Method must involve a Direct Impact upon the Distribution System.

**(d) Generates knowledge that can be shared amongst all DNOs**

2.16. A Second Tier Project must demonstrate that the Method(s) it is trialling will generate knowledge which did not exist before the Trial. A key aspect of the LCN Fund is to share knowledge from projects to help DNOs prepare for the role they will play as the UK moves towards a low carbon economy. It is therefore vital that the learning from the trial (whether successful or not) is disseminated amongst DNOs.

2.17. DNOs must therefore provide evidence of how the Method(s) being trialled will generate knowledge. DNOs must also demonstrate that the Project includes a robust methodology to capture the results from the trial and disseminate that learning to all DNOs.

2.18. We recognise that a Project may generate intellectual property rights (IPR) either for the DNO or for any Project Partners (whether both or jointly) and have set out default requirements for IPR in Section Five.

2.19. Where a DNO wishes to deviate from the default IPR conditions it must demonstrate how the learning from the Project can be disseminated to other DNOs

taking into account any potential constraints or costs caused or resulting from, the proposed IPR arrangements.

**(e) Focuses on network Methods which are at the trialling stage and require Second Tier Funding**

2.20. The LCN Fund is specifically targeted at projects that a DNO would not perform in its normal course of business. Furthermore, Methods being deployed in LCN Fund projects should not be at the R&D stage as such projects will often be eligible for funding under the existing IFI.

2.21. The DNO must demonstrate that the Method(s) being trialled are untested at the scale and circumstance in which the DNO wishes it to be deployed and that consequently new learning will result from the Project. This will prevent the widespread deployment of proven technology or practices using Second Tier Funding. DNOs must also outline why the scale of the Project is required to deliver the learning and why the Project would not have been an appropriate First Tier Project.

2.22. The DNO must demonstrate why it has not previously used such a Method (including where this Method is a commercial arrangement) to solve the Problem and why it can be undertaken only with the support of LCN Fund. This could involve an outline of the specific technical, operational, commercial or regulatory risks associated with the Project.

## Screening process

2.23. In order for a Second Tier Project to pass the ISP it must conform to the process set out below.

2.24. DNOs must submit their Screening Submission by the specific Screening Submission date set by Ofgem. This date may alter from year to year but will be communicated to DNOs at least two Calendar Months in advance of the deadline for Screening Submissions<sup>13</sup> and also published on our website<sup>14</sup>. DNOs should submit their submissions via Ofgem's LCN Fund extranet site<sup>15</sup>. If the extranet site is unavailable, Ofgem will permit the DNO to submit its Screening Submission by email. As part of granting this permission, Ofgem will notify the DNO of the email address it must use for the submission.

2.25. Screening Submissions must be submitted using the Screening Submission Pro-forma provided by Ofgem. This pro-forma limits the length of the Screening

---

<sup>13</sup> In the first year it is expected that DNOs will get two months' notice of the precise date. In future years we hope to be able to provide much more notice.

<sup>14</sup> The Low Carbon Network Fund area of Ofgem's website can be found at:  
<http://www.ofgem.gov.uk/Networks/ElecDist/lcnf/Pages/lcnf.aspx>

<sup>15</sup> This is a secure area of Ofgem's website which requires a password to access. DNOs can apply to Ofgem for a password to access this site.

Submission. DNOs are not permitted to submit any appendices or supplementary information alongside their Screening Submission. The information which we will require in the Screening Submission Pro-forma is set out in Table 2.1 below.

2.26. Ofgem will confirm receipt of the submission one Working Day following the successful upload of a Screening Submission to the extranet site. Where Ofgem deem that any necessary information is missing within the Screening Submission DNOs will have two Working Days in which to provide this information following any request. If the missing information is not provided within these two Working Days then the Project will be deemed to have failed the ISP.

2.27. The Project will be deemed to have passed ISP unless, within twenty Working Days of the Screening Submission date, Ofgem has sent to the DNO written notification saying that their Screening Submission has failed to meet the Eligibility Requirements. This notification will outline Ofgem's reasons in full. Ofgem will still publish a list of the projects which have passed ISP twenty working days following the Screening Submission date.

2.28. All notification letters will be first sent to DNOs (via email and in the post) and will then be published on Ofgem's website. Publication of the Screening Submissions is described in the publication section below.

2.29. The Authority may provide separate feedback on some Projects which have passed ISP where it feels the DNO will need to provide greater clarity on aspects of the Project for Full Submission.

2.30. A Project must be submitted for the ISP in any year in which the DNO intends to develop it into a Full Submission. This includes Projects which have passed ISP in previous years. This ensures that Ofgem, DNOs and wider interested parties have full visibility of the Projects which could be competing for funding as part of a Full Submission.

## Screening Submission

2.31. Below we outline the information which DNOs must provide in a completed Screening Submission Pro-forma.

**Table 2.1: Information required in Second Tier Screening Submission**

<b>Pro-forma category</b>	<b>Information required</b>
Project Title	
DNO	The Lead DNO for the Project.
Participant DNOs	Where the Project is a collaboration between DNOs, the collaborating DNOs should be identified here.
DNO area	The DNO area(s) in which the Trial(s) will take place.

<b>Pro-forma category</b>	<b>Information required</b>
Problem	The DNO must provide a narrative which explains the Problem(s) which the Project is seeking to address.
Method(s)	The DNO should describe the Method(s) which are being trialled. It must also outline how the Method(s) could solve the Problem. The type of Method should be identified where possible e.g. technical or commercial.
Estimated Project Funding	The DNOs must provide an approximate figure of the total cost of the Project and the amount of LCN funding for which they consider they will apply in the Full Submission.
Funding commentary	The DNOs should provide a commentary on the accuracy of its funding estimate and state any potential for the phasing the Project.
Specific requirements	DNOs must identify which of the specific requirements detailed in paragraph 2.8 their Project meets. A Project must meet at least one specific requirement in order to pass the ISP.
Accelerates the development of a low carbon energy sector	The DNO must demonstrate that the Solution makes a contribution to the Low Carbon Transition Plan.
Deliver net financial benefits to existing and/or future customers	The DNO must demonstrate that the Method(s) they are trialling has the potential to deliver the Solution at a lower cost than alternative methods.
Has a Direct Impact on the operation of the distribution network	The DNO must set out the Method(s) it is trialling and demonstrate the Direct Impact it has on the operation of its distribution network.
Generate knowledge that can be shared amongst all network operators	<p>The DNO must explain the learning which it expects the Method(s) it is trialling to deliver.</p> <p>The DNO must demonstrate that it has a robust methodology in place to capture the learning from the Trial(s).</p> <p>If the DNO wishes to deviate from the default requirement for IPR then it must demonstrate that the IPR arrangements it wishes to use allow the learning to be disseminated amongst all other DNOs.</p>
Focus on Methods that are at the trialling stage	<p>The DNO must explain why they consider that the Method(s) which the project is trialling are novel, and why they are different to existing methods or has not previously been implemented in such circumstances. The DNO must also outline why it would not run the trial as part of its normal course of business and why the Method is not R&amp;D.</p> <p>The DNO must demonstrate that the Method (including where the Method involves commercial arrangements) has not been used previously and why LCN funding is required to undertake it.</p>



Project Partners and external resourcing/funding	The DNO should provide details of any Project Partners who will be actively involved in the Project and are prepared to devote time, resources and/or funding to the Project. A summary of any existing or planned contractual arrangements with these parties in relation to the project should also be detailed at this stage if in place. If the DNO has not identified any specific Project Partners, it should provide details of the type of Project Partners it wishes to attract to the Project.
Derogations or exemptions	The DNO should outline if they consider that the Project will require any derogations, exemptions or changes to the regulatory arrangements.
Customer impact	The DNO should outline any planned interaction with Customers or Customers' premises as part of the Project, and any other direct impact (such as amended contractual or charging arrangements, or supply interruptions).

## Publication

2.32. Following the ISP deadline, Ofgem will publish the Screening Submission in full. This is to provide full transparency of the projects being developed and enable DNOs to identify where there are opportunities to collaborate. The DNO must clearly identify any information contained in the Screening Submission that it does not consent to being published in full. It must demonstrate that it (or its Project Partners) will face commercial harm from its disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or Environmental Information Act 2004. We would not expect that any such information would need to be included as part of the first three sections<sup>16</sup> of the Screening Submission which Ofgem would publish shortly after the ISP submission deadline.

## Project changes

2.33. The purpose of ISP is to prevent DNOs incurring costs developing projects which are not eligible to receive funding under the Second Tier Funding Mechanism. A further objective of ISP is to provide an early indication of the projects being developed and to allow both DNOs and Ofgem to plan accordingly. If DNOs can change their Projects substantially between ISP and Full Submission, then the purpose of the ISP will be defeated.

<sup>16</sup> Note that this would not include the commentary on the accuracy of the Project funding estimate.

2.34. Therefore, we want to ensure that the DNO does not fundamentally alter a project after it has passed ISP and before it is developed into a Full Submission. To this end, once a submission has passed ISP, a DNO must not alter the high level Solution(s) it wishes to facilitate in order to solve the Problem or the Method(s) which it will use to deliver the Solution(s).

2.35. We consider that the methodology used to capture learning from the Trial(s) should remain unaltered at a high level and would expect a Full Submission to expand on (rather than materially alter) the methodological details provided within the Screening Submission and/or to provide new ideas on how learning from the Project could be disseminated. Furthermore, where a Second Tier Project deviates from the default requirements for IPR and has been deemed to meet the Eligibility Requirements, the IPR arrangements for that Project must not be altered ahead of a Full Submission except where the DNO wishes to revert to the default IPR arrangements.

2.36. If, subsequent to the twenty Working Day evaluation period following the ISP deadline, two or more DNOs decide to merge or combine elements of Projects which have passed the ISP, they must notify Ofgem, in writing as early as possible and at least ten Working Days prior to the Full Submission date.

## 3. Full Submission

### Introduction

3.1. In this chapter we set out the process for Full Submission of Second Tier Projects. We also set out how these will be evaluated, how Second Tier Funding will be awarded and the conditions that Projects which receive Second Tier Funding will need to comply with on an ongoing basis.

### Project ownership

3.2. If DNO Groups decide to collaborate with each other on a Second Tier Project, they must appoint a Lead DNO who will act as the single point of contact with Ofgem. The Lead DNO will be the DNO that applies for funding in respect of a Project and submits the Full Submission. Further, the Lead DNO will be the recipient of any Second Tier Funding for that Project and will be responsible for ensuring that the Project, including any work undertaken by the Project Partners, adheres to CRC13, this Governance Document and any subsequent Project Direction for the Project. References to DNO or DNO Group in this section refer to this Lead DNO where there is DNO collaboration.

### Eligible submissions

3.3. A DNO may not submit a Project for Full Submission if Ofgem has provided written confirmation within twenty Working Days of the Screening Submission deadline that the Project has not met the Eligibility Requirements. Further, for each Project submitted at Full Submission the DNO must demonstrate that it has complied with the rules on Project changes set out in Chapter 2.

