

**To: Eastern Power Networks Plc
Electricity North West Limited
London Power Networks Plc
Northern Powergrid (Northeast) Limited
Northern Powergrid (Yorkshire) Plc
Scottish Hydro Electric Power Distribution Plc
South Eastern Power Networks Plc
Southern Electric Power Distribution Plc
SP Distribution Plc
SP Manweb Plc
Western Power Distribution (East Midlands) Plc
Western Power Distribution (South Wales) Plc
Western Power Distribution (South West) Plc
Western Power Distribution (West Midlands) Plc**

**Electricity Act 1989
Section 11A(2)**

Notice of statutory consultation on a proposal to modify the special conditions of electricity distribution licence held by the electricity distribution licensees

1. The Gas and Electricity Markets Authority (the Authority)¹ proposes to modify the special conditions of the electricity distribution licence held by the licensees granted, or treated as granted, under section 6(1)(c) of the Electricity Act 1989 (the "Act") by amending:
 - Special Condition CRC 5A (The Network Innovation Competition) (NIC)
 - Special Condition CRC 2J (The Low Carbon Networks Fund).
2. The Funding Return Mechanism (FRM) set out in the NIC licence condition is the method by which the Authority can direct money associated with a project to be returned to customers. We propose to make changes to the NIC licence condition to widen the scope of the FRM. To do this, we propose to introduce a new category called 'Returned Project Revenues'. The proposed changes formalise practices that are already taking place and provide clarity on the arrangements for new projects.
3. There are two main reasons for the proposed modification to the NIC licence condition which are further set out in the accompanying cover letter. In summary:

Reason 1: The FRM should be capable of returning money to customers during, or after the end of, the relevant project, if the Funding Licensee² has acted in line with the Project Direction but has spent less than the sum provided for in the project budget. The proposed licence change would allow customers to benefit from these financial savings.

There could be occasions where the Authority considers it appropriate for a proportion of any underspent project budget to be retained by Funding Licensees (who may then redistribute it amongst parties involved in the Eligible NIC Project as appropriate).

The Funding Return Mechanism, as currently set out in the NIC licence condition, does not make this clear. Therefore, the change is intended to clarify this.

Reason 2: In recent NIC competitions, licensees have included innovative ways of generating money from the relevant projects (that is not Intellectual Property) that will be returned to customers eg City CNG³ and OSEAIT⁴.

¹ The terms 'the Authority', 'we' and 'us' are used interchangeably in this document.

² Unless otherwise defined, capitalised terms have the meaning given to them in the NIC licence condition.

³ <https://www.ofgem.gov.uk/publications-and-updates/network-innovation-competition-2015-northern-gas-networks-decision-resubmission>

⁴ <https://www.ofgem.gov.uk/publications-and-updates/electricity-nic-submission-national-grid-electricity-transmission-oseait>

We propose that the new Returned Project Revenues category also covers the return of money generated by the Project, other than by Intellectual Property (this is already covered in the licences). The default position is for money to be returned to customers. It may however be appropriate to return some of the money generated by the relevant project to the Funding Licensee (who may then decide to redistribute it amongst parties involved in the Eligible NIC Project as appropriate). For new NIC projects it is for the licensee, in their Full Submission, to identify any revenues that could be earned from their Project that should be subject to return. This will then be recognised in the Project Direction. For projects already in force, that have identified in their Full Submissions potential sources of revenue to be returned, we will need to amend the Project Directions to recognise this revenue source. The mechanism is not intended to be used to return revenue streams identified retrospectively.

- 4. The effect of the proposed modifications is to:
 - enable the return of NIC funding during or at the end of a project, where the project has underspent its budget but where the Funding Licensee has acted in line with the Project Direction, to customers
 - allow the return of revenue generated by the project, other than through Intellectual Property
 - allow the Authority to direct whether money can be retained by customers and/or the Funding Licensee.
- 5. This Notice and associated documents⁵ have been published on our website (www.ofgem.gov.uk). Alternatively, they are available from our Research and Information Centre, 9 Millbank, London, SW1P 3GE (020 7901 7003).
- 6. Any representations with respect to the proposed licence modifications must be made on or before 25 October 2016 to: Stacy Feldmann, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to stacy.feldmann@ofgem.gov.uk.
- 7. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
- 8. If we decide to make the proposed modifications they it will take effect not less than 56 days after the decision is published.

