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

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Date: 19 December 2011

Dear Company Secretary,

Project Direction ref: SPD/ Flexible Networks for a Low Carbon Future/ 19-12-12

Project Direction issued to SP Distribution Limited ("SPD") pursuant to the LCN Fund Governance Document¹ issued pursuant to Part E of Charge Restriction Condition 13 (Low Carbon Networks Fund) ("CRC13") of the Electricity Distribution Licence setting out the terms to be followed in relation to the Flexible Networks for a Low Carbon Future project (the "Project") as a condition of it being funded under the Second Tier and Discretionary Funding Mechanism².

CRC13 establishes the arrangements, known as the Low Carbon Networks Fund ("LCN Fund"), for the purposes of incentivising the development of low carbon networks.

Part E of CRC13 requires the Gas and Electricity Markets Authority (the "Authority") to issue the LCN Fund Governance Document for the purposes of regulating, governing and administering the LCN Fund.

Part G of CRC13 defines a Project Direction as a direction issued by the Authority pursuant to the LCN Fund Governance Document setting out the terms to be followed in relation to the Eligible LCN Fund Project³ as a condition of its being funded pursuant to the Second Tier and Discretionary Funding Mechanism. A Project Direction must, by virtue of paragraph 3.74 of Section Three of the LCN Fund Governance Document:

- set out the Project-specific conditions that a distribution network operator ("DNO") is committing to in accepting Second Tier Funding⁴;
- require the DNO to undertake the Project in accordance with the commitments it has made in the Full Submission⁵. Where appropriate the Project Direction may therefore include extracts from the Full Submission;

¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/ElecDist/Lcnf>

² Second Tier and Discretionary Funding Mechanism has the meaning given in CRC 13.3(b).

³ Eligible LCN Fund Project has the meaning given in Part G of CRC 13.

⁴ Second Tier Funding has the meaning given in CRC13.11.

⁵ Unless otherwise specified, defined terms (terms in capitals) in this Project Direction are defined in Section seven of the LCN Fund Governance Document.

- 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.

SPD submitted the Project for funding under the LCN Fund on 18 August 2011 and the Authority decided to award the funding to SPD in a decision dated 27 November 2011 (the "Decision Document"⁶) subject to SPD complying with CRC 13, the LCN Fund Governance Document (as may be modified from time to time in accordance with CRC 13 and as modified and/or augmented in respect of this Project by this Project Direction) and this Project Direction. In accordance with the LCN Governance Document the Authority hereby requires SPD to comply with the conditions set out in the Schedule to this Project Direction.

This Project Direction is issued by the Authority, and provided SPD complies with the LCN Fund Governance Document and this Project Direction, the Project is deemed to be an Eligible LCN Fund Project, as defined in CRC13.

This Project Direction constitutes notice pursuant to section 49A (Reasons for decisions) of the Electricity Act 1989.



Rachel Fletcher

Acting Senior Partner, Distribution and Governance

Signed on behalf of the Authority and authorised for that purpose by the Authority
19 December 2011

⁶ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=92&refer=Networks/ElecDist/lcnf>

Schedule to Project Direction

1. TITLE

Project Direction ref: SPD/Flexible Networks for a Low Carbon Future/19-12-11

2. PREAMBLE

This Project Direction issued by the Gas and Electricity Markets Authority (the "Authority") to SP Distribution Limited (the "Implementing DNO") pursuant to the LCN Fund Governance Document issued pursuant to Part E of Charge Restriction Condition 13 (Low Carbon Networks Fund) ("CRC 13") of the Electricity Distribution Licence (the "Licence") sets out the terms to be followed in relation to the Flexible Networks for a Low Carbon Future project (the "Project") as a condition of it being funded under the Second Tier and Discretionary Funding Mechanism⁷.

Unless otherwise specified, defined terms in this Project Direction are defined in section 7 of the LCN Fund Governance Document.

References to specific sections of the Implementing DNO's Full Submission in this Project Direction are, for ease of reference, made by referring to the section number in the Implementing DNO's Full Submission pro-forma.

3. CONDITION PRECEDENT

The Implementing DNO will not access any funds from the Project Bank Account until it has signed contracts with the Project Partners named in Table 1.

