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Low Carbon Networks Fund Governance Document v.7

Governance Document

Publication date: 2 April 2015

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Overview:

This document is version 7 of the LCN Fund Governance Document referred to at Charge Restriction Condition (CRC) 2J of the Electricity Distribution Licence.

It sets out all the regulation, governance and administration of Projects funded by the Low Carbon Networks (LCN) Fund established under the fifth Distribution Price Control Review (DPCR5).

Context

In December 2009, we published our Final Proposals for the fifth 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.

This document is version seven of the LCN Fund Governance Document. It sets out the regulation, governance and administration of Projects funded by the LCN Fund established under DPCR5.

This document is issued by the Authority under Part E (The LCN Fund Governance Document) of Charge Restriction Condition (CRC) 2J of the Electricity Distribution Licence and in accordance with Part F (Procedure for issuing the LCN Fund Governance Document) of CRC 2J. This document may be revised and re-issued by the Authority in accordance with Part E of CRC2J.

The DNOs are required by CRC 2J 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
- Charge Restriction Condition 2J (The Low Carbon Networks Fund)

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1. Introduction

1.1. Innovation is a key element of the new RIIO (Revenue = Incentives + Innovation + Outputs) model for price controls. This document has been published to ensure that appropriate governance arrangements are in place for ongoing projects funded through the Second Tier Funding Mechanism and First Tier Funding Mechanism during DPCR5. It also includes arrangements for the Discretionary Funding Mechanism and obligations for ensuring intellectual property developed by a Project is shared among all licensees.

The Low Carbon Networks Fund

1.2. The LCN Fund has now been replaced for funding new projects by the Network Innovation Competition and the Network Innovation Allowance. The LCN Fund was first established as part of Final Proposals of DPCR5¹. We proposed a £500m 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 was to help all DNOs understand how they could 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.

1.3. 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.

1.4. 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.

1.5. 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 [Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations - \(Reference number: 145/09\), December 2009.](#)

1.6. 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 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.

1.7. 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. Such practices have the potential to lower the costs of developing and maintaining the distribution network.

1.8. 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.

1.9. The LCN Fund enables 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 in future price control reviews.

1.10. The LCN Fund consisted of two tiers. DNOs were 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 could recover from First Tier Funding was subject to an annual limit.

1.11. 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 held 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.

1.12. 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.

The LCN Fund Governance Document

1.13. This document is the LCN Fund Governance Document and sets out the regulation, governance and administration for ongoing Second Tier LCN Fund Projects.

1.14. This is the seventh version of the LCN Fund Governance Document and has been issued to ensure the continuing regulation and governance of ongoing Second Tier Projects and to allow for the running of the Discretionary Funding Mechanism.

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 Six.

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 proposed 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.

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1. Introduction

Background

1.1. The Second Tier Funding Mechanism provided total funding, on a competitive basis, of £208m during the five years of the DPCR5 period for 23 significant 'flagship' Projects. A total of £64m could have been allocated to projects in a single year. These Projects differed in their scope and value from First Tier LCN Projects and consequently were subject to separate governance arrangements which are detailed in this section of the document.

2. Project Implementation

Introduction

2.1. In this chapter we set out the conditions that Projects which received Second Tier Funding will need to comply with on an ongoing basis.

Successful Delivery Reward Criteria

2.2. 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.

2.3. The Successful Delivery Reward Criteria are Project specific. A DNO must have 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.

2.4. The Expert Panel and Ofgem may have suggested changes to the Successful Delivery Reward Criteria proposed within the Full Submission as part of their consideration of the Full Submissions. The DNO could choose to accept these changes, which then formed part of the Full Submission.

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

2.6. 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.

Project Implementation

Project Bank Account

2.7. 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 in the Project Direction.

2.8. Where a DNO that was awarded funding demonstrated to Ofgem that it was unable to keep the funds in a separate bank account, Ofgem may have approved that it uses the alternative arrangements set out in paragraphs 2.9 to 2.12 below.

2.9. The DNO must provide a financial tracking and reporting system which is functionally equivalent to a separate bank account for this Project. This means it 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 account² 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.

2.10. 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.

2.11. 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.

2.12. 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.

² 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.

2.13. For the remainder of this document, the term Project Bank Account applies to the separate bank account set out in paragraph 2.7 or, where Ofgem has given the DNO approval for use of alternative arrangements, the alternative arrangements set out in paragraphs 2.8 to 2.12 above.

