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Date: 23 July 2015

Dear Company Secretary,

Low Carbon Networks (LCN) Fund – amendments to Western Power Distribution (East Midlands)'s (WPD) FALCON project direction

This letter contains our decision to approve changes you requested to the Project Direction for the LCN Fund project FALCON (the Project).

Background

In 2011, you were awarded Second Tier Funding¹ for the Project. On 19 December 2011 we² issued a Project Direction³ to you.⁴ The Project Direction contains the terms to be followed in relation to the Project as a condition of it being funded under the Second Tier and Discretionary Funding Mechanism.⁵

On 18 March 2015, you asked us to make amendments to the Project Budget in the Project Direction. We asked you for further explanation of the requested amendments and received the final details on 1 June 2015.

Under the terms of paragraph 2.6 of version 7 of the LCN Fund Governance document,⁶ you are required to report on Project progress at least every six months. In addition, Section 6 of the Project Direction requires you to report against specific line items of expenditure and explain any variance of in excess of 5 per cent. Furthermore, as the Funding DNO⁷, you must not spend more than 110 per cent of any cost category total in Annex 1 of the Project Direction without our prior consent.

Changes to the budget for the Project

You have asked us to approve the transfer of allocations between Project budget categories. The changes proposed are to: (i) reflect a change in delivery approach on a number of aspects of the project, (ii) align the budget with WPD financial systems,⁸ (iii)

¹ Second Tier Funding has the meaning given in CRC 2J of the Electricity Distribution Licence.

² The terms "we", "us", "Ofgem" and "the Authority" are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

³ <https://www.ofgem.gov.uk/publications-and-updates/low-carbon-network-fund-project-direction-falcon>

⁴ This was pursuant to the LCN (Low Carbon Networks) Fund Governance Document and to Part E of Charge Restriction Condition 13 ("CRC13") of the Electricity Distribution Licence.

⁵ Second Tier and Discretionary Funding Mechanism has the meaning given in CRC 2J of the Electricity Distribution Licence.

⁶ [Low Carbon Networks Fund Governance Document v.7](#)

⁷ Capitalised terms not otherwise defined in this letter have the meaning given to them in the [Low Carbon Networks Fund Governance Document v.7](#).

⁸ The Project was initially developed by Central Networks, which was acquired by WPD in April 2011.

correct errors contained in the Full Submission spreadsheet and (iv) more clearly track expenditure on the individual aspects of the project. Without these changes, expenditure in the 'Equipment' category exceeds 110% of the total. The change request is not intended to affect the overall cost of the Project.

The main proposed changes to the budget relate to the 'Labour', 'Contractors', 'Equipment', 'IT', and 'Travel & Expenses' categories in the Project Direction. The effect would be to reduce the 'Labour' and 'Travel & Expenses' budgets while increasing the 'Contractors', 'Equipment' and 'IT' budgets. This is the result of you using less internal resource for a number of Project elements and of a Project Partner, CGI, taking on additional tasks within the Project. There is also some movement of costs from the 'Contractors' budget to the 'Equipment' budget, as you wrongly allocated some of the costs in the Full Submission. The 'Travel & Expenses' budget is reduced as most of these costs are included within the 'Contractors' category. These changes are shown in Table 1, below.

Table 1. Proposed changes to budget categories (note that figures may not tally due to rounding)

| Category | Original (£k) | New (£k) | Variance (£k) | Percentage variance | Explanation |
|------------------------------|---------------|----------|---------------|---------------------|--|
| Labour | 2,281 | 1,601.15 | -679.85 | -30% | This reduction is the result of contractors undertaking some of the tasks originally allocated to internal staff. |
| Equipment | 1,679 | 1,899.87 | 220.87 | 13% | This increase is to fully account for the costs of the LV monitoring equipment and other costs which were erroneously originally included within the Contractors category. |
| Contractors | 6,014 | 6,639.92 | 625.92 | 10% | This increase is the result of contractors undertaking tasks within the project that were planned to be undertaken by WPD staff, and the inclusion of Travel and Expenses costs within the contractor contracts. In addition, some costs that were included in this category in error have moved to the Equipment and IT categories. |
| Travel & Expenses | 330 | 1.51 | -328.49 | -100% | These costs are now included within the contractor contracts. |
| IT | 2,913 | 3,072.5 | 159.50 | 5% | This increase is due to costs for the communications solution moving from the Contractors budget to IT. The original allocation to Contractors was made in error. |

The other changes requested by you are to provide a clearer breakdown within categories (eg 'Equipment') for each of the component parts of the Project (eg technique 2 – switchgear). These would not change any of the budget categories beyond the proposed changes in table 1. The purpose of these changes is to reflect better how the Project has been delivered and the actual costs of the techniques being trialled. You have stated that this will aid dissemination of learning as the project reporting will clearly indicate the costs of the different interventions trialled by the Project.