3.4. A DNO Group may submit a maximum of two Projects for Full Submission in any given year.

### Derogations and requests to change regulatory arrangements

3.5. If a DNO considers that there is any possibility that they will require a derogation or exemptions, either as a known requirement or as a contingency, from any of their regulatory arrangements then it must state this in the Full Submission. It must also provide, as part of its Full Submission, the evidence that it would put forward as part of its subsequent formal request to seek a derogation or exemption from those arrangements (should the Project be awarded Second Tier Funding), as well of details as to how and when it would apply for such a derogation. The evidence that should be submitted for potential derogations should follow the latest guidance on licence derogation requests, as published on the Derogations page of the Ofgem

website<sup>17</sup>. The DNO must also provide the evidence for why the derogation or exemption is necessary and justified, and outline the likely impact on customers. It must also indicate whether, if the Method(s) being trialled is proved successful, similar derogations or exemptions would be required in order to roll-out the Method(s). The DNO must indicate where there would need to be changes to industry code arrangements in order to enable the roll-out. It will also need to set out whether it would withdraw the request for Second Tier Funding in the event that Ofgem would not support the change to the regulatory arrangements that it requested within its Full Submission.

### **Distribution charging methodology derogations**

3.6. Where a Project will involve changes to any part of its distribution charging methodology, the DNO must provide, in its Full Submission, the information it would provide when requesting a derogation from its charging methodology. This information must include an indication of which of the relevant objectives set out in SLC 13, 13A and 13B (as applicable) the DNO considers the Method(s) being trialled will better achieve. Alongside this indication, the DNO must provide a short summary justification of the reasons why they consider their Method will better achieve these objectives. Where the Project involves trialling multiple charging arrangements, this information must be provided for each of the arrangements to be trialled.

3.7. The DNO must outline in its Full Submission how Customers will be recruited for the trial, including whether the recruitment will be voluntary and whether Customers will "opt in" or "opt out". It must also outline the circumstances, if any, under which Customers participating in the Trial could experience higher distribution charges under the new charging arrangements.

3.8. As part of its Customer engagement plan (set out below) the DNO must describe the information they will provide to prospective participants in the Trial and, where Customers could experience higher distribution charges, the guidance the DNO intends to provide on how the Customer can influence and reduce its charges.

3.9. For the avoidance of doubt, compliance with paragraphs 3.5 to 3.12 does not replace the requirement on the DNO to follow the standard process for pursuing a licence derogation request should the Project be awarded Second Tier LCN funding. The DNO would therefore still need to make a formal application for a derogation if required in order to undertake the Project.

### **Customer impacts**

3.10. A DNO must outline in its Full Submission any interaction or engagement with a Customer or Customer's premises as part of the Project, or any direct impact the Project may have on Customers (eg through charging or contractual arrangements or supply interruptions). If the Project is selected for funding, the DNO will have to set

---

<sup>17</sup> <http://www.ofgem.gov.uk/Networks/Techn/TechStandds/Derogtns/Pages/Derogtns.aspx>

out further details of its proposed Customer engagement plan - which is detailed in the Project Implementation section.

### **Projects involving interruptions to Customers' supply**

3.11. A DNO must, in its Full Submission, detail the expected number and duration of any interruptions to Customers' supply that will be required in order to implement the Project (i.e. planned interruptions) and the reason for these interruptions. It should also indicate if there is any risk of the Project causing unplanned interruptions, the potential number and duration, and the potential cause of these interruptions.

3.12. The DNO must set out the steps they have undertaken to investigate alternative ways to implement the Project which could reduce or avoid the need for Customer interruptions. DNOs must set out the alternatives it investigated and provide a summary of why these alternatives were rejected.

3.13. Where the DNO wishes to request protection from the Interruption Incentive Scheme (IIS) penalties associated with the planned interruptions it has identified, it must include the value of the penalties in its Second Tier Funding Request. The DNO will therefore not be exempted from any resultant penalties incurred under the IIS but will have received funding to cover the forecast penalty cost associated with the planned interruptions.

### **Second Tier Funding Request**

3.14. To calculate the level of Second Tier Funding that can be requested for a Project as part of the Full Submission (the Second Tier Funding Request), the DNO must adhere to the following:

3.15. The DNO must identify Total Project Costs, which are the forecast costs the DNO expects to require to undertake the Project. Where the DNO wishes to be protected from IIS penalties arising from planned interruptions associated with the Project, it should include the anticipated value of these penalties within the Total Project Costs.

3.16. The DNO must deduct from the Total Project Costs any funding it will receive from:

- Project Partners
- External Funders, and
- the DNO which is in excess of the DNO Compulsory Contribution described below.

3.17. This sum is the Initial Net Funding Required. The DNO must then make a DNO Compulsory Contribution equal to 10 per cent of the Initial Net Funding Required. This is the DNO Compulsory Contribution.

3.18. The DNO may use Direct Benefits to cover all or part of the DNO Compulsory Contribution.

3.19. Direct Benefits are any benefits of the Project accruing to the DNO during the Project implementation, and include the following:

- revenue included in the DNO's Full Business Plan Questionnaire (FBPQ) for DPCR5 that will be saved through undertaking the Project, and
- incentive payments generated as a result of the Project during the implementation of the Project.

3.20. If Direct Benefits do not exceed the value of the DNO Compulsory Contribution, then the Initial Net Funding Required less the DNO Compulsory Contribution is the Outstanding Funding Required. If Direct Benefits exceed the value of the DNO Compulsory Contribution, then the Initial Net Funding Required less the Direct Benefits is the Outstanding Funding Required.

3.21. It should be noted that the DNO has to supply funding to the amount of the Direct Benefits identified in the Full Submission into the Project Bank Account (the Project Bank Account is described in paragraph 3.77 onwards).

3.22. The costs and Direct Benefits of the Second Tier Project will arise over the duration of the Project, whereas the Second Tier Funding will be provided to the DNO over the course of the Regulatory Year following the award of funding to the Project. The Second Tier Funding Request is the amount of money (provided over the course of the first whole Regulatory Year of the Project) that is required to fund the Outstanding Funding Required, including a deduction for the bank account interest that the DNO will earn on the balance of funding over the duration of the Project. The Second Tier Funding Request is automatically calculated within the Excel spreadsheet which DNOs must complete and submit as part of the Full Submission. The bank interest shall be calculated at midyear using the Bank of England base rate plus 1.5 per cent on 31st June of the year in which the Full Submission is made.

3.23. In forecasting the Project costs, the DNO should use the RPI forecast that Ofgem will provide at least two Calendar Months prior to the date Ofgem has set for receipt of Full Submissions.

3.24. The DNO should clearly identify the assumptions that underlie the way in which the costs, External Funding and hence the Outstanding Funding Required have been assumed to be phased throughout the duration of the Project.

3.25. In the annual call for Projects, the maximum amount of LCN funding that a DNO can request as part of a Full Submission is £64m. Ofgem has no obligation to make Second Tier Funding awards totalling this amount in any year, and the difference between £64m and the amount awarded will not be carried over for the remaining years of the scheme.

## Successful Delivery Reward Criteria

3.26. As set out in Chapter 4 of Section Three, a DNO will be eligible to apply for Discretionary Funding (the Second Tier Successful Delivery Reward), up to the level of its DNO Compulsory Contribution, if; (a) it has incurred this expenditure in undertaking the Second Tier Project; and (b) it meets the Successful Delivery Reward Criteria set out in the Project Direction. This is designed to reward those Projects that are well managed and completed at least to the standard that could be expected given the information provided in the Full Submission.

3.27. The Successful Delivery Reward Criteria will be Project specific. A DNO must set out the Successful Delivery Reward Criteria that it proposes for its Project as part of its Full Submission. These proposed Successful Delivery Reward Criteria must comply with the following principles in that they must be:

- linked to meeting identified targets for the outputs that will be expected to be delivered through the Project,
- linked to meeting identified Project milestones, on at least an annual basis,
- linked to achieving the proposals it puts forward for generation of new knowledge to be shared amongst all network operators, and
- SMART objectives - specific, measurable, achievable, relevant and time bound.

3.28. The Expert Panel and Ofgem may suggest changes to the Successful Delivery Reward Criteria proposed within the Full Submission as part of their consideration of the Full Submissions. The DNO does not have to accept these changes, but if it does then the revised Successful Delivery Reward Criteria will be deemed to be part of the Full Submission. As outlined in paragraph 3.69, the Expert Panel and the Authority will consider the quality of the Successful Delivery Reward Criteria as part of the Evaluation Criteria.

3.29. The process for applying for, and the awarding of, the Second Tier Successful Delivery Reward is detailed in the Discretionary Funding Section (Section Three).

3.30. If a Project is selected for funding, the DNO must submit to Ofgem a Project Progress Report at least every six months. The Project Progress Report must be of a standard considered by Ofgem as sufficient to provide Ofgem with the comfort that the Project is being successfully delivered and demonstrate progress against the agreed Successful Delivery Reward Criteria. However, as part of its Successful Delivery Reward Criteria, the DNO can suggest additional reporting requirements that it will meet.

## Submission process

3.31. For it to be considered by Ofgem, a DNO must submit a Full Submission by the specific Full Submission date set by Ofgem. This date may alter from year to year but will be communicated to DNOs as part of the ISP. A DNO must ensure that the Full Submission (consisting of the Full Submission Pro-forma and Full Submission Appendices) are submitted in their original formats and also provide a single PDF file

which is formatted to print out the whole submission on A4 pages. Any Full Submission submitted after 17:00 on the Full Submission date will not be considered. The DNO is responsible for ensuring that all required information is provided within its Full Submission.

3.32. A DNO should submit Full Submissions via Ofgem's LCN Fund extranet site into the relevant Second Tier Project folder for that DNO. If the extranet site is unavailable, Ofgem will permit the DNO to submit its Full Submission by email. As part of granting this permission, Ofgem will notify the DNO of the email address it must use for the submission.

3.33. Ofgem will acknowledge receipt of the Full Submission one Working Day following its successful submission.

3.34. Whilst Full Submissions will be published after the notification of the LCN Fund award (see the Award notification and Project Direction section), following submission Ofgem will publish, and may provide to third parties, summary information on the Projects submitted - including Project title, high level summary and the submitting DNO.

### **Full Submission Pro-forma and appendices**

3.35. The DNOs will be required to submit information in the Full Submission including, but not limited to, the items listed below:

- Lead DNO
- Project description and related information,
- Total Project Cost, External Funding, DNO contribution, Direct Benefits and the Second Tier Funding Request,
- Requested threshold for the funding of cost over-runs if different to the default,
- Requested protection on Direct Benefits, if different to the default,
- Customer impact of Project implementation,
- Project Management structure and related information,
- Derogations/ Exemptions that the Project would/may require,
- Proposed Successful Delivery Reward Criteria for the Project, and
- Explanation and evidence of how the Method, Project or Solution performs against the Evaluation Criteria, and
- The key learning outcomes which the Project aims to deliver

3.36. For any Project that a DNO wishes to submit for consideration for Second Tier Funding, it must complete a Full Submission Pro-forma, as provided by Ofgem.