.....
Geoffrey Randall
Head of RIIO, Electricity Transmission
Duly authorised on behalf of the
Gas and Electricity Markets Authority 21 September 2016

⁵ These are:
- our cover letter to this statutory consultation which contains our response to stakeholders who responded to our March 2016 informal consultation on this issue,
Notices to other network companies that have the NIC licence condition in force, to make similar changes.

Special Condition CRC 5A. The Network Innovation Competition

Part C: The Funding Return Mechanism

5A.5 The Funding Return Mechanism relates to payments to be made by the licensee to the System Operator, to such extent as may be relevant, in each of the following cases (if any):

- (a) Halted Project Revenues;
- (b) Disallowed Expenditure; ~~and~~
- (c) Returned Royalty Income; and
- (d) Returned Project Revenues.

5A.6 The Funding Return is the total amount, in respect of the licensee, of any amounts arising under paragraph 5A.5.

5A.7 Halted Project Revenues are any revenues received by the licensee from the System Operator under the NIC Funding Mechanism in respect of an Eligible NIC Project that have not yet been spent, or otherwise committed, at the time that the Authority requires that project to be halted in accordance with the applicable provisions of the NIC Governance Document or the terms of the relevant Project Direction.

5A.8 Disallowed Expenditure is any revenue received by the licensee from the System Operator under the NIC Funding Mechanism that the Authority determines has not been spent in accordance with the applicable provisions of the NIC Governance Document or the terms of the relevant Project Direction.

5A.9 Returned Royalty Income is revenue earned from intellectual property generated through Eligible NIC Projects undertaken by the licensee, less Directly Attributable Costs, and that is payable to Customers under the NIC Funding Mechanism, as calculated in accordance with the provisions of the NIC Governance Document.

5A.10 For the purposes of paragraph 5A.9, Directly Attributable Costs are costs relating to the maintenance and management of intellectual property generated through Eligible NIC Projects undertaken by the licensee that have not been otherwise remunerated by Base Demand Revenue, revenue from Directly Remunerated Services, or the NIC Funding Mechanism.

5A.11 Returned Project Revenues are:

- (a) revenues received by the licensee from the System Operator under the NIC Funding Mechanism in respect of an Eligible NIC Project that the Authority determines have not been spent, and where the Project has been carried out in accordance with the applicable provisions of the NIC Governance Document and/or the terms of the relevant Project Direction; or
- (b) revenues earned from Eligible NIC Projects by the licensee other than Returned Royalty Income, that the Authority determines are payable to customers.

5A.12 The Authority may direct how the relevant revenues under paragraphs (a) and (b) above should be paid to customers through the Funding Return Mechanism, or where the Authority considers it to be appropriate, whether they should be retained by the licensee, or distributed by the licensee to other parties involved in the Eligible NIC Project.

5A.13 In each Regulatory Year t, in accordance with the appropriate provisions of the NIC Governance Document, the Authority will calculate and then, by direction given to the licensee, will specify:

- (a) the amount of any Funding Return that the licensee must pay to the System Operator; and
- (b) the manner in which and the timescale over which that amount is to be so paid.

5A.14 The licensee must comply with any direction that is issued by the Authority under paragraph 5A.14 ~~13~~.

Part G: Interpretation

[For clarity, we only show the new or modified definitions to be inserted in alphabetical order within this condition]

Returned Project Revenues

has the meaning given to that term in Part C of this condition.

CRC 2J. Low Carbon Networks Fund

Introduction

- 2J.1 This condition makes provision for the maintenance of arrangements (known as the Low Carbon Networks Fund) for determining the amount of the LCN term that applies in CRC 2A (Restriction of Allowed Distribution Network Revenue) for the purpose of incentivising the development of low carbon networks.
- 2J.2 The arrangements to which paragraph 2J.1 refers will apply in relation to the funding, regulation, and administration of:
- (a) Low Carbon Networks Fund projects that at any time within the period from 1 April 2010 to 31 March 2015 were the subject of a direction under Part C of CRC 13 (Low Carbon Networks Fund) of this licence in the form in which it was in force at 31 March 2015; and
 - (b) Low Carbon Networks Fund projects that at any time within that period were commenced pursuant to the provisions of that condition relating to the First Tier Funding Mechanism.