Table 1 Condition Precedent

University of Strathclyde
TNEI Services Ltd
Nortech Management Ltd
Building Research Establishment Ltd

4. COMPLIANCE

The Implementing DNO must comply with CRC13 and the LCN Fund Governance Document (as may be modified from time to time in accordance with CRC13 and as modified and/or augmented in respect of the Project by this Project Direction) and the Project Direction.

Any part of the Approved Amount that the Authority determines not to have been spent in accordance with this Project Direction (or the LCN Fund Governance Document) is deemed to be Disallowed Expenditure.

Pursuant to CRC 13.14 Disallowed Expenditure is revenue received (whether by the Implementing DNO or another DSP⁸) under the Second Tier and Discretionary Funding Mechanism that the Authority determines not to have been spent in accordance with the provisions of the LCN Fund Governance Document or those of the relevant Project Direction.

Pursuant to paragraph 3.117 of Section Two of the LCN Fund Governance Document, Disallowed Expenditure includes any funds that must be returned if the Project is halted

⁷ Second Tier and Discretionary Funding Mechanism has the meaning given in CRC 13.3(b).

⁸ As defined in the Licence.

without Ofgem's⁹ permission, any funds that have not been spent in line with the approved Project Budget contained within the Project Direction, and any unspent funds on the completion of the Project.

5. APPROVED AMOUNT FOR THE PROJECT

The Approved Amount is £3,600k

6. PROJECT BUDGET

The Project Budget is set out in Annex 1. The Implementing DNO must not spend more than 110% of any category total (e.g. "Labour") in Annex 1 without the Authority's prior consent (such consent is not to be unreasonably withheld).

The Implementing DNO will report on expenditure against each line under the category totals in the Project Budget, and explain any projected variance against each line total in excess of 5% as part of its detailed report which will be provided at least every six months, in accordance with paragraph 3.92 of Section Two of the LCN Fund Governance Document. Ofgem will use the reported expenditure and explanation to assess whether the funding has been spent in accordance with the LCN Fund Governance Document or with this Project Direction.

For the avoidance of doubt this reporting requirement does not change or remove any obligations on the Implementing DNO with respect to reporting that are set out in the LCN Fund Governance Document.

7. PROJECT IMPLEMENTATION

The Implementing DNO must undertake the Project in accordance with the commitments it has made in the Full Submission approved by the Authority pursuant to the LCN Fund Governance Document and the terms of this Project Direction. These include (but are not limited to) the following:

- (i) undertake the Project in accordance with the description set out in Section 2 (Project Description);
- (ii) provide a DNO compulsory Contribution of £625k¹⁰
- (iii) provide extra funding in excess of the DNO Compulsory Contribution of at least £1,963k¹¹
- (iv) complete the Project on or before the Project completion date of 31 December 2014; and
- (v) disseminate the learning from the Project at least to the level described in Section 5 (Knowledge Dissemination).

8. REPORTING

Ofgem will produce guidance (which may be amended from time to time) about the structure and content of the reports required by paragraph 3.92 of Section Two of the LCN Fund Governance Document. The Implementing DNO must follow this guidance in preparing the reports required by paragraph 3.92 of Section Two of the LCN Fund Governance Document.

9. COST OVERUNS

⁹ Ofgem is the offices of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'Authority' are used interchangeably in this Project Direction.

¹⁰ The DNO Compulsory Contribution may take the form of Direct Benefits realised from the Project

¹¹ The DNO Compulsory Contribution may take the form of Direct Benefits realised from the Project

The maximum amount of Discretionary Funding that the Implementing DNO can request as additional funding for cost overruns on the Project is 0%.¹²

10. SHORTFALL IN DIRECT BENEFITS

The maximum amount of Discretionary Funding that the Implementing DNO can request to cover a shortfall in Direct Benefits 0% of any shortfall in Direct Benefits in excess of the DNO Compulsory Contribution.¹³

11. INTELLECTUAL PROPERTY RIGHTS (IPR)

In Section 5 (Knowledge Dissemination) the Implementing DNO has stated that the Project does conform to the default IPR arrangements set out in Section 5 of the LCN Fund Governance Document and must therefore undertake the Project in accordance with the default IPR arrangements.