2.14. 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 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

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

2.16. 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, Relevant 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 Relevant Customer or premises of a Relevant Customer or proposed interruption to the supply of any Customer for the purposes of the Project, and how the Customer will be notified in advance;
 - ongoing communications with the Relevant Customers involved in the Project; and
 - arrangements for responding to queries or complaints relating to the Project from Relevant Customers; 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

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

2.18. The DNO and its Project Partners must also:

- not visit a premises of any 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.

2.19. 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 Project Partners 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

2.20. Where the Project involves the collection of any personal data (as defined in the Data Protection Act 1998) 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 Office³).

Compliance

2.21. It is the DNO's responsibility to ensure that the Project, in its entirety, is undertaken in accordance with CRC 2J, this Governance Document and the relevant Project Direction, including work undertaken by its Project Partners.

³ See http://www.ico.gov.uk/news/current_topics/privacy_by_design_conference.aspx

Reporting

2.22. 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 publish the report on its website. If there is any confidential information in the Project Progress Report, this must be included in a separate confidential annex, which will not be published on Ofgem's website.

2.23. Within the Project Progress Report, or other report as may be detailed by Ofgem in the future, the DNO will also be required to provide details of any royalties earned through Foreground intellectual property rights (IPR), or income generated through the transfer of Foreground IPR. The Authority may require that the details of any royalties specified in Regulatory Instructions and Guidance (RIGs) issued under Standard Condition 47 (Reporting Control Revenue Information) of the electricity distribution licence. This includes the cost of licensing any Foreground IPR. The Authority may decide to audit a Project to examine these licensing costs. Where such costs are found to be inaccurate, they will be deemed Disallowed Expenditure as under paragraphs 2.50 and 2.512.51.

Project changes

2.24. 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.

2.25. 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

2.26. 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.

2.27. 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.

2.28. 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.

2.29. 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.

2.30. 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. A DNO that reserves the option in its Full Submission to recover cost overruns but does not apply for cost overruns funding may still apply for the Successful Delivery Reward.

2.31. 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.

2.32. 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.

2.33. 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

2.34. 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.

2.35. 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.

2.36. 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.

2.37. 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.

2.38. 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 2.50 and 2.51.

Close-Down Report

2.39. 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, including discharging the requirements of section 3 paragraph 2.10 of this document. 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.

2.40. 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.

2.41. 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.

2.42. 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.

2.43. 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.

2.44. Ofgem has issued detailed guidance on what should be included within this Close-Down Report.⁴ In addition the DNO must provide, for review, a draft of each second tier Close-Down Report to at least one other DNO. The reviewing DNO is expected to review the draft Close-Down Report before its publication. Evidence of robust peer review will be a key consideration in our decision of whether to accept the Close-Down Report.

2.45. The reviewing DNO should review the Close-Down Report and evaluate whether the Close-Down Report is clear and understandable and provides sufficient information to enable a DNO, not closely involved in the Project, to effectively consider whether and how to implement the Project's learning in to its business as usual activities. Where the report provides sufficient information this should be confirmed in writing.

2.46. Where the reviewer provides this confirmation, the DNO developing the Close-Down Report should publish it alongside the final version of the report. Where the reviewer does not consider the Close-Down Report meets these expectations, it should provide feedback on the areas for improvement. Before publishing the report the DNO should update its Close-Down Report to account for such feedback. It should also demonstrate how it has addressed the reviewing DNO's comments.

2.47. 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.

2.48. 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 (described later in this chapter), as well as provide updates on those Projects that are still ongoing.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/low-carbon-networks-lcn-fund-content-and-structure-second-tier-close-down-reports>

Second Tier Project audits

2.49. 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

2.50. Disallowed Expenditure is funding that the DNO receives for Eligible Second Tier Projects or via the Discretionary Funding Mechanism or recovers as Directly Attributable Costs that Ofgem determines not to have been spent or recovered 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, any unspent funds for completed Projects, and any Directly Attributable Costs that the Authority deems to have been misreported following a Project audit.

2.51. 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.

Annual conference

2.52. 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.

2.53. This conference may form part of the same event as any Innovation Stimulus⁵ conference and the DNO may charge attendees a nominal sum for attending the conference. The DNO's income from charges is not to exceed the efficient cost to the DNO of organising the conference.

⁵ The Innovation Stimulus is a package of measures that expands parts of the LCN Fund to other network sectors.