3.37. Ofgem will issue guidance for completing the Full Submission alongside the Full Submission Pro-forma which will specify the detail required within each of these categories, and rules/advice on completion of the Pro-forma and content of appendices.



3.38. The length of the Full Submission Pro-forma and Full Submission Appendices should be no more than 100 pages in length using Verdana 10pt font.

3.39. The DNO must clearly identify any information contained in the Full Submission that it does not consent to being published in full. It must demonstrate that it (or its Project Partners) will face commercial harm from its disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or Environmental Information Act 2004. The DNO must provide Ofgem with a non-confidential version which may be published by Ofgem.

## **Evaluation Process**

3.40. Ofgem has appointed an Expert Panel<sup>18</sup> that will provide a recommendation to the Authority as to which projects should receive Second Tier Funding. The Authority will take into account the recommendation of the Expert Panel in awarding Second Tier Funding.

3.41. Ofgem may appoint consultants to review the submissions and otherwise assist the Expert Panel or the Authority as appropriate. The consultants will be required to have engineering expertise, and in particular expertise of distribution networks. The consultants will conclude their review with the production of a report (or reports) which will, inter alia:

- So far as is possible, seek to place the information provided for each Project on a comparable basis to allow the Expert Panel to compare them more easily,
- Provide an assessment of whether the Full Submission appears objectively credible, including an assessment of the costs and benefits that have been assumed as well as an evaluation of the aims of the Project and the timetable over which the Project will be undertaken,
- Identify and assess the materiality of any risks to the Project that it considers have not been made transparent in the Full Submission,
- Provide an assessment of the feasibility of the Project and an indication of the applicability of the resultant learning.

3.42. Ofgem, or its consultants, may request that the DNO provide clarification about aspects of its Full Submission. Any requests for clarification will be issued on specified day(s) in each week. These days will be agreed and communicated to DNOs prior to the Full Submission deadline. If the DNO wishes to provide clarification, it must do so in writing within the specific time period requested by Ofgem. This time period will be no less than two Working Days. Any written clarification provided by the DNO will be deemed to be part of the Full Submission and the requirements as regards confidentiality apply.

3.43. The report(s) produced by the consultants, together with the Full Submissions (including any written clarifications), will be made available to the Expert Panel and

---

<sup>18</sup> Please see:

<http://www.ofgem.gov.uk/Networks/ElecDist/lcnf/stlcnp/EpertPanel/Pages/ExpertPanel.aspx>

the Authority. This will form part of the evidence base that the Expert Panel will use to make its recommendation and the Authority will use to make its decision. Ofgem will circulate a draft version of the report(s) produced by the consultants to DNOs for their information prior to the consultants producing their final version(s). DNOs will be able to highlight any information contained in the draft report which they consider to be factually incorrect.

3.44. For each Full Submission that complies with the requirements of paragraphs 3.31 to 3.32, the Expert Panel will have a meeting or meetings to discuss that Project with the Lead DNO. The length of the meeting(s) will be set in advance and each Project will receive the same time allocation. The DNO will be provided with at least ten Working Days notice of the date of this meeting(s).

3.45. In advance of the meeting(s) the Expert Panel may (at its discretion) provide the DNO with a list of questions that it intends to ask at the meeting. It may then ask further questions during the meeting. These questions may include asking the DNO whether it will consider changing its proposed Successful Delivery Reward Criteria. The DNO may submit written responses to these questions, or choose to answer them orally at the meeting(s). However, to the extent that an answer either clarifies or changes something contained within the Full Submission, this must be submitted in writing to Ofgem within two Working Days of the date of the meeting, or as otherwise agreed with Ofgem. This will then be deemed to be part of the Full Submission and the requirements as regards confidentiality will apply.

3.46. The Authority may also ask the DNO questions about a project. The DNO may submit written responses to these questions, or choose to answer them orally if the Authority offers to have a meeting. However, to the extent that an answer either clarifies or changes something contained within the Full Submission, this must be submitted in writing to Ofgem within two Working Days of the date of the meeting, or as otherwise agreed with Ofgem. This will then be deemed to be part of the Full Submission and the requirements as regards confidentiality will apply.

3.47. DNOs must highlight if any of their responses to either requests for clarification from Ofgem (or its consultants), or to questions from the Expert Panel, alter part of their Full Submission. DNOs must state which sections of the Full Submission their responses alter.

3.48. Where a DNO has provided information which alters its Full Submission it can submit a revised copy of the Full Submission at any point, clearly identifying the amendments and with version numbering. At minimum, it must submit a revised copy of the Full Submission five Working Days following the final Expert Panel meeting(s) with the DNOs. This must be submitted via the extranet in a printable PDF format. This revised copy should be updated to take account of responses to requests for clarifications and to the Expert Panel questions. This revised copy will be published on Ofgem's website following the end of the Full Submission process.

## Evaluation Criteria

3.49. This section sets out the Evaluation Criteria that will be used to evaluate the Projects put forward in the Full Submissions. The Expert Panel will use its judgement to recommend, and the Authority will use its judgement to decide, which Projects should receive funding, based on the different strengths and weaknesses of each Project across all the Evaluation Criteria. They will also consider the impact of the Project on the overall portfolio of Second Tier Projects that either have been awarded funding in the past, or are seeking funding as part of the same Full Submission process.

3.50. The Authority is not obliged to award Second Tier Funding, even to those Projects that perform best against the criteria in a given year, if it deems them, on balance against the relevant criteria, to be of insufficient quality, to offer insufficient carbon benefits or fail to offer value for money to customers.

3.51. Although the Expert Panel and the Authority will consider the information provided by DNOs, including any quantitative estimates supplied in the Full Submission, they may also conduct their own research or assessment and make their own evaluation to allow consistent comparisons to be made between Full Submissions.

3.52. The Evaluation Criteria that will be taken into account in evaluating Second Tier Projects are set out below.

### **(a) Accelerates the development of a low carbon energy sector**

3.53. A DNO must demonstrate how the Solution or Solutions associated with the Project makes a contribution to the UK Government's current strategy for reducing greenhouse gas emissions as set out in the document entitled "The UK Low Carbon Transition Plan", as published by the Department of Energy and Climate Change (DECC), as may be amended from time to time or may be replaced by the Government, such change to be notified to the DNOs in writing by Ofgem. Where the Project involves multiple Solutions, the contribution of each Solution should be detailed separately. The greater the expected contribution, the higher the ranking of the Project against this criterion. This assessment will take into account the level of funding being requested.

3.54. To reduce carbon in the energy sector, the UK Low Carbon Transition Plan considers that electricity use may increase. A Solution may involve facilitating the use of electricity instead of an alternative higher carbon energy source. Therefore, a DNO can outline the potential carbon benefits across the total energy sector that the roll out of the Method could reasonably be expected to deliver.

3.55. In outlining the expected contribution of the Project, DNOs must provide a description of the following:

- The aspect(s) of the Low Carbon Transition Plan which the Solution(s) facilitate,
- The contribution the roll out of the Method(s) across GB can play in facilitating this aspect(s) of the Low Carbon Transition Plan,
- How the roll out of the Method(s) across GB will deliver the Solution(s) more quickly than the most efficient method currently in operation on the GB Distribution System,
- The potential for replication of the Method across GB in terms of the number of sites, or the percentage of the GB Distribution System where it could be rolled out. The DNO should use this to outline the potential carbon contribution the roll out of the Method(s) can make.

DNOs can provide a quantitative assessment of the carbon saving they estimate their Project has the potential to deliver. To reduce carbon in the energy sector, the UK Low Carbon Transition Plan considers that electricity use may increase. A Solution may involve facilitating the use of electricity instead of an alternative higher carbon energy source.

**(b) Has the potential to deliver net financial benefits to existing and/or future customers**

3.56. There must be a clear expectation and evidence that the Method(s) being trialled has the potential to deliver the Solution(s) at a lower cost than the most efficient method currently in use on the GB Distribution System<sup>19</sup>.

3.57. A DNO must estimate the costs of delivering the Solution(s) (at the scale being tested within the Project) through the most efficient method currently in use on the GB Distribution Systems - the Base Case Costs. DNOs must compare the Base Case Costs to the costs of replicating the Method, once it has been proven successful, at the scale being tested in the Project - the Method Costs. The difference between the Base Case Cost and the Method Costs is the financial benefit of the Project. Where a DNO is looking to test more than one Method it should outline the financial benefit of each separate Method.

3.58. DNOs must also detail how replicable the Method(s) are across GB in terms of the number of sites, or the percentage of the GB Distribution System, where it could be rolled out. In addition DNOs must provide an outline of the costs of rolling out the Method across GB. The greater the financial benefit (taking into account the level of funding requested) the higher the Project will be ranked against this criterion.

**(c) Level of impact on the operation of the Distribution System**

3.59. The LCN Fund is focussed on the role that DNOs can play as GB moves towards a low carbon economy. Consideration will therefore be given to the extent to which

---

<sup>19</sup> In assessing the most efficient method currently in use on the GB Distribution System, DNOs should look at the minimum cost scheme under which they would deliver the Solution (at the scale being tested within the Project). We also expect that they take into account lower cost methods which other DNOs have deployed successfully on their network which could deliver the Solution (at the scale being tested in the Project).

the Project will be expected to provide learning and benefits to the DNOs relating to the planning, development and operation of an efficient distribution system versus providing benefits elsewhere in the energy supply chain.

3.60. Therefore Projects will be evaluated on the size of benefits calculated under criteria (b) above that can be attributed to the Distribution System versus elsewhere, taking into account the level of funding requested.

3.61. However, for the avoidance of doubt, this criterion does not confine Projects to trialling Methods that only impact the Distribution System. It also does not favour a Project where the Method is focussed on a DNO activity, rather than a Method that relies on the involvement of third parties whose actions may nevertheless have a Direct Impact on the operation of a DNO's Distribution System.

**(d) Generates knowledge that can be shared amongst all DNOs**

3.62. One of the main purposes of the LCN Fund is to generate and share knowledge from Projects to help DNOs prepare for the role they will play as GB moves towards a low carbon economy.

3.63. When evaluating how Projects perform against this criterion, consideration will be given to the following aspects.

- The level of incremental learning expected to be provided by the Project.
- The applicability of the new learning to the other DNOs,
- The plans to disseminate learning from the Project, both to DNOs and to other interested parties, with credit being given to innovative plans, tools and techniques which will be shared openly and easily with DNOs,
- The robustness of the methodology to capture the results from the Project and disseminate the learning to other DNOs,
- The treatment of IPR. Where a DNO wishes to deviate from the default requirement for IPR set out in Section Five, it must demonstrate how the learning from the Project can be meaningfully disseminated to network operators and other interested parties. This must take into account any potential constraints or costs caused, or resulting from, the imposed IPR arrangements. It must justify why the proposed IPR arrangements provide value for money for consumers.