12. SUCCESSFUL DELIVERY REWARD CRITERIA

The Project will be judged by the Authority for the purposes of the Second Tier Successful Delivery Reward against the Successful Delivery Reward Criteria set out in Table 2¹⁴ below (that comply with paragraphs 3.27 and 3.28 of Section Two of the LCN Fund Governance Document).

Table 2. Successful Delivery Reward Criteria

Successful Delivery Reward criterion	Evidence
The project will be delivered to budget in accordance with the Tier 2 full submission. A 5% variance will be acceptable between work packages but the overall project will be delivered in line with this submission in order to demonstrate effective cost control.	Ongoing cost reporting to monitor progress and publication of a final report to Ofgem will identify costs incurred per work package to assess compliance with the Tier 2 submission. Project completion date of December 2014.
The project will be delivered in accordance with the timelines outlined in the Tier 2 submission to ensure timely learning can be disseminated and adopted in advance of RIIO-ED1 commencing. Delivery in accordance with these timelines, and in line with budget as per criterion 1 will demonstrate effective project management.	Ongoing project reporting and formal reports to Ofgem will identify the how well the project is being delivered in accordance with the time lines set out within this submission. Should individual work package time lines deviate from plan, a lower reward weighting may be appropriate as long as the overall project is delivered on time. Completion date December 2014.
This criterion is to reward on the basis of degree of success on achieving the stated project outputs. The St Andrews trial will be making use of the network monitoring to improve knowledge of the network and provide robust evidence of the benefits of the physical solutions. The flexible network control, dynamic asset rating and voltage regulators will provide additional back-feed capability such that the existing substation	The Evidence will be submitted in the form of a sufficiently robust business case paper detailing the full basis, costs and benefits of the installed Flexible Network solution sufficient for Scottish Power to defer or avoid the business as usual reinforcement. At the end of the project, evidence detailing how a 20% headroom has been achieved will be published along with details of the methodology for this, along with supporting verification from one of the

¹² This is the amount requested by the Implementing DNO in its Full Submission.

¹³ This is the amount requested by the Implementing DNO in its Full submission.

¹⁴ These are the Successful Delivery Reward Criteria set out in the Implementing DNOs Full Submission

<p>and OHL reinforcements can be deferred or avoided. An increase in capacity of 20% is being targeted.</p>	<p>project partners. A comparative analysis of the traditional reinforcement solution will also be provided to demonstrate the nature of the saving.</p> <p>Work will be undertaken within the permitted CI/CML allowance and with no health, safety or environmental incidents. All of these measures will form part of the internal reporting structure and will feature in any formal report to Ofgem, Completion date December 2014.</p>
<p>This criterion is to reward on the basis of degree of success on achieving the stated project outputs.</p> <p>The Wrexham trial (to be undertaken within the SP Manweb DNO licence area) will be making use of the cascade monitoring to improve knowledge of the network and provide robust evidence of the benefits of the physical solutions. The improved knowledge will then be used to allow further PV connections without significant reinforcement as is currently envisaged with the target to facilitate an additional 20% of PV onto the network.</p>	<p>The Evidence will be submitted in the form of a sufficiently robust business case paper detailing the full basis, costs and benefits of the installed Flexible Network solution sufficient for the Licensee to defer or avoid the business as usual reinforcement.</p> <p>An evidence base will be published which outlines the amount of microgeneration which the project has proven can be connected to this part of the network as a result of this solution, a comparative analysis will be provided of the volume of microgeneration which could be connected pre-project, with the target to facilitate an additional 20%. This will be supported by independent analysis by an appropriate project partner to verify the results.</p> <p>Work will be undertaken within the permitted CI/CML allowance and with no health, safety or environmental incidents. All of these measures will form part of the internal reporting structure and will feature in any formal report to Ofgem. Completion date December 2014.</p>
<p>This criterion is to reward on the basis of degree of success on achieving the stated project outputs.</p> <p>The Whitchurch trial (To be undertaken within the SP Manweb DNO license area) will be making use of the network monitoring to improve knowledge of the network and provide robust evidence of the benefits of the physical solutions. The flexible network control, dynamic asset rating and voltage regulators will provide additional back-feed capability such that the existing substation and OHL reinforcements can be deferred or avoided. A increase in capacity of 20% is being targeted.</p>	<p>The Evidence will be submitted in the form of a sufficiently robust business case paper detailing the full basis, costs and benefits of the installed Flexible Network solution sufficient for the Licensee to defer or avoid the business as usual reinforcement.</p> <p>At the end of the project, evidence detailing how a 20% headroom has been achieved will be published along with details of the methodology for this, along with supporting verification from one of the project partners. A comparative analysis of the traditional reinforcement solution will also be provided to demonstrate the nature of the saving.</p> <p>Work will be undertaken within the</p>