SECTION TWO – Discretionary Funding Mechanism

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1. Introduction

1.1. As part of DPCR5 Final Proposals, we set out our 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 One, Chapter 2,
- To reward DNOs under the Second Tier Successful Delivery Reward, as described in 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 we hope are being 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 detailed criteria specified in this section of the document.
- 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 was 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. A total of £15m of funding is available in the First Tier Portfolio Reward.

Process

2.2. The assessment to determine whether to award any First Tier Portfolio Rewards will take place in 2017. Ofgem will provide at least six months' notice of the date of the assessment window. Projects that began under the LCN Fund but concluded under the Network Innovation Allowance will be eligible to enter if they spent more than half of their life under the LCN Fund.

2.3. Each DNO will have to submit a First Tier Portfolio Report (ie the application for a reward) by a specified date, which must include details of all First Tier LCN Projects for which Ofgem has accepted the Close-Down 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 in chapter one of this section and paragraphs 2.8 to 2.13 later in this chapter. Ofgem may issue further guidance on the application process to applicants two months in advance of the assessment.

2.4. We would typically expect only a limited number of DNOs to receive a First Tier Portfolio Reward, 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.

Assessment

2.5. The Expert Panel⁶ will evaluate the First Tier Portfolio Reports against the Discretionary Reward Criteria. The Authority may issue guidance to the Expert Panel on the range of appropriate reward amounts. Any such guidance would be made publically available and included in any decision made by the Authority regarding the reward.

2.6. Based on its 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.

2.7. Once the Authority has considered the First Tier Portfolio Reports and the First Tier Portfolio Reward Recommendation Report against the Discretionary Reward

⁶ As defined in Section Four.

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. The Authority's decision will be made publically available. This Additional Amount will be included in a subsequent Funding Direction, as described in Section Three.

2.8. The detailed criteria, are as follows:

(a) Accelerated the development of a low carbon energy sector and has delivered net financial benefits to future and/or existing customers

2.9. A DNO must demonstrate how the Solution or Solutions associated with the portfolio makes or could make a contribution to the UK Government's current strategy for reducing greenhouse gas emissions as set out in the document entitled "The Carbon Plan", as published by the Department of Energy and Climate Change (DECC). This 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. To reduce carbon in the energy sector, the Carbon Plan considers that electricity use may increase. This criterion also requires that the Solution(s) can provide financial benefits compared to the most efficient method currently in use.

2.10. Exceptional performance could be demonstrated by actual rollout (by the DNO or by other DNOs). In demonstrating exceptional performance against this criterion, DNOs should:

- describe and provide evidence of the aspects of the Carbon Plan that have been facilitated
- describe and provide evidence of the network capacity released
- describe and provide evidence of the financial benefits
- describe and provide evidence of the scale of rollout of the Method(s) (or techniques derived from the Method(s)) across their system and across GB
- describe and provide evidence of how outputs and learning from unsuccessful solutions have impacted on other innovation Projects and informed DNO business operations.

2.11. Exceptional performance could also be achieved as a result of planned rollout of the Solution(s). DNOs could demonstrate the potential benefits that could be achieved by the Project by:

- describing and providing analysis and assumptions of the aspects of the Carbon Plan that will be accelerated
- describing and providing analysis and assumptions of the capacity that has been/will be released
- describing and providing analysis and assumptions of the financial benefits that have been/will be realised

- describing and providing analysis and assumptions of the scale of rollout of the Method(s) (or techniques derived from the Method(s)) across their system and across GB
- describing and providing evidence of how outputs and learning from unsuccessful solutions could impact on other innovation Projects and inform DNO business operations.

(b) Knowledge that has been shared amongst all DNOs

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

2.13. In demonstrating exceptional performance against this criterion, the DNO should:

- describe and provide evidence of the level of new learning generated (including learning from things that didn't work)
- describe and provide evidence of effective knowledge dissemination by the Project
- describe and provide evidence of the applicability of the new learning to other DNOs. This evidence should include examples of other DNOs using the learning
- describe and provide evidence of the value of the intellectual property (IP) generated by the Project to customers and how the IP has been shared.

3. Second Tier Reward

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

Process

3.2. We will undertake two assessments of whether to award any Second Tier Rewards. Second Tier Projects which have published a Close-Down Report before the end of June 2016 will be assessed in 2018. Other Projects will be assessed in a second assessment, which will take place two years after the final Project has ended. Projects may only be put forward to one assessment.