**(e) Involvement of other partners and external funding**

3.64. Collaboration between DNOs and other parties in the energy supply chain is a central objective of the LCN Fund. Further, we expect DNOs to leverage alternative funding arrangements where these are available, either through alternative funding mechanisms or from other parties that will get value from being part of the Project. Further, the DNO itself could choose to contribute more funding than the DNO Compulsory Contribution.

3.65. When evaluating how Projects perform against this criterion, consideration will be given to the following aspects.

- Collaboration that is appropriate to the Project being undertaken will be looked on favourably. Consideration will also be given to whether the Project Partner is under different ownership from the DNO, and whether the contractual arrangements have already been put in place and are robust, including the specific measures in place to procure the cooperation of collaborators to ensure compliance with the requirements of this Governance Document.
- Evidence of 'reasonable endeavour' attempts to collaborate or obtain external funding will be taken into account, even if it has not resulted in collaboration or funding from parties outside the ownership group the DNO is part of.
- Accessing secure additional funding will be looked on favourably: the higher the proportion of external funding to Second Tier Funding the better. This may be from other External Funders, or from Project Partners who have an interest in the results of the Project, or from the DNO contributing more funding than the DNO Compulsory Contribution. Indeed, where the benefits from the Project lie outside of the Distribution System (as identified under criterion (b) above) we would expect the collaborators to be involved and to provide funds commensurate with the benefits they could be expected to get from participating in the Project.
- The degree to which any external funding that is claimed has been secured. For the avoidance of doubt, there will be no option for the DNO to seek to subsequently have this external funding replaced by additional Second Tier Funding.

#### **(f) Relevance and timing**

3.66. Consideration will be given to Projects that aim to address those developments associated with a move to a low carbon economy that are more likely to happen. However, for the avoidance of doubt, this does not mean we will necessarily favour the Method that is most likely to be successful, as we recognise that there will be benefits associated with trialling a variety of Methods.

3.67. The DNO must demonstrate how, if the Method proves successful, it would use it as part of their future business planning and how it would impact on its business plan submissions in future price control reviews.

3.68. When evaluating how Projects perform against this criterion, consideration will be given to the appropriateness of the timing of the proposed Project. This is to reflect that knowledge and technology will both be expected to change over the duration of the LCN Fund. It also recognises that other activities and investments will be taking place over the period, notably the start of the domestic smart meter roll-out.

#### **(g) Demonstration of a robust methodology and that the project is ready to implement**

3.69. The Expert Panel and the Authority will need to be confident that the DNO can be reasonably expected to deliver the Project. When comparing Projects, consideration will be given to the following.

- The detailed Project plan, with responsibilities clearly established and inter-dependencies identified,
- The resources to deliver the Project, which should be of a sufficient size and quality to be reasonably expected to ensure its delivery,
- Demonstration that the Project can be started in a timely manner.
- The Customer impact of Project implementation,
- That costs and benefits of the Project have been reasonably estimated. Any uncertainties in those estimates should be identified, together with any measures it will employ to minimise the possibility of cost overruns or shortfalls in Direct Benefits. The circumstances under which the DNO would apply to the Authority to request extra funding to cover cost overruns or shortfalls in Direct Benefits should be identified (as provided for under paragraphs 3.95 and 3.102). Credit will be given if limitations are placed on either the scale of protection or the circumstances under which it will be sought,
- The robustness of the proposed methodology on which the Project is based. For example, if the extrapolation of an outcome demonstrated through the Project is required to solve the Problem, the DNO must clearly show that the approach it is taking to undertake such an extrapolation is both statistically and technically sound, reliable and/or verifiable.,
- The quality of the Successful Delivery Reward Criteria,
- The verification of all information included in the proposal,
- The identification of appropriate risk mitigation processes, including:
  - a risk register,
  - risk management and mitigation plans, and
  - contingency plans.

3.70. The Full Submission should also identify the processes that will be in place to identify circumstances where the most appropriate course of action will be to suspend the Project, pending permission from Ofgem that it can be halted.

## **Award notification and Project Direction**

3.71. The Authority will issue its decision about which, if any, Projects it intends to award Second Tier Funding (subject to agreeing Project Directions), by 30th November in each year. In addition to publishing its decision, Ofgem will publish the report by the Expert Panel (excluding any confidential information) setting out its recommendation to the Authority and all non-confidential information provided as part of the Full Submission process. These will all be published on Ofgem's website.

3.72. If a DNO wishes to receive further feedback on why a Project has not been awarded funding, then it must make the request in writing to Ofgem within 20 Working Days of the Authority issuing its decision.

3.73. Ofgem will send a draft Project Direction for each Project that has been provisionally awarded Second Tier Funding shortly after the Authority issues its

decision. If the DNO cannot accept the draft Project Direction (subject to any clarification) within four Working Days of receipt of the draft, a Project Direction in respect of the Project will not be issued and the Project will not receive Second Tier Funding. Once a Project Direction has been issued by the Authority, and provided the DNO complies with this Governance Document and the Project Direction, the Project identified within it is deemed to be an Eligible LCN Fund Project, as defined in CRC13.

3.74. The Project Direction will:

- Set out the Project-specific conditions that the DNO is committing to in accepting Second Tier Funding.
- Require the DNO to undertake the Project in accordance with the commitments it has made in the Full Submission. Where appropriate the Project Direction may therefore include extracts from the Full Submission or refer to specific sections of the Full Submission.
- Set out the Approved Amount for the Project, as defined in CRC13.28, that will form part of the calculation contained in the direction issued by the Authority under CRC13.16 (the Funding Direction).
- Set out the Project Budget that the DNO must report against and how variances against the Project Budget will be reported and approved.

3.75. The mechanism for the DNO receiving the Approved Amount is set out in Section Four on the Funding Direction.

3.76. The Project Direction is a direction issued by the Authority setting out the terms to be followed during Project implementation as a condition of its being funded. Once a Project Direction has been issued, the DNO must comply with all terms within it. Failure to do so means that Ofgem may determine all or part of the Approved Amount as received by the DNO to be Disallowed Expenditure.

## **Project Implementation**

### **Project Bank Account**

3.77. A DNO that is awarded Second Tier Funding must keep these funds in a separate bank account (the Project Bank Account), unless alternative arrangements have been approved by Ofgem.

3.78. Where a DNO that is awarded funding demonstrates to Ofgem that they are unable to keep the funds in a separate bank account, Ofgem may approve that they use the alternative arrangements set out in paragraphs 3.79 to 3.82 below.

3.79. The DNO must provide a financial tracking and reporting system which is functionally equivalent to a separate bank account for this Project. This means they must hold any Approved Amounts, the DNO Compulsory Contribution and all other funding from the DNO, Project Partners and External Funders, that the DNO has



identified within its Full Submission as being used to fund the Project, unless otherwise agreed by Ofgem, in a memorandum account<sup>20</sup> which is capable of providing all the information that would be available from a separate bank account. This memorandum account must:

- i. Show all transactions relating to (and only to) the Project;
- ii. Be capable of supplying a real time statement (of transactions and current balance) at any time;
- iii. Accrue expenditures when a payment is authorised (and subsequently reconciled with the actual bank account);
- iv. Accrue payments from the moment the receipt is advised to the bank (and then subsequently reconciled with the actual bank account);
- v. Calculate a daily total; and
- vi. Calculate interest on the daily total according to the rules applicable to the account within which the funds are actually held.

3.80. The DNO's auditors must review the systems and processes that the DNO is proposing to use to conform to the requirements set out in this section and provide a signed statement to Ofgem that the systems and processes are fit for purpose, before the Project is initiated and any funds are spent.

3.81. The DNO's auditors must provide an annual report to Ofgem to confirm that the DNO is conforming to the requirements set out in this section.

3.82. The DNO must provide an audited schedule of all the memorandum account transactions, including interest (calculated according to sub point (vi) above), as part of its detailed progress reports to Ofgem.

3.83. For the remainder of this document, the term Project Bank Account applies to the separate bank account set out in paragraph 3.77 or, where Ofgem has given the DNO approval for use of alternative arrangements, the alternative arrangements set out in paragraphs 3.79 to 3.82 above.

3.84. The Project Bank Account must be used for the sole purpose of holding any Approved Amounts, the DNO Compulsory Contribution and all other funding from the DNO, Project Partners and External Funders that the DNO has identified within its Full Submission as being used to fund the Project, unless otherwise agreed by Ofgem. For the avoidance of doubt this does not include funding for initiatives which are being implemented independently of the Project and which would have proceeded regardless of the Project being awarded funding. Deposits to the Project Bank Account from the different funding sources will be made no later than the start of the year that the DNO identified they would be used in the Full Submission. A DNO

---

<sup>20</sup> Or equivalent unique code within their financial system, if approved as functionally equivalent by the Implementing DNOs' auditors. For this direction, the term memorandum account will also refer to the equivalent unique code if the auditor's approval has been obtained.

can only access funds from the Project Bank Account if it meets the requirements for use of these funds as set out in their Electricity Distribution Licence, this Governance Document and the Project Direction.

### **Customer protection**

3.85. Where the Eligible LCN Fund Project involves any interaction with a Customer or Customer's premises, or any direct impact on or engagement with Customers (eg through charging or contractual arrangements or supply interruptions) the DNO must comply with the conditions set out in this Customer protection section.

3.86. The DNO must submit to Ofgem, at least two months prior to initiating any form of Customer engagement, a plan of how it, or any of its Project Partners, will engage with, or impact upon, Customers as part of the Project. The DNO and its Project Partners cannot initiate any form of Customer engagement until the plan has been approved by the Authority, and must comply with the approved plan at all times. The plan must include:

- a communications strategy which sets out inter alia:
  - any proposed interaction with a Customer or premises of a Customer or proposed interruption to the supply of a Customer for the purposes of the Project, and how the Customer will be notified in advance;
  - ongoing communications with the Customers involved in the Project; and
  - arrangements for responding to Customer queries or complaints relating to the Project; and
- information on the Priority Services Register Customers who will be involved in the Project and how they will be appropriately treated (including providing information to any person acting on behalf of a Priority Services Register Customer in accordance with condition 26 of the Electricity Supply Licence, where applicable);
- details of any safety information that may be relevant to the Project; and
- details of how any consents that may be required as part of the Project will be obtained; and

3.87. The DNO must publish the plan by making it readily available on its website.

3.88. The DNO and its Project Partners must also:

- not visit a premises of a Customer for sales or marketing activities in connection with, in the context of or otherwise under the guise of the Project, and
- have regard to the implementation of the smart meter roll-out in its Distribution Services Area to ensure that the Project does not impede the implementation in any way.