	permitted CI/CML allowance and with no health, safety or environmental incidents. All of these measures will form part of the internal reporting structure and will feature in any formal report to Ofgem. Completion date December 2014.
<p>This criterion covers both Internal and External engagement and dissemination activities as described in Work Package 3.</p> <p>It will also monitor how the Licensee adopts or incorporates the outputs of the LCNF project into the core business processes going forward. Having the positive outcomes accepted as beneficial for core business will be a strong indication of both success of the trials as well as an indication of the commitment of the Flexible Networks project team in driving the business change and acceptance process.</p> <p>The key aspects of this criterion are to ensure that the project provides high quality and timely engagement and dissemination with the internal and external stakeholders.</p>	<p>Internal and External workshops which will include formal post-workshop surveys to effectively score the success of the learning. Surveys will include points on whether there is sufficient high level information to understand the project context, as well as detailed information on the solution design, data/information gathered and shared, and how the acceptance process within SP Energy Networks progressed.</p> <p>A survey will also be undertaken within each trial area of the affected Stakeholders to gauge the level of satisfaction and to confirm whether they felt they were sufficiently informed of the activities, benefits and risks of the LCNF project.</p> <p>Further proposed milestones which will demonstrate this success are:</p> <ul style="list-style-type: none"> - Project website established to provide overview of project - April 2012 - Site visit of PNDC for DNO and Ofgem representatives to demonstrate technology - June 2013 - Formal dissemination event to disseminate outcomes - December 2014

The maximum amount of the Second Tier Successful Delivery Reward (which will not exceed the DNO Compulsory Contribution) that the Project will be eligible for is £625k.

13. USE OF LOGO

The Implementing DNO and Project Partners, External Funders and Project Supporters¹⁵ may use the LCN Fund logo for purposes associated with the Project but not use the Ofgem or Ofgem E-Serve logos in any circumstances.

14. AMENDMENT OR REVOCATION

As set out in the LCN Fund Governance Document and this Project Direction, this Project Direction may be amended or revoked under the following circumstances:

- (i) if the Implementing DNO considers that there has been a material change in circumstance that requires a change to the Project Direction, and the Authority agrees (paragraph 3.94 of Section Two of the LCN Fund Governance Document); or

¹⁵ As listed in Box 1.5 of Section 1 of the Full Submission pro-forma.

- (ii) if Ofgem agrees to provide Discretionary Funding, which requires the re-issue of the Project Direction (paragraph 3.102 of Section Two of the LCN Fund Governance Document); or
- (iii) if the Implementing DNO applies for Discretionary Funding to cover a decrease in Direct Benefits and the Authority decides it would be in the best interest of customers to make changes to the Project Direction before the Discretionary Funding would be awarded (paragraph 3.101 of Section Three of the LCN Fund Governance Document).

15. HALTING OF PROJECTS

This Project Direction is subject to the provisions contained in paragraphs 3.103 to 3.107 of Section Two of the LCN Fund Governance Document relating to the halting of projects. By extension, this Project Direction is subject to any decision by the Authority to halt the Project to which this Project Direction relates and to any subsequent relevant Funding Direction issued by the Authority pursuant to CRC13.16.

In the event of the Authority deciding to halt the Project to which this Project Direction relates, the Authority may issue a statement to the Implementing DNO clarifying the effect of that halting decision as regards the status and legal force of the conditions contained in this Direction.

NOW THEREFORE:

In accordance with the powers contained in the LCN Fund Governance Document issued pursuant to Part E of CRC13 (Low Carbon Networks Fund) of the Licence the Authority hereby issues this Project Direction to the Implementing DNO in relation to the Project.

This constitutes notice of reasons for the Authority's decision pursuant to section 49A of the Act.



Rachel Fletcher

Acting Senior Partner, Distribution and Governance

Signed on behalf of the Authority and authorised for that purpose by the Authority
19 December 2011