3.3. A total of £61m is available in the Second Tier Reward. This money will be shared equally between the two assessments. Funds will not roll over between assessments.

3.4. We will provide at least six months' notice of our intention to open a window to consider awarding any Second Tier Reward. Each DNO that has a Second Tier Project with a published 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 in Chapter 1 of this Section and later in this chapter. We may issue further guidance on the application process to applicants two months in advance of the assessment.

3.5. 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.

Assessment

3.6. The Expert Panel will evaluate the Second Tier Reward Reports against the Discretionary Reward Criteria. The Authority may issue guidance to the Expert Panel on the range of appropriate reward amounts. Any such guidance would be made publically available and described in any decision made by the Authority regarding the reward.

3.7. Based on its 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.

3.8. 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. The Authority's

decision will be made publically available. This Additional Amount will be included as part of a subsequent Funding Direction, as described in Section Three.

3.9. The detailed criteria are as follows:

(a) Accelerated the development of a low carbon energy sector and delivered net financial benefits to future and/or existing customers

3.10. A DNO must demonstrate how the Solution or Solutions associated with the Project makes or could make a contribution to the UK Government's current strategy for reducing greenhouse gas emissions as set out in the document entitled "The Carbon Plan", as published by the Department of Energy and Climate Change (DECC). This 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. To reduce carbon in the energy sector, the Carbon Plan considers that electricity use may increase. This criterion also requires that the Solution(s) can provide financial benefits compared to the most efficient method currently in use.

3.11. Exceptional performance could be demonstrated by actual rollout of Project outcomes (by the DNO or by other DNOs). In demonstrating exceptional performance against this criterion, DNOs should:

- describe and provide evidence of the aspects of the Carbon Plan that have been facilitated
- describe and provide evidence of the network capacity released
- describe and provide evidence of the financial benefits
- describe and provide evidence of the scale of rollout of the Method(s) (or techniques derived from the Method(s)) across their system and across GB
- describe and provide evidence of how outputs and learning from unsuccessful solutions have impacted on other innovation Projects and informed DNO business operations.

3.12. Exceptional performance could also be achieved as a result of planned rollout of the Solution(s). DNOs could demonstrate the potential benefits that could be achieved by the Project by:

- describing and providing analysis and assumptions of the aspects of the Carbon Plan that will be facilitated
- describing and providing analysis and assumptions of the capacity that has been/will be released
- describing and providing analysis and assumptions of the financial benefits that have been/will be realised

- describing and providing analysis and assumptions of the scale of rollout of the Method(s) (or techniques derived from the Method(s)) across their system and across GB
- describing and providing evidence of how outputs and learning from unsuccessful solutions could impact on other innovation Projects and inform DNO business operations.

(b) Value for money provided to distribution Customers in the delivery of the Project

3.13. The LCN Fund is focussed on the role that DNOs can play as GB moves towards a low carbon economy. Therefore Projects will be evaluated on the size of benefits and resulting learning from the Project that can be attributed to or are applicable to the Distribution System versus elsewhere, taking into account the level of funding requested.

3.14. In demonstrating exceptional performance against this criterion, the DNO should:

- describe and provide evidence that the Project was value for money to Customers⁷
- describe the size of Project benefits in comparison to the Project funding (including use of competitive processes to minimise costs)
- demonstrate persistence to deliver a Project through exceptional effort and/or additional external funds that exceeds the expected delivery of outcomes.

(c) Knowledge shared amongst all DNOs

3.15. 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.

3.16. In demonstrating exceptional performance against this criterion, the DNO should:

- describe and provide evidence of the level of new learning generated (including learning from things that didn't work)
- describe and provide evidence of effective knowledge dissemination by the Project

⁷ Customers are defined in the electricity distribution licence as "any person who is supplied or requires to be supplied with electricity at any premises in Great Britain, but does not include any Authorised Electricity Operator in its capacity as such."

- describe and provide evidence of the applicability of the new learning to other DNOs. This evidence should include examples of other DNOs using the learning
- describe and provide evidence of the value of the IP generated by the Project to customers and how the IP has been shared
- describe and provide evidence of effective dissemination of learning of the role of Project partners to allow that role to be completed by the DNO or another third party during and in the event of rollout.

(e) Relevance and timing

3.17. Consideration will be given to Projects that aim to address those developments that are more likely to happen.

3.18. In demonstrating exceptional performance against this criterion, the DNO should:

- describe and provide evidence of how the outcomes of the Project are being used in business planning
- describe and provide evidence of how the outcomes of the Project are being used in the DNO's day to day activities.