3.89. In addition, if the DNO or its Project Partners is installing any equipment at the Customer's premises as part of the Project, the DNO and its Project Partners must comply with the following conditions:

- not enter the premises of a Customer, other than for the purposes contained in the Licence or for communication purposes (set out above), unless it first obtains the prior consent of the Customer, such consent to be formally recorded;
- where the equipment is any form of smart meter, the Implementing DNO or its External Collaborators must first notify the Customer's Electricity Supplier ; and
- provide the Customer with information (which should be identified as part of the communications strategy) on how the equipment will be installed, how long it will be installed for, and how it will be decommissioned.

### **Data protection**

3.90. Where the Eligible LCN Fund Project involves the collection of any personal data (as defined in the Data Protection Act 1988) the DNO must submit a strategy for dealing with this personal data to Ofgem at least two months prior to collecting or using the data. The DNO or its Project Partners cannot collect or use any personal data until the strategy has been approved by the Authority. The strategy must set out the following:

- what personal data will be collected for the purposes of the Project;
- how this personal data will be used;
- how consent for use of the personal data will be obtained;
- what information will be provided to the Customer prior to consent being sought;
- if Priority Services Register Customers are included in the Project, how their personal data will be obtained;
- who owns the personal data;
- how long the personal data will be retained; and
- how this personal data will be managed (which should be based on a 'privacy by design' approach, as advocated by the Information Commissioner's Office<sup>21</sup>).

### **Compliance**

3.91. It is the DNO's responsibility to ensure that the Project, in its entirety, is undertaken in accordance with CRC13, this Governance Document and the relevant Project Direction, including work undertaken by its Project Partners.

### **Reporting**

3.92. The DNO will be required to provide a detailed report, (the Project Progress Report), at least every six months, of sufficient detail to allow Ofgem to evaluate the progress of the Eligible LCN Fund Project. This must include information that will allow Ofgem to monitor how the DNO is performing against all of the Successful Delivery Reward Criteria. Ofgem may provide further guidance about the structure and contents of this report. Ofgem will look to publish an executive summary of the report on its website.

---

<sup>21</sup> See [http://www.ico.gov.uk/news/current\\_topics/privacy\\_by\\_design\\_conference.aspx](http://www.ico.gov.uk/news/current_topics/privacy_by_design_conference.aspx)

## **Project changes**

3.93. The DNO will inform Ofgem promptly in writing of any event or circumstance likely to affect the ability of it to deliver the Project as set out in its Full Submission.

3.94. If a DNO considers that there has been a material change in circumstance that requires a change to the Project Direction, it may submit a request for a change to Ofgem. This request should provide sufficient detail to allow Ofgem to decide whether the change would be appropriate in the circumstances, including whether it would be in the best interest of Customers. Once Ofgem has enough information to make this decision, it will provide its response in writing to the DNO, including any revisions it has accepted to the Project Direction. Ofgem expects that changes to the Project Direction will only be made in exceptional circumstances.

## **Application for Discretionary Funding for cost overruns or shortfalls in Direct Benefits**

3.95. We recognise that innovation and trialling involves an element of risk in that the costs, benefits and impacts of the project are not fully understood. This is one of the main reasons why DNOs may not undertake these projects under the normal regulatory framework. We therefore provide some protection for cost overruns and non-realisation of Direct Benefits, as set out below.

3.96. However it should be noted that protection will not be provided for poor project management, and that it is our expectation that the DNO will employ all reasonable endeavours to deliver the Project without recourse to Discretionary Funding for cost overruns or shortfalls in Direct Benefits. Ofgem will decide whether it is appropriate and justified to provide additional funding in such circumstances.

3.97. A DNO may request Discretionary Funding if it anticipates that the Project will cost more than it had forecast as part of its Full Submission. The default position is that the maximum amount that can be requested as additional funding for cost overruns is capped at five per cent of the Approved Amount unless an alternative arrangement is set out within the Project Direction. For the avoidance of doubt, a DNO could choose to identify in its Full Submission that it will not seek to recover any cost overruns and this will be included within its Project Direction.

3.98. If a DNO wishes to make an application for Discretionary Funding to cover anticipated cost overruns, it must notify Ofgem of its intention at least three Calendar Months before it incurs any additional costs. It will provide Ofgem with sufficient information to allow Ofgem to evaluate the request. The Authority will decide whether it would be appropriate in the circumstances, including whether it would be in the best interest of customers to award Discretionary Funding for that Project, the size of any award and any changes that may need to be made to the Project Direction before it would be awarded. The Authority may decide that no additional funding is warranted. In particular, the Authority is unlikely to be minded to provide additional funding for a Project where it has concerns about the quality of

project management that, in its opinion, outweigh any benefits expected to be generated by the provision of additional funding.

3.99. If a DNO seeks additional funding for a cost overrun then it will not be eligible to receive the Second Tier Successful Delivery Reward for that Project.

3.100. A DNO can also request Discretionary Funding if it experiences Direct Benefits that were lower than it forecast in its Full Submission. The default position is that a DNO can apply for up to 50 per cent of any shortfall in Direct Benefits in excess of the DNO Compulsory Contribution, unless an alternative arrangement is set out within the Project Direction.

3.101. If a DNO wishes to make an application for Discretionary Funding to cover a decrease in Direct Benefits, it will provide Ofgem with sufficient information to allow Ofgem to evaluate the request. The Authority will decide whether it would be appropriate in the circumstances, including whether it would be in the best interest of customers to award Discretionary Funding for that Project, the size of any award and any changes that may need to be made to the Project Direction before it would be awarded. The Authority may decide that no additional funding is warranted.

3.102. If Ofgem does agree to provide Discretionary Funding, Ofgem will reissue the Project Direction, if required, and will notify the DNO of when it will issue a Funding Direction to allow recovery of the Additional Funding. This process is set out in Section Four.

## **Halting Projects**

3.103. A DNO may also put a request to Ofgem to halt a Project, for example because it has become clear that the Method is not viable or there are other reasons why it does not make sense or is not possible to continue with the Project. The DNO may suspend the Project from the time it puts in this request, pending a decision from Ofgem to the request to halt. Ofgem may also request that a DNO halts a Project. From the time that either a DNO or Ofgem puts in the request to halt a Project, the DNO must not make any further withdrawals from the Project Bank Account unless:

- funds have already been committed to the Project, or
- the DNO can demonstrate to Ofgem that the funds are required to be incurred as part of the suspension of the Project.

3.104. As part of the process to evaluate whether a Project should be halted, either at the request of Ofgem or the DNO, the DNO will need to provide Ofgem with sufficient information to evaluate whether halting the Project will be appropriate in the circumstances, including whether it would be in the best interest of customers and identifying any costs it will incur and the actions required in halting the Project.

3.105. If Ofgem is satisfied that it is appropriate in the circumstances, including whether it would be in the best interests of customers to halt the Project then it will confirm in writing that it shall require that the Project be halted. It will also identify any funds from the LCN Fund that have been received by the DNO which have not yet been spent, less funds already committed and less any costs that Ofgem has agreed can be incurred to halt the Project. These revenues will be deemed to be Halted Project Revenues and will be returned through a subsequent Funding Direction, as described in Section Four.

3.106. A Project that is halted must still comply with the other requirements of this Governance Document, including the requirement to provide a Close-Down Report.

3.107. If a Project is halted without Ofgem's permission, all Approved Amounts or Additional Funding that the DNO has received for that Project will be deemed to be Disallowed Expenditure. The process for Disallowed Expenditure is set out in paragraphs 3.93 and 3.94.

### **Close-Down Report**

3.108. The DNO must provide a Close-Down Report for each Project that receives LCN Funding. It needs to provide sufficient information for third parties to understand what has been learnt from the Project. If the Project has generated IPR that Ofgem has agreed as part of the Project Direction do not need to be shared, the Close-Down Report must provide sufficient information for other DNOs to determine whether the IPR would be of value.

3.109. The DNO must submit its Close-Down Report to Ofgem within three Calendar Months of the Project completion date set out in the Project Direction, or if a Project has been halted, within three calendar months of Ofgem approving the halting of the Project.

3.110. As part of the Close-Down Report, the DNO must identify any unspent Approved Amounts or Additional Funding for the Project. This will be deemed to be Disallowed Expenditure.

3.111. In the event that Ofgem considers that a Close-Down Report is of an unacceptable standard, it may ask the DNO to resubmit the Close-Down Report.

3.112. Subject to its obligations to generate new knowledge that can be shared among all DNOs, a DNO can identify information from the Close-Down Report if Ofgem agrees that it has demonstrated that it (or its Project Partners) will face commercial harm from disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

3.113. Ofgem will issue more detailed guidance on what should be included within this Close-Down Report in 2011. It will include information similar to that required for the First Tier LCN Project Close-Down Reports detailed in Table 5.1 in Section One.

3.114. Project Close-Down Reports will be published on the Ofgem website. A DNO must clearly identify any information contained in the Close-Down Report that it considers to be confidential. If Ofgem agrees that it has demonstrated that it (or its Project Partners) will face commercial harm from disclosure and that the information is considered eligible for exemption under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004, then the DNO must provide a non-confidential version of the Close-Down Report which will be published by Ofgem.

3.115. The DNOs will also be expected to present at the annual conference described in Section One. They must (subject to any confidentiality or IPR arrangements approved in the Project Direction) deliver presentations and answer questions on all Projects that have been completed since the previous conference, as well as provide updates on those Projects that are still ongoing.

## **Second Tier Project audits**

3.116. All Second Tier Projects may be subject to an audit. This will include requiring the DNO to demonstrate that the Project is compliant with the appropriate conditions in the relevant Electricity Distribution Licence, the RIGs, this Governance Document and the relevant Project Direction. This audit may be undertaken by Ofgem, or by a third party appointed at the discretion of Ofgem.

## **Disallowed Expenditure**

3.117. Disallowed Expenditure is funding that the DNO receives for Eligible Second Tier Projects or via the Discretionary Funding Mechanism that Ofgem determines not to have been spent in accordance with this Governance Document or with the relevant Project Direction. It includes any funds that must be returned if the Project is halted without Ofgem's permission, any funds that have not been spent in line with the approved Project budget contained within the Project Direction, and any unspent funds for completed Projects.

3.118. If Ofgem considers that any funds are Disallowed Expenditure it will notify the DNO who will have twenty Working Days to challenge this decision. Ofgem will consider any representation from the DNO before finalising the determination as regards Disallowed Expenditure. The Disallowed Expenditure will be returned through a subsequent Funding Direction, as described in Section Four.

**SECTION THREE - Discretionary Funding Mechanism**

**1. Introduction ..... 62**  
**2. First Tier Portfolio Reward..... 63**  
**3. Second Tier Reward..... 64**  
**4. Second Tier Successful Delivery Reward ..... 65**



## 1. Introduction

1.1. As part of DPCR5 Final Proposals, Ofgem set out its intention that up to £100m of Discretionary Funding would be available for Eligible LCN Fund Projects. This Discretionary Funding may be made available for the following purposes:

- To cover cost overruns or shortfalls in Direct Benefits, as described in Section Two, Chapter 3,
- To reward DNOs under the Second Tier Successful Delivery Reward, as described in paragraphs 3.26 to 3.30 of Section Two and Chapter 4 below,
- To reward any DNO that is deemed to have undertaken an exceptional portfolio of First Tier LCN Projects (the First Tier Portfolio Reward), as described in Chapter 2 below,
- To reward any DNO that has undertaken a Second Tier LCN Project that is deemed to be exceptional (the Second Tier Reward) as described in Chapter 3 below.

