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Dear Arun

**Further consultation on implementing the Discretionary Funding Mechanism under the Low Carbon Networks (LCN) Fund**

I welcome the opportunity to provide further comments on the implementation the Discretionary Funding Mechanism in the LCN Fund.

In relation to the magnitude of the individual reward elements I propose that the Second Tier Reward (STR) and First Tier Portfolio Reward (FTPR) of the Discretionary Funding Mechanism are sized in proportion to the use of the first and second tier funds as this reflects the efforts of the DNOs. We wish to see two assessments for the STR with each assessment proportioned in relation to the size of the projects eligible to apply in each period. We would also like to see the assessment for the FTPR to occur as soon as practical after the close of the LCN Fund on 31 March 2015. In Annex 1 I have provided detailed responses to your consultation questions.

Please do not hesitate to contact Steve Cox or Simon Brooke if you have further questions.

Yours sincerely,

Paul Bircham  
Regulation Director

## **Annex 1: Consultation question responses**

These are our detailed responses to the consultation questions.

**Question 1: Do you agree with our proposed approach to allocating the £100m across the rewards?**

**&**

**Question 2: Do you have an alternate proposal for how we should allocate the £100m between rewards? Please explain why you think this is a better option.**

We agree that it is appropriate and fair that the value of the SDR, set at the cumulative value of the DNO compulsory contribution, is taken off the £100 million first and the remaining amount is proportioned across the STR and FTPR. This allocation could be done now using the maximum values available for the LCN Fund. But our preference is that the allocations are completed with knowledge of the use of the First and Second Tier LCN Fund. We proposed the apportionment ratio between STR and FTPR is worked out based on the outturn values for the two LCN Fund Tiers if we are using the actual value for the SDR, which you comment will be known by December 2014. This makes the allocation accurate and a true reflection of the effort between the two LCN Fund Tiers.

**Question 3: Which of the two options for assessment of the STR do you support? Why?**

**&**

**Question 4: If you support having two assessments, how should the available funding be split between the two and why?**

Our preference is to have two assessments, rather than one. An earlier assessment is fairer to the participants and will positively reinforce the principle of reward for exceptional projects, a key feature in the design of the LCN Fund Governance document when originally designed and drafted. It is sensible that the fund is split based on the sum of the projects eligible to apply for the reward funding between the two time periods ie up to 2017 and post 2017. As projects may amend the finish date whilst in flight, with the agreement of Ofgem, some flexibility in allowing the roll-over of funds from the first assessment period to the second period would be beneficial.

**Question 5: Do you agree with having one assessment for the FTPR?**

**&**

**Question 6: Should First Tier projects that conclude under the NIA be considered in the assessment? Why?**

We agree that there should only be one assessment which should only include projects completed with LCN funding. NIA is a separate funding mechanism, and any First Tier projects not completed by the close of the LCN Fund on 31 March 2015 should not be considered in the portfolio reward scheme.

**Question 7: When should we conduct the assessment for the FTPR? Why?**

Our preference is that the assessment for the FTPR is held as soon as reasonably practical, after the close of the First Tier LCN Fund on 31 March 2015. It could be held in the same assessment window as the SDR ie between May and July.

**Question 8: Do you agree with our proposed changes to the criteria?**

**&**

**Question 9: Do you have any suggested alternatives to these criteria? Please explain why you believe they are appropriate.**

We agree in principle that the Second tier evaluation criteria should be applied *ex post*, but we note in application this does not work for all of the criteria. You have already highlighted concerns over the ex post rules for criteria (d) and (f), which we agree with and would like to see further clarity on these criteria. Our preference is that criterion (d) is combined with criterion (c) as the exceptional nature is how the partner has embraced and shared the learning/knowledge from the project and this appears to support your comments on criterion (d). The ex post evaluation of criterion (f) appears to cover similar aspects to the SDR and therefore our preference is that criterion (f) is not included.

With regard to the proposed First Tier evaluation criteria we agree it is not appropriate to include criteria (b), (d) and (e). However this only leaves two criteria for the evaluation for the FTPR and both criteria will be evaluated by focusing on individual project outputs, whereas the reward is for the exceptional delivery of the portfolio of projects. We propose there should be three additional high level evaluation criteria of value for money (ie outputs represent value for money against project costs), relevance (ie learning influences further innovation work/ business plans) and balanced innovation portfolio (ie targeted use of innovation funding) that considers the portfolio as a whole.

**Question 10: What do you believe is the most appropriate way for applications to be assessed? Why?**

In the same way that GEMA appointed an independent panel of experts to evaluate and recommend funding for Second Tier LCN Fund projects we see that it remains appropriate for GEMA to delegate the evaluation and recommendation for reward funding to a similarly formed panel of specialists. The key is that the process is transparent and the evaluation panel has the requisite level of knowledge, skills and experience as the existing LCN Fund Expert Panel. The rigorous selection process for panel members and the on-going annual review ensures that there are no conflicts of interest and safe guards both the applicant and customers' interests. If the evaluation of completed projects cannot be fulfilled by the existing LCN Fund Expert Panel as it has been disbanded then we suspect the Network Innovation Competition Expert Panel is next best option to perform the evaluation and propose recommendations, with suitable support from Ofgem and/ or consultants.