(f) Demonstration of a robust methodology and that the Project is ready to implement

3.19. At Full Submission, Projects' methodologies and readiness were scrutinised. In demonstrating exceptional performance against this criterion, DNOs should:

- demonstrate that the Project's methodology and execution were at least as robust as specified in the Full Submission (eg trials resulting in statistically robust sample sizes), and were evolved as appropriate
- demonstrate that the Project's readiness was at least at the level specified in the Full Submission (eg Project begun in timely manner and delivered in line with Project Plan).

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 One, Chapter 2. The Successful Delivery Reward Criteria against which the Projects will be judged are set out in the Project Directions.

Process

4.2. The DNO can apply to Ofgem to receive a Second Tier Successful Delivery Reward for a Second Tier Project once its final Close-Down Report for that project has been peer reviewed and published as described in Section One, Chapter 2. Submissions must be made by 1 May each year to be considered during that year's assessment window. Ofgem will assess submissions in an annual assessment window between 1 May and 31 July. For the avoidance of doubt, the DNO can enter any assessment window once the Project has concluded and the Close-Down Report has been published. The last window will occur one year after the final Second Tier Project has concluded. Ofgem may issue further guidance on the application process to applicants in advance of the assessment. Any new guidance will be issued two months in advance of the assessment.

4.3. The DNO must provide sufficient evidence to allow Ofgem to evaluate the application. The DNO may be permitted to resubmit its application in light of any clarification asked by Ofgem. Any resubmission or additional evidence submission may affect the timing of our decision. Ofgem may also use any other information it has gathered throughout the duration of the Project to inform its evaluation. If Ofgem considers that there is insufficient evidence to evaluate the application then the request for Second Tier Successful Delivery Reward will be rejected and the DNO notified.

4.4. The maximum level of Second Tier Successful Delivery Reward is set out in the Project Direction and cannot exceed the level of the DNO Compulsory Contribution. 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.

4.5. Ofgem will notify the DNO of the value of its reward on or before 31 July. 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 in a subsequent Funding Direction, as described in Section Three.

Assessment

4.6. 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. Ofgem will assess whether the Project delivered Successful Delivery Reward Criteria outputs in a timely, cost effective manner and whether the outputs were of sufficient quality to have satisfied the requirements of the Successful Delivery Reward Criteria which were included in

the Project Direction. The DNO should provide evidence of this and should also consider consulting on its application with stakeholders, including non-DNO parties. Ofgem reserves the right to publish and seek comment from stakeholders on applications.

4.7. The DNO should also provide robust evidence demonstrating how the Project has managed uncertainty and change. This should include evidence of appropriate Project governance and risk management, including timely mitigation and the impact of any residual risks on the outcomes of the Project. Projects which have submitted change requests should provide evidence to Ofgem on how well the change was managed and how well the Project performed against what was originally intended.

4.8. No Second Tier Project that puts in a request to recover cost overruns will be eligible to receive a Second Tier Successful Delivery Reward. Second Tier Projects which have submitted change requests can apply to the Second Tier Successful Delivery Reward.

SECTION THREE – Funding Direction

1.1. As set out in the Electricity Distribution Licence (paragraph 2J.14.18 of CRC 2J), 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. Returned LCN Fund Royalties to be returned to customers for each DNO
- v. The customer numbers for each DNO.
- vi. The calculation apportioning the Approved Amounts in (i), Additional Amounts in (ii), and Halted Project Revenues, Disallowed Expenditures in (iii), and Returned LCN Fund Royalties in (iv) above between DNOs based on customer numbers and thus setting out the amounts to be recovered by each DNO in LCN2.
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), refund the Halted Project Revenues and Disallowed Expenditures in (iii) and Returned LCN Fund Royalties in (iv) 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.

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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.

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 Foreground IPR shall be agreed between the DNO and Project Partners in accordance with the requirements of this chapter.

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, 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. A DNO is able to recover Directly Attributable Costs, as defined in the Electricity Distribution Licence. These are the costs of maintaining and managing Foreground IPR. Therefore for each Project, the DNO will return the gross revenue generated through royalties or income generated through IPR less the Directly Attributable Costs.

3.3. We will 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 Approved Amount plus the total amount contributed by the DNO, 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.