1.2. The last two of these purposes reflect the fact that the Projects that Ofgem hope will be undertaken using the LCN Fund involve the DNOs changing their traditional business practices and taking on additional risk. These rewards are therefore designed to provide an additional incentive for DNOs to actively engage in the objectives underpinning the LCN Fund. In particular, they are designed to provide an incentive to the DNOs to meet the following Discretionary Reward Criteria when undertaking Projects using LCN funding:

- To perform exceptionally against one or more of the Specific Requirements set 2 (for First Tier LCN Projects) or the Evaluation Criteria (for Second Tier Projects).
- To invest the DNO's own money (over and above any compulsory funding) to enable the Project to be successfully delivered.
- To undertake exceptional effort to ensure the Project exceeds the expected delivery outcomes and the learning from it is maximised for the good of all DNO customers.

---

## 2. First Tier Portfolio Reward

2.1. The First Tier Portfolio Reward is designed to act as an incentive for a DNO to use its First Tier LCN Funding so as to meet the Discretionary Reward Criteria. Rather than making an award on the basis of performance on an individual First Tier LCN Project, Ofgem instead intends to make any award dependent on the entire portfolio of each DNO Group's First Tier LCN Projects.

2.2. First Tier LCN Projects will be of different sizes and durations. Rather than waiting until all such Projects are completed, Ofgem will instead undertake more than one assessment about whether to award any First Tier Portfolio Rewards. Ofgem will decide on the timing of its assessments on the basis of the number of completed LCN Fund Projects available to be assessed. Ofgem expects to hold a maximum of three such assessments to cover the time period spanning the expected duration of First Tier LCN Projects that will be started within the five year period from 1 April 2010.

2.3. Ofgem will provide at least six months' notice of its intention to consider awarding any First Tier Portfolio Reward. Each DNO will have to submit a First Tier Portfolio Report by a specified date, which must include details of all First Tier LCN Projects for which Ofgem has approved a Close-Down Report that have not already been included within a previous First Tier Portfolio Report. We would expect the First Tier Portfolio Report to summarise the key learning points from the Close-Down Reports and to focus on how the portfolio has performed against the Discretionary Reward Criteria identified above.

2.4. We would typically expect only a limited number of DNOs to receive a First Tier Portfolio Reward each time Ofgem makes an assessment, although lower awards could be made to more DNOs if this was thought to best reflect overall performance. It may also be the case that no award is made.

2.5. The Expert Panel will evaluate the First Tier Portfolio Reports against the Discretionary Reward Criteria. Based on this evaluation, the Expert Panel will produce a First Tier Portfolio Reward Recommendation Report which will outline its recommendations about which, if any, DNOs it considers eligible to receive a First Tier Portfolio Reward, the reasons for this view and the size of any such reward.

2.6. Once the Authority has considered the First Tier Portfolio Reports and the First Tier Portfolio Reward Recommendation Report against the Discretionary Reward Criteria, it will then notify DNOs of its decision in respect of whether any DNO has been awarded a First Tier Portfolio Reward and the amount of that reward. This Additional Amount will be included as part of a subsequent Funding Direction, as described in Section Four.

---

## 3. Second Tier Reward

3.1. The Second Tier Reward is designed to act as an incentive for a DNO to undertake each Second Tier Project so as to meet the Discretionary Reward Criteria.

3.2. Second Tier Projects will be of different sizes and durations. Rather than waiting until all such Projects are completed, Ofgem will instead undertake more than one assessment about whether to award any Second Tier Rewards and will decide on the timing of these assessments on the basis of the number of completed LCN Fund Projects available to be assessed. It is expected to hold a maximum of three such assessments to cover the time period spanning the expected duration of Second Tier Projects that will be started within the five year period from 1 April 2010.

3.3. Ofgem will provide at least six months notice of its intention to consider awarding any Second Tier Reward. Each DNO that has a Second Tier Project for which Ofgem has approved a Close-Down Report and which has not previously been submitted for a Second Tier Reward can submit a Second Tier Reward Report for that Project by a specified date. We would expect the Second Tier Reward Report to set out why the DNO considers the Project meets the Discretionary Reward Criteria set out previously.

3.4. We would typically expect only a limited number of Projects to receive a Second Tier Reward each time Ofgem makes an assessment, although lower awards could be made to more Projects if this was thought to best reflect overall performance. It may also be the case that no award is made.

3.5. The Expert Panel will evaluate the Second Tier Reward Reports against the Discretionary Reward Criteria. Based on this evaluation, the Expert Panel will produce a Second Tier Reward Recommendation Report which will outline its recommendations about which, if any, Projects it considers eligible to receive a Second Tier Reward, the reasons for this view and the size of any such reward.

3.6. Once the Authority has considered the Second Tier Reward Reports and the Second Tier Reward Recommendation Report against the Discretionary Reward Criteria, it will then notify DNOs of its decision in respect of whether any DNO has been awarded a Second Tier Reward and the amount of that reward. This Additional Amount will be included as part of a subsequent Funding Direction, as described in Section Four.

---

## 4. Second Tier Successful Delivery Reward

4.1. The Second Tier Successful Delivery Reward is designed to reward those Projects that are well managed and completed at least to the standard that could be expected given the information provided in the Full Submission as described in Section Two, Chapter 3, paragraphs 3.26 to 3.30. The Successful Delivery Reward Criteria against which the Project will be judged will be set out in the Project Direction.

4.2. A Second Tier Successful Delivery Reward will only be made if there is sufficient evidence that the Second Tier Project has been well managed and has achieved the Successful Delivery Reward Criteria. No Second Tier Project that puts in a request to recover cost overruns will be eligible to receive a Second Tier Successful Delivery Reward.

4.3. The DNO can apply to Ofgem to receive a Second Tier Successful Delivery Reward for a Second Tier Project once Ofgem has approved the Project Close-Down Report. The maximum level of Second Tier Successful Delivery Reward will be set out in the Project Direction and cannot exceed the level of the DNO Compulsory Contribution.

4.4. The DNO must provide sufficient evidence to allow Ofgem to evaluate the application. If Ofgem does not consider the application is of sufficient detail to allow it to make a judgement, it will notify the DNO, who may choose to resubmit its application. If, following resubmission, Ofgem still considers that there is insufficient information to evaluate the application then the request for Second Tier Successful Delivery Reward will be rejected. Ofgem may also use any other information it has gathered throughout the duration of the Project to inform in its evaluation.

4.5. The Authority will determine the level of the Second Tier Successful Delivery Reward that will be payable to the DNO. This may be all, part or none of the amount requested. Ofgem will notify the DNO of whether it has been approved within 30 working days of it having sufficient information to make its decision. This will set out whether the Project has been awarded any Second Tier Successful Delivery Reward and, if so, its value. This Additional Amount will be included as part of a subsequent Funding Direction, as described in Section Four.

---

## SECTION FOUR - Funding Direction

1.1. As set out in the Electricity Distribution Licence (paragraph 13.16 of CRC 13), Ofgem will issue a direction (the Funding Direction) that will:

- Set the value that each DNO can recover from customers to cover Second Tier and Discretionary Funding in each year,
- Identify the net amounts that must be transferred between DNOs, and
- The manner in which and the timescale over which the net amounts will be transferred.

1.2. Each Funding Direction will include any Second Tier Funding and Discretionary Funding less any Halted Project Revenues and Disallowed Expenditures that have not been included in a previous Funding Direction.

1.3. Ofgem will usually issue a Funding Direction to each DNO once a year, to allow sufficient time for each DNO to reflect the impact on its allowed revenue in its charges from 1 April of the following year.

1.4. The Funding Direction will set out:

- i. The Approved Amounts that have not already been funded through previous Funding Directions for each DNO for Second Tier Funding.
- ii. The Additional Amounts that have not already been funded through previous Funding Directions for each DNO for Discretionary Funding.
- iii. Halted Project Revenues and Disallowed Expenditures that have not already been recovered through previous Funding Directions for each DNO.
- iv. The customer numbers for each DNO.
- v. The calculation apportioning the Approved Amounts in (i), Additional Amounts in (ii), and Halted Project Revenues and Disallowed Expenditures in (iii) above between DNOs based on customer numbers and thus setting out the amounts to be recovered by each DNO in LCN2.
- vi. The transfers of funds to be made between DNOs to ensure that the DNOs receive the Approved Amounts in (i), the Additional Amounts in (ii) and refund the Halted Project Revenues and Disallowed Expenditures in (iii) via transfers of the amounts recovered by each DNO in LCN2.

1.5. If the Funding Direction determines that a DNO must make a transfer of revenue to one or more other DNOs, the DNO must make these transfers on an equal monthly basis, for the entirety of the Relevant Year, on the day of the month agreed by the DNO making the transfer.

1.6. A DNO that is due to receive funds under the terms of the Funding Direction is responsible for notifying the DNOs that will be transferring funds to it of the bank account details to which the transfers must be made.

---

## SECTION FIVE - Intellectual Property Rights

<b>1. Introduction .....</b>	<b>68</b>
<b>2. Default IPR conditions.....</b>	<b>69</b>
Scope.....	69
Ownership and transfer of ownership of IPR .....	69
Licensing of Background IPR .....	70
Licensing of Foreground IPR .....	70
Right to protect IPR.....	71
<b>3. Royalties .....</b>	<b>72</b>

## 1. Introduction

1.1. We recognise that the projects financed by the LCN Fund may create intellectual property rights (IPR) either for the DNO or for any Project Partners (whether for both or jointly), and that these rights could restrict the dissemination of learning and also provide a valuable income stream from royalties earned.

1.2. We have therefore created a default treatment for IPR, which is set out in the Default IPR conditions chapter. Where the DNO or any Project Partners deem any work product or output of the Project to be IPR, we hope that in the majority of cases they will conform to the default IPR conditions. However, we recognise that in some circumstances potential Project Partners may not be prepared to enter into agreements on this basis. We are therefore willing to consider alternative arrangements on a case by case basis as part of the Project Registration for First Tier LCN Projects or evaluation process for Second Tier Projects. The information required to justify these alternative arrangements is set out in paragraph 2.16 of Section One and paragraph 3.63 of Section Two.

1.3. We have also set out the treatment of any royalties earned by the DNO in the Royalties chapter. It should be noted that our expectation is that there will be no derogation from the treatment of royalties.