Conclusions

We note that the amendments result in no change to the final costs to customers of the Project, only a re-allocation of funds between categories to reflect Project delivery. We also note that the majority of the Project's budget has already been spent.

You have known about the need to make changes to the budget for some time (you discussed the change request in 2013 but it was not followed up until early in 2015). The long period of uncertainty raises questions about how well-designed the budget was and about the quality of the project management. This ongoing uncertainty about the budget also appears to have resulted in WPD spending more than 110% in one of the budget categories prior to this change request, which is counter to the provisions of the Project

Direction. These factors will likely form part of our consideration of any application made by you for the Successful Delivery Reward at the end of this Project.

However, we consider it is in the best interests of customers⁹ and appropriate in the circumstances to approve these changes. These changes will provide greater clarity on how much each aspect of the Project costs, which will aid dissemination of project learning. Consequently, we approve the transfer between cost categories in the Project Direction.

Decision

In accordance with Section 13 of the Project Direction, we hereby amend the Schedule to the Project Direction in the manner set out in the Schedule to this letter.

This letter constitutes notice of reasons for our decision pursuant to section 49A of the Electricity Act 1989.

Yours sincerely,

A handwritten signature in blue ink that reads "Andy Burgess".

Andy Burgess

Associate Partner, Electricity Distribution
For and on behalf of the Authority

⁹ The term 'customer' has the meaning given to the term 'Customer' in the Electricity Distribution Licence.

Schedule

1. Amend existing Annex 1 (Project Budget)

Amend existing Annex 1 of the Schedule to the Project Direction by replacing the project budget table with the new table below.

| Cost Category | Total(£K) |
|---|------------------|
| Labour | 1,601 |
| Technique 1 - Site Works | 35 |
| Technique 2 - Site Works | 135 |
| Technique 3 - Site Works | 219 |
| Technique 4 - Site Works | 86 |
| LV Monitoring - Site Works | 95 |
| WPD Project Management & Design Team | 1032 |
| Equipment | 1900 |
| Technique 1 - Dynamic Asset Relays + enclosures & Sensors | 182 |
| Technique 2 - Phasor Measurement Units, GPS, Enclosures | 89 |
| Technique 2 - WiMax & CT Mods | 15 |
| Technique 2 - Switchgear | 146 |
| Technique 3 - Protection relays | 256 |
| Technique 3 - Switchgear | 184 |
| Technique 4 - Battery Storage Devices x 5 | 786 |
| LV Monitoring - Installation Materials | 242 |
| Contractors | 6,640 |
| Technique 1- Site Works | 9 |
| Technique 1- Design Support | 106 |
| Technique 1- Academic Support | 51 |
| Technique 2 - Site Works | 34 |
| Technique 2- Design Support | 106 |
| Technique 2- Academic Support | 51 |
| Technique 3-Site Works | 55 |
| Technique 3- Design Support | 106 |
| Technique 3- Academic Support | 51 |
| Technique 4 - Site Works | 22 |
| Technique 4 - Academic Support | 51 |
| LV Monitoring - Site Works | 24 |
| Telecoms - Planning & Design | 901 |
| SIM - Design, build and support | 1,104 |
| SIM - Academic Support | 160 |
| Techniques 5&6 - Design & Develop | 288 |
| Techniques 5&6 - Attitudinal Surveys | 30 |
| Load Estimation - Design & Develop models | 950 |
| CGI Project Management & Design Team | 1,448 |
| WPD Design & Build Team | 701 |
| Knowledge Capture & Dissemination | 395 |
| IT | 3,073 |
| Telecommunications Equipment | 891 |
| Telecommunications Installation Services | 309 |
| Telecommunications IT software & licenses | 239 |
| Telecomms Engineers | 86 |
| Telecomms Planning & Design | 164 |
| Trials Data - Distribution Management System | 1,032 |
| Trials Data - Ihost integration | 15 |
| SIM - Network Modelling tool | 166 |
| SIM - IT equipment | 20 |
| Techniques 5&6 - Billing System | 54 |

| | |
|----------------------------|---------------|
| WPD IT | 97 |
| Travel and Expenses | 2 |
| Technique 1 | 0 |
| Technique 2 | 0 |
| Technique 3 | 0 |
| Technique 4 | 0 |
| SIM | 0 |
| Payments to Users | 240 |
| Other | 668 |
| Total | 14,123 |