3.4. Every Regulatory Year, the Authority will calculate the royalties earned through Second Tier Projects that are to be returned to customers. These are LCN Fund Royalties as defined in paragraph 3.11. As set out in the Electricity Distribution Licence (paragraph 13.18 of CRC 2J) LCN Fund Royalties will be included in the Funding Direction as part of the LCN2 term. This term will adjust the allowed revenue of DNOs to take account of LCN Fund Royalties.

3.5. The Authority will follow these steps to calculate the amounts to be defined in the funding direction.

3.6. In a given year, Retained LCN Fund Royalties (RLCNR) is the total royalties earned through all Second Tier Projects to be retained by each DNO y as additional profit in each year t and is calculated through the following formula:

$$RLCNR_y = \sum AR_{k,y}$$

3.7. Where:

3.8. $AP_{k,y}$ is the Additional Profit earned through royalties to be retained by each DNO y for a Project k , and is calculated through the following formula:

$$AP_{k,y} = (RR_{k,y} - DAC_{k,y}) \times \frac{DNOCC_k + DNOEC_k}{RA_k + DNOCC_k + DNOEC_k}$$

3.9. Where:

$RR_{k,y}$ is the pre tax sum of the Second Tier LCN Fund Royalties reported by DNO y on the Project k ;

$DACK$ is the Directly Attributable Costs reported by DNO y of maintaining and managing IPR generated through the Project k ;

$DNOCC_k$ is the DNO Compulsory Contribution to the Project k ;

$DNOECK$ is the Extra DNO Contribution to the Project k ; and

RA_k is the Approved Amount set out in the Project k Direction;

3.10. The DNO must record Retained LCN Fund Royalties as such in its internal accounting records and show it as a reconciling revenue item in the Reconciliation Inputs section of the detailed return required under Standard Condition 46 (Reporting of Price Control Revenue Information) of its distribution licence.

3.11. The remaining royalties are to be returned to all GB customers. This is the royalty revenue earned by all DNOs minus the sum of all Retained LCN Fund Royalties. This amount is defined as LCN Fund Royalties (LCNR) and is calculated through the following formula for each year t :

$$LCNR = \sum RR - \sum RLCNR$$

This is apportioned across all DNOs based on customer numbers and subtracted from the DNO's allowed revenue. The amount to be subtracted from each DNO's revenue is Returned LCN Fund Royalties. This will be defined in the Funding Direction on an annual basis as part of the LCN2 term.

SECTION FOUR - 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 CRC 2J of the Electricity Distribution Licence.

Approved Amount

As defined in CRC 2J 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 3.115.

Customer

As defined in the Electricity Distribution Licence.

Direct Benefits

Direct Benefits are the benefits of a Project accruing to the DNO during the Project implementation and comprise any expenditure included within the DNO's FBPQ for DPCR5 that will be saved as a result of undertaking the Project.

Disallowed Expenditure

As defined within CRC 2J 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 or an individual DNO that does not share the same ultimate controller as any other DNO.

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 Funding 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 LCN Fund Project

As defined within CRC 2J 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.

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 2.30 of Section One.

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.

Full Submission Workbook

The Excel workbook issued by Ofgem in which DNOs detail Project costs and benefits including the Second Tier Funding Request, DNO Compulsory Contribution, External Funding and Direct Benefits.

Funding Direction

The direction referred to in CRC 2J.18 of the Electricity Distribution Licence.

Funding DNO

The DNO named in the Full Submission as the Funding 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.

Halted Project Revenues

As defined within CRC 2J of the Electricity Distribution Licence.

Initial Net Funding Required

The amount of funding calculated as per paragraphs 3.14 to 3.25 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.

LCN2

As set out in CRC 2J of the Electricity Distribution Licence.

Method

The proposed way of solving the Problem.

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 Direction

As defined in CRC 2J of the Electricity Distribution Licence.

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.

Relevant Background IPR

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

Relevant Customer

A customer with a profile class of 1,2,3 or 4 as defined in Part 2 of Schedule 16 of the Distribution Connection and Use of System Agreement.

Relevant Foreground IPR

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

Returned LCN Fund Royalties

As set out in the Electricity Distribution Licence

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 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.

Working Day

As defined in the Electricity Distribution Licence.

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 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 ran from 1 April 2010 until 31 March 2015.

[Distribution Use of System Charges \(DUoS\)](#)

G

[Great Britain \(GB\)](#)

I

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

L

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

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

R

Regulatory 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.