Part A: Funding mechanisms for Low Carbon Networks Fund functions

- 2J.3 The following functions are to be discharged by the Low Carbon Networks Fund:
- (a) the recovery of funding for Eligible LCN Fund Projects raised through revenues contributed through the licensee's Use of System Charges between 1 April 2010 and 31 March 2015 ("the First Tier Funding Mechanism") that the Authority determines to be unrecoverable; and
 - (b) the funding of Eligible LCN Fund Projects and awards through revenues contributed through the Use of System Charges of all Distribution Services Providers ("the Second Tier and Discretionary Funding Mechanism") in accordance with Part B below and the LCN Fund Governance Document.
- 2J.4 The amount of the LCN term that is to be incorporated into the Allowed Distribution Network Revenue in accordance with the provisions of CRC 2A and this condition in respect of any Regulatory Year comprises the total of the allowed revenues of the licensee recovered from Use of System Charges under each particular funding mechanism set out in this licence condition in that year.
- 2J.5 Accordingly, for the purposes of Part B of CRC 2A, which provides for the calculation of the licensee's Allowed Distribution Network Revenue, the amount of the LCN adjustment in Regulatory Year t is derived from the following formula (in this condition, the "LCN _{t} Formula"):

$$LCN_t = LCN_{2t} - LCN_{1t}$$

where:

- (a) LCN2_t is an amount determined under the Second Tier and Discretionary Funding Mechanism in accordance with Part B of this condition and the LCN Fund Governance Document; and
- (b) LCN1_t is an amount recovered by the licensee in relation to a previous Regulatory Year under the First Tier Funding Mechanism that the Authority has determined, in accordance with the provisions set out in the LCN Fund Governance Document, to be unrecoverable.

Part B: The Second Tier and Discretionary Funding Mechanism

2J.6 The Second Tier and Discretionary Funding Mechanism relates to the recovery by, and apportionment among, the licensee and other Distribution Services Providers of:

- (a) Second Tier Funding;
- (b) Discretionary Funding;
- (c) Halted Project Revenues;
- (d) Disallowed Expenditure; ~~and~~
- (e) Returned LCN Fund Royalties; and
- (f) LCN Fund Returned Project Revenues.

2J.7 Second Tier Funding is the aggregate (for the licensee and all other Distribution Services Providers) of all the Approved Amounts in the 2015/16 Regulatory Year.

2J.8 Discretionary Funding is the aggregate (for the licensee and all other Distribution Services Providers) of the additional funding awarded by the Authority, on a discretionary basis in accordance with the LCN Fund Governance Document, in respect of Eligible LCN Fund Projects.

2J.9 Halted Project Revenues are revenues received (whether by the licensee or another Distribution Services Provider) under the Second Tier and Discretionary Funding Mechanism in respect of an Eligible LCN Fund Project that have not yet been spent, or otherwise committed, at the time that the Authority requires that Eligible LCN Fund Project to be halted in accordance with the provisions of the LCN Fund Governance Document or those of the relevant Project Direction.

2J.10 Disallowed Expenditure is revenue received (whether by the licensee or another Distribution Services Provider) under the Second Tier and Discretionary Funding Mechanism that the Authority determines not to have been spent in accordance with the provisions of the LCN Fund Governance Document or those of the relevant Project Direction.

2J.11 Returned LCN Fund Royalties are the revenues earned from intellectual property generated through Second Tier LCN Fund projects (whether by the licensee or another Distribution Services Provider), less Directly Attributable Costs, and that are payable to customers under the Second Tier and Discretionary Funding Mechanism, and is calculated in accordance with the provisions of the LCN Fund Governance Document.

2J.12 For the purpose of paragraph 2J.11, Directly Attributable Costs are costs relating to the maintenance and management of intellectual property generated through Second Tier LCN Fund projects (whether by the licensee or another Distribution Services Provider) that must not have been remunerated by Use of System Charges, charges for Metering Point Administration Service, Legacy Metering Equipment Charges or revenue from Data Services or Directly Remunerated Services or by the Second Tier and Discretionary Funding Mechanism.

2J.13 LCN Fund Returned Project Revenues are:

- (a) revenues received (whether by the licensee or another Distribution Services Provider) under the Second Tier and Discretionary Funding Mechanism in respect of an Eligible LCN Fund Project that the Authority determines have not been spent, and where the Project has been carried out in accordance with the applicable provisions of the LCN Fund Governance Document and/or the terms of the relevant Project Direction; or
- (b) revenues earned from Eligible LCN Fund Project (whether by the licensee or another Distribution Services Provider) other than Returned Royalty Income, that the Authority determines are payable to customers.