---

## 2. Default IPR conditions

2.1. The default IPR conditions are as follows.

### Scope

2.2. Knowledge transfer is one of the key aims of the LCN Fund. The benefits of a Project are maximised by the ability of other Electricity Distributors to be able to learn from the Project. However, not all IPR generated by a Project will necessarily be pertinent to this knowledge transfer. The default IPR conditions apply to IPR which is material to the dissemination of learning in respect of a given Project. This learning may be the knowledge necessary to reproduce or simulate the outcome of a Project. It may also be the knowledge necessary to avoid a negative outcome. Where the deployment of IPR materially reduces the cost, difficulty or time associated with reproducing the outcome of a Project, this would also constitute an IPR which is material to the dissemination of learning.

2.3. It will be the DNO's responsibility to describe all work products generated during the course of a Project that are material to the dissemination of learning and relevant to a Project, and to identify where such work products constitute IPR and how it will be shared.

### Ownership and transfer of ownership of IPR

2.4. For the avoidance of doubt, each participant in the Project (Participant), whether a DNO or a Project Partner, shall retain all rights in and to its Background IPR.

2.5. Each Participant shall own all Foreground IPR that it independently creates as part of the Project, or where it is created jointly then it shall be owned in shares that are in proportion to the effort and work done in its creation.

2.6. Where any non-DNO Participant transfers any of its right, title or interest in or to any Foreground IPR to any other person, it shall only do so where the assignee/transferee agrees to abide by these default IPR conditions.

2.7. A DNO can only transfer any of its right, title or interest in or to any Foreground IPR to any other person, subject to:

- having regard to the true commercial value of the IPR, and
- where the assignee/transferee agrees to abide by these default IPR conditions.



## **Licensing of Background IPR**

2.8. Where access to a Participant's Background IPR is required to undertake the Project, the Participant shall grant a non-exclusive licence to this Background IPR (Relevant Background IPR) to the other Participants, solely for the purposes of the Project during the term of the Project.

2.9. Once the Project is over, Relevant Background IPR will be licensed for use by the Participants in connection with another Participant's Foreground IPR solely to the extent necessary to use that Foreground IPR, upon terms to be agreed. We do not anticipate that these terms will be on arms-length terms or include provision for payment of a royalty.

## **Licensing of Foreground IPR**

2.10. Foreground IPR that other DNOs will need to utilise in order to implement the Method(s) being trialled in the Project is classed as Relevant Foreground IPR. This will be identified in the Project Close Down Report in sufficient detail to enable others to identify whether they wish to licence that IPR. For clarification it is not expected that the confidential details of IPR would be disclosed in the Close Down Report, only sufficient information to enable others to identify whether the IPR is of use to them. Where Background IPR is required to use the Relevant Foreground IPR, this must also be clearly stated. For the avoidance of doubt, Foreground IPR within commercial products where those products will be available for use by the other DNOs after the end of the Project is not deemed Relevant Foreground IPR.

2.11. Licensing of the Relevant Foreground IPR will depend on who uses it and how the IPR is to be used.

2.12. All other Electricity Distributors will have the automatic right to use Relevant Foreground IPR for use within their Distribution System royalty-free.

2.13. Where the Relevant Foreground IPR can only be used with a Participant's Background IPR, other Electricity Distributors will have the automatic right to request a limited licence of such Background IPR for that sole purpose.

2.14. Electricity Distributors may be required by the licensor to enter into a confidentiality agreement to protect the IPR licensed to it.

2.15. Other parties (who are not Participants and are not Electricity Distributors) may request a licence to use Relevant Foreground IPR, such licence to be on arms-length terms, which may include payment of a commercial royalty.

## Right to protect IPR

2.16. Each Participant will warrant that it has the right, power, title and authority to license its Relevant Background IPR on the terms of the licence agreement.

2.17. Each Participant will warrant that use of the Relevant Background IPR in accordance with the terms of the licence agreement will not infringe any third party rights.

2.18. Each Participant will warrant that it will pay all fees necessary to maintain registered rights that form part of the licensed Relevant Background IPR.

2.19. Each Participant will undertake to protect Relevant Foreground IPR (subject to the transfer options above) in the following terms:

- Seek registered protection where that is available and maintain such registered protection for as long as the subject matter of that Relevant Foreground IPR is licensed and used by the other Participants,
- Where a Participant believes that registered protection should not be filed, agree terms with the other Participants setting out how this unregistered IPR will be protected and demonstrate how this is consistent with the knowledge transfer and dissemination of information requirements of the Project,
- Comply with agreed publication requirements, including as necessary to comply with academic requirements and co-authoring of publications,
- Set up a regime whereby unrelated third parties can access the Relevant Foreground IPR so that it can be further disseminated throughout the relevant industry whilst protecting the Participants' rights as owners and licensors.

### 3. Royalties

3.1. As stated in DPCR5 Final Proposals, it is our intent that any royalties earned by the DNO through Foreground IPR (whether relevant or not) will be shared with customers in proportion to the funds that customers have contributed to the Project. Where a DNO has transferred its right, title or interest in or to any Foreground IPR in return for an income (as set out in paragraph 2.7), this income should be treated in the same way.

3.2. We intend to treat royalties (or income generated from the transfer of Foreground IPR) as regulated revenue and apply the following treatment:

- the proportion of royalties (or income generated from the transfer of Foreground IPR) equivalent to the proportion of the total amount contributed by the DNO (i.e. the DNO contribution which is in excess of the DNO Compulsory Contribution plus the DNO Compulsory Contribution) versus the Outstanding Second Tier Project Funding will be retained by the DNO as additional profit, and
- the proportion of royalties (or income generated from the transfer of Foreground IPR) equivalent to the proportion of the Second Tier LCN Fund funding versus the Outstanding Second Tier Project Funding will be offset against the DNOs' allowed revenues.

3.3. We will seek a modification to the licence to enable this treatment and consult appropriately.

## SECTION SIX - Two Year Review

1.1. Ofgem will undertake a review of the LCN Fund after it has been in operation for two years. This will take into account the lessons learnt from the first two years of operation and the development of the Innovation Stimulus as part of the new RIIO regulatory framework. It is possible that, following this review, we will make changes to aspects of the LCN Fund operations and governance. However, any changes will not be retrospective, and will not affect any Projects already approved or being undertaken.

1.2. In the Two Year Review Ofgem will also assess the degree of First Tier LCN Project duplication across the DNOs and if we deem that the level of unnecessary duplication has been excessive we may set up a process for disallowing such duplication in future years.

---

## SECTION SEVEN - Definitions

### Additional Funding

Additional Funding is an amount awarded by the Authority in relation to Discretionary Funding under Part C: The Second Tier and Discretionary Funding Mechanism of CRC13 of the Electricity Distribution Licence.

### Affiliate

As defined in the Electricity Distribution Licence.

### Allowable First Tier Expenditure

Allowable First Tier Expenditure is the total expenditure that can be recovered from the First Tier Funding Mechanism. It includes Allowable Set-up Expenditure and Allowable First Tier Project Expenditure.

### Allowable First Tier Project Expenditure

Expenditure incurred by the DNO as part of a registered First Tier LCN Project can be recovered from the First Tier Funding Mechanism if it is Allowable First Tier Project Expenditure.

### Allowable Set-up Expenditure

Allowable Set-up Expenditure is expenditure incurred by a DNO to put in place the people, resources and processes to progress innovative Projects. This may include the costs of putting together bids for the Second Tier Funding Mechanism. Allowable Set-up Expenditure is subject to an annual limit.

### Approved Amount

As defined in CRC 13 of the Electricity Distribution Licence.

### Background IPR

Background IPR means all Intellectual Property owned by or licensed to a Participant at the start of the Project.

### Base Case Costs

The lowest cost method of delivering the Solution (on the scale outlined as part of the Project) which has been proven on the GB Distribution System.

### Calendar Month

Calendar Month is the period of time between any day in one month and the day numerically corresponding to that day in the subsequent month; save that, if the

period starts at the end of a month which contains more days than the subsequent month, the period expires at the end of the latter month.

#### Close-Down Report

The report that a DNO must provide for each First Tier LCN Project or Second Tier Project at the end of the Project as set out in Section One paragraph 5.3 and Section Two paragraph 3.84.

#### Combined Allowed Distribution Network Revenue

As defined in the Electricity Distribution Licence.

#### Customer

As defined in the Electricity Distribution Licence.

#### Direct Impact

Where the deployment of the Method will cause a directly related measurable change in the operation of the Distribution System in a controllable way.

#### Direct Benefits

Direct Benefits are the benefits of a Project accruing to the DNO during the Project implementation and include:

- any revenue included within the DNO's FB PQ for DPCR5 that will be saved as a result of undertaking the Project, and
- any incentive payments generated as a result of the Project for the duration of the Project implementation.

#### Disallowed Expenditure

As defined within CRC13 of the Electricity Distribution Licence.

#### Discretionary Funding

Funding which is provided to DNOs under the Discretionary Funding Mechanism.

#### Discretionary Funding Mechanism

The mechanism by which project cost overruns, shortfalls in Direct Benefits, First Tier Portfolio Rewards, Second Tier Rewards and Second Tier Successful Delivery Rewards are funded.

#### Discretionary Reward Criteria

The criteria used to assess whether to award a First Tier Portfolio Reward or a Second Tier Reward under the Discretionary Funding Mechanism.

### Distribution System

As defined in the Electricity Distribution Licence.

### Distribution System User (User)

For the purposes of this document means any of the following entities that the DNO has a direct or indirect contractual relationship:

The holder of a Generation Licence,  
The holder of a Supply Licence,  
The holder of an Electricity Distribution Licence,  
Demand customer, or  
GB System Operator.

### Distribution Network Operator (DNO)

As defined for distribution services provider (DSP) in the Electricity Distribution Licence.

### DNO Group

A group of DNOs who share the same Ultimate Controller.

### DNO Compulsory Contribution

The minimum contribution by the DNO to the Total Project Cost which is 10 per cent of the value of the Initial Net Funding Required

### DNO Partner

All DNO Participants except the Lead DNO.

### DPCR5

Distribution Price Control Review 5.

### Electricity Distributor

As defined in the Electricity Distribution Licence.

### Electricity Supplier

As defined in the Electricity Distribution Licence.

### Eligibility Requirements

Criteria and specific requirements used to assess whether a project has passed or failed the ISP.

### Eligible First Tier DNO Expenditure

The expenditure calculated using the formula set out in paragraph 3.8 of Section One.

#### Eligible First Tier Project Expenditure

The expenditure on a First Tier LCN Project according to the criteria set out in this Governance Document.

#### Eligible LCN Fund Project

As defined within CRC13 the Electricity Distribution Licence.

#### Evaluation Criteria

The criteria used to evaluate and compare Second Tier Projects at Full Submission, in order to assess which Projects (if any) should receive funding.

#### Expert Panel

A panel of independent senior experts who together provide knowledge and expertise under the following headings: energy network industries, environmental policy, technical and engineering, economics and financial and consumer interests. The panel is appointed by Ofgem to advise the Authority's decision-making process on the selection of Second Tier projects for funding and the award of the discretionary rewards.

#### External Funder

A non-DNO entity that provides funding for the project without requiring a return on their investment.

#### External Funding

Project funding provided by an External Funder or Project Partner.

#### External First Tier Funding

Funding from an Project Partner, third parties or other funding sources that covers Eligible First Tier Project Expenditure that is not Unrecoverable First Tier Project Expenditure.

#### First Tier Funding

Funding available under/of or pertaining to the First Tier Funding Mechanism

#### First Tier Funding Mechanism

The mechanism by which First Tier LCN Projects are funded.

#### First Tier LCN Project



A Project that satisfies the criteria set out in paragraphs 2.1 to 2.25 of Section One.

#### First Tier LCN Project Registration Pro-forma

The pro-forma which DNOs must complete and submit to Ofgem in order to apply for funding under the First Tier Funding Mechanism.

#### First Tier Portfolio Report

A report prepared by a DNO which sets out why their portfolio of First Tier Projects should receive a First Tier Portfolio Reward.

#### First Tier Portfolio Reward

A discretionary reward under the Discretionary Funding Mechanism that may be awarded to a DNO for its portfolio of First Tier Projects for their performance against the Discretionary Reward Criteria.

#### First Tier Portfolio Reward Recommendation Report

A report prepared by the Expert Panel outlining their recommendation to the Authority on which, if any, DNO(s) should receive a First Tier Portfolio Reward.

#### Foreground IPR

Foreground IPR means all Intellectual Property created by or on behalf of any of the Participants, their sub-licensees, agents and sub-contractors as part of, or pursuant to, the Project, including all that subsisting in the outputs of the Project.

#### Full Submission

The full application for funding under the Second Tier Funding Mechanism. The Full Submission consists of the completed Full Submission Pro-forma and any appendices.

#### Full Submission Pro-forma

A pro-forma which DNOs must complete and submit to Ofgem in order to apply for funding under the Second Tier Funding Mechanism.

#### Funding Direction

The direction referred to in CRC13.16 of the Electricity Distribution Licence.

#### Halted Project Revenues

As defined within CRC13 of the Electricity Distribution Licence.

#### Initial Net Funding Required

The amount of funding calculated as per paragraphs 3.10 to 3.13 of Section Two.

### Initial Screening Process (ISP)

As set out and described in Section Two of this Governance Document, the process through which Second Tier Projects must pass prior to being developed into a Full Submission and considered by the Expert Panel and Authority for Second Tier Funding.

### Intellectual Property Rights (IPR)

All industrial and intellectual property rights including patents, utility models, rights in inventions, registered designs, rights in designs, trademarks, copyright and neighbouring rights, database rights, moral rights, trade secrets, and rights in confidential information and know-how (all whether registered or unregistered and including any renewals and extensions thereof) and all rights or forms of protection having equivalent or similar effect to any of these which may subsist anywhere in the world and the right to apply for registrations of any of the foregoing.

### LCN First Tier Allowance

The LCN First Tier Allowance is an annual limit on the amount of funding that a DNO can recover from the First Tier Funding Mechanism.

### LCN2

As set out in CRC13 of the Electricity Distribution Licence.

### Lead DNO

The DNO named in the Full Submission as the Lead DNO, which receives the Approved Amount and is responsible for ensuring the Project complies with this Governance Document and the terms of the Project Direction.

### Method

A means of solving the Problem.

### Method Costs

The costs of replicating the Method, at the scale being tested in the Project, once it has been proven successful.

### Outstanding Funding Required

The amount of funding being requested from the LCN Fund, on a year by year basis over the duration of the Project.

### Participant

A party who is involved in a Project. A Participant will be one of the following: DNO, DNO Partner, Project Partner, External Funder, Project Supplier or Project Supporter.

### Priority Service Register Customers

As defined within the Electricity Distribution Licence.

### Problem

The obstacle or issue that needs to be resolved in order to facilitate the low carbon future.

### Project

The Trial or groups of Trials which is being proposed or undertaken.

### Project Bank Account

A separate bank account opened and used solely for the purpose of all financial transactions associated with a Second Tier Project.

### Project Eligibility Assessment (PEA)

Documentation prepared by the DNO prior to initiation of a First Tier LCN Project, demonstrating that the Project and funding comply with all criteria and conditions set out in this document.

### Project Direction

As defined in CRC13 of the Electricity Distribution Licence.

### Project Method Costs

The costs of replicating the Method at the scale being tested in the Trial once the Method has been proved successful.

### Project Partner

A non-DNO Participant that makes a contractual commitment to contribute equity to the Project (e.g. in the form of funding, personnel, equipment etc.) the return on which is related to the success of the DNO Project.

### Project Progress Report

A report, submitted by the implementing DNO to Ofgem, to demonstrate the Project progress.

### Project Supplier

A non-DNO Participant that makes a contractual commitment to supply a product or service to the Project according to standard commercial terms that are not related to the success of the Project.

### Project Supporter

A non- DNO Participant that makes no contractual or binding commitment to the DNO or any other Participant in relation to the Project but who intends to endorse and provide support to the Project and agrees to be publicly named as a supporter of the Project.

### Registration

Registration is the process by which a First Tier Project is registered with Ofgem, before the Project can start.

### Regulatory Year

As defined in the Electricity Distribution Licence.

### Related Undertaking

As defined in the Electricity Distribution Licence.

### Relevant Background IPR

Any Background IPR that is required to be accessed in order to undertake the Project.

### Relevant Foreground IPR

Foreground IPR that is required to disseminate knowledge in or reproduce any results of the Project.

### Screening Submission

The submission for ISP as set out in paragraph 2.3 in Section Two.

### Second Tier Funding

Funding available under/of or pertaining to the Second First Tier Funding Mechanism.

### Second Tier Funding Mechanism

The mechanism by which Second Tier Projects are funded.

### Second Tier Funding Recommendation Report

A report prepared by the Expert Panel outlining its recommendation to the Authority on which, if any, Second Tier Projects should be provided with a Second Tier Reward under the Discretionary Funding Mechanism.

### Second Tier Funding Request

The Second Tier Funding a DNO is applying for within its Full Submission.

### Second Tier Projects

Projects applying for or considered for funding under the Second Tier Funding Mechanism.

### Second Tier Reward

A discretionary reward under the Discretionary Funding Mechanism that may be awarded to a Second Tier Project for its performance against the Discretionary Reward Criteria.

### Second Tier Reward Report

A report prepared by a DNO which sets out why their Second Tier Project should receive a Second Tier Reward.

### Second Tier Reward Recommendation Report

A report prepared by the Expert Panel outlining their recommendation to the Authority on the Second Tier Project(s) which should receive a Second Tier Reward

### Second Tier Successful Delivery Reward

A reward under the Discretionary Funding Mechanism for completed Second Tier Projects which are judged by Ofgem against the Successful Delivery Reward Criteria.

### Solution

The outcome if the Problem is solved.

### Specific Requirements

The criteria a Project must meet to qualify as a First Tier LCN Project.

### Successful Delivery Reward Criteria

The Project specific criteria set out in the Project Direction against which the Project will be judged for the Second Tier Successful Delivery Reward.

### Total Project Costs

The total costs (including external contributions and funding) of the Second Tier Project.

### Trial

A limited, controlled and monitored test to demonstrate or prove that the Method works.

### Ultimate Controller

As defined within the Electricity Distribution Licence.

#### Unrecoverable First Tier Project Expenditure

Unrecoverable First Tier Project Expenditure is any Eligible First Tier Project Expenditure incurred in undertaking R&D activities, arising from a failure to conform to technical requirements or arising from an increase in payments associated with a reduction in standards of performance.

#### Working Day

As defined in the Electricity Distribution Licence.

## Appendices

### Index

<b>Appendix</b>	<b>Name of Appendix</b>	<b>Page Number</b>
1	The Authority's Powers and Duties	77
2	Glossary	79

## Appendix 1 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>22</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>23</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>24</sup>;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>25</sup>

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

<sup>22</sup> entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>23</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>24</sup> under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

<sup>25</sup> The Authority may have regard to other descriptions of consumers.



- promote efficiency and economy on the part of those licensed<sup>26</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>27</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

---

<sup>26</sup> or persons authorised by exemptions to carry on any activity.

<sup>27</sup> Council Regulation (EC) 1/2003

---

## Appendix 2 - Glossary

### A

#### Authority

The Gas and Electricity Markets Authority is the governing body for Ofgem, consisting of non-executive and executive members

### D

#### Demand side management (DSM)

Demand side management is any mechanism that allows a customer's demand to be intelligently controlled in response to events on the power system. Such events would include lack of network capacity or insufficient generation.

#### Department for the Environment and Rural Affairs (DEFRA)

#### Department of Energy and Climate Change (DECC)

#### Distributed Generation (DG)

Any generation which is connected directly into the local distribution network, as opposed to the transmissions network, as well as combined heat and power schemes of any scale. The electricity generated by such schemes is typically used in the local system rather than being transported for use across the UK.

#### Distribution Price Control Review 5 (DPCR5)

Distribution price control review 5. This price control is expected to run from 1 April 2010 until 31 March 2015.

#### Distribution Use of System Charges (DUoS)

### E

#### Energy Networks Association (ENA)

ENA is the industry body funded by UK gas and electricity transmission and distribution licence holders. It lobbies on common issues in the operating environment, both at domestic and European levels, and provides technical services for the benefit of members.

### F

#### Forecast Business Plan Questionnaire (FBPQ)

### G

---

Great Britain (GB)

## **I**

### [Independent Distribution Network Operator \(IDNO\)](#)

Any electricity distributor whose licences were granted after 1 October 2001. IDNOs do not have distribution services areas.

### [Innovation Funding Incentive \(IFI\)](#)

Scheme established under SLC 46 and CRC10 of the licence. The IFI is intended to encourage DNOs to invest in appropriate research and development activities that are designed to enhance the technical development of distribution networks (up to and including 132 kV) and to deliver value (i.e. financial, supply quality, environmental, safety) to end consumers.

### [Intellectual Property Rights \(IPR\)](#)

## **L**

### [Low Carbon Network \(LCN\) Fund](#)

Funding to encourage the DNOs to innovate to deliver the networks we will need for a low carbon economy.

## **N**

### [Net present value \(NPV\)](#)

Net present value is the discounted sum of future cash flows, whether positive or negative, minus any initial investment.

## **R**

### [Reporting instructions and guidance \(RIGs\)](#)

A document that is published as part of the price control settlement which sets out further detail on how the price control is to be implemented and how compliance with it will be monitored.

### [Research and development \(R&D\)](#)

### [RPI-X@20](#)

An Ofgem project to fundamentally review regulation, following 20 years of regulation under the RPI-X approach whereby allowances are pegged to a certain amount below RPI inflation.

## **T**

---

### Technology readiness level (TRL)

Technology readiness level is a measure used to assess the maturity of evolving technologies. It is graded on a scale from 1 to 9. TRL 1 occurs when scientific research begins to be translated into applied R&D with TRL 9 describing a proven technology.

### **U**

United Kingdom (UK)