2J.14 The Authority may direct how the relevant revenues under paragraphs (a) and (b) above should be paid to customers through the Second Tier and Discretionary Funding Mechanism, or where the Authority considers it to be appropriate, whether they should be retained by the licensee.

2J.15 For the purposes of the LCN_t Formula, LCN_{2t} is to be the amount specified for Regulatory Year t that is to be recovered by each Distribution Services Provider as directed by the Authority under paragraph 2J.14 16 in relation to:

- (a) the Second Tier Funding specified for Regulatory Year t ;
- (b) any Discretionary Funding specified for Regulatory Year t ;
- (c) any Halted Project Revenues specified for Regulatory Year t ;
- (d) any Disallowed Expenditure specified for Regulatory Year t ; ~~and~~
- (e) any Returned LCN Fund Royalties specified for Regulatory Year t ; and
- (f) any LCN Fund Returned Project Revenues specified for Regulatory Year t .

2J.16 In each Regulatory Year t , as provided for by the LCN Fund Governance Document, the Authority will calculate and, by direction given to all of the Distribution Services Providers, specify in accordance with the appropriate provisions set out in the LCN Fund Governance Document:

- (a) the value for LCN_{2t} for each Distribution Services Provider (being the amount to be recovered by each Distribution Services Provider through Use of System Charges in order to contribute to its own or another Distribution Services Provider's Second Tier Funding and Discretionary Funding for that Regulatory Year);

- (b) the net amounts to be transferred between Distribution Services Providers in order to ensure that each Distribution Services Provider receives an amount (if any) equal to the proportion of the Second Tier Funding and Discretionary Funding for that Regulatory Year that is attributable to the licensee's Eligible LCN Fund Projects (adjusted to take into account any Halted Project Revenue, Returned LCN Fund Royalties, ~~and Disallowed Expenditure~~ and LCN Fund Returned Project Revenues); and
- (c) the manner in which and the timescale over which the net amounts referred to in 2J.14-~~16~~(b) are to be transferred.

2J.17 The licensee must comply with any direction issued by the Authority under paragraph 2J.14-~~16~~.

2J.18 Eligibility, assessment, implementation, and other relevant matters relating to Eligible LCN Fund Projects under the Second Tier and Discretionary Funding Mechanism are provided for in or pursuant to the LCN Fund Governance Document issued by the Authority under Parts D and E of this condition.

Part C: Unrecoverable expenditure

2J.19 For the purposes of the LCN_t Formula, the amount of LCN_{1t} is an amount recovered by the licensee in relation to Regulatory Year t or a previous Regulatory Year under the First Tier Funding Mechanism that the Authority has determined, in accordance with the provisions set out in the LCN Fund Governance Document, to be unrecoverable.

2J.20 In any Regulatory Year t , the Authority may set, by direction given to the licensee, an amount for LCN_{1t} that will reduce the licensee's Allowed Distribution Network Revenue by the amount that the Authority has determined to be unrecoverable.

Part D: The LCN Fund Governance Document

2J.21 The Authority will issue, and may from time to time revise, a document, to be known as the LCN Fund Governance Document, for purposes connected with the regulation, governance, and administration of the Low Carbon Networks Fund.

2J.22 The LCN Fund Governance Document may, amongst other things, make provision about or impose requirements in respect of:

- (a) the eligibility criteria to be applied by, and information to be provided to, the Authority in relation to the assessment and approval of Eligible LCN Fund Projects;
- (b) the criteria against which the funding of such projects will be assessed and approved (where necessary);
- (c) the process and procedures that will be in place for the assessment, approval and financing of such projects' funding (where necessary);

- (d) the arrangements for ensuring that relevant matters learnt from the implementation of Eligible LCN Fund Projects can be captured and disseminated;
- (e) the nature of the reporting obligations in respect of such projects (which may include reporting in respect of the funding and the completion of such projects, as well as reporting on compliance with this condition and the LCN Fund Governance Document);
- (f) arrangements relating to intellectual property rights, including Returned LCN Fund Royalties, in respect of Eligible LCN Fund Projects; and
- (g) any other matters related to the regulation, governance, or administration of the Low Carbon Networks Fund.

2J.23 Where any provisions of the LCN Fund Governance Document require the compliance of the licensee, the licensee must comply with those provisions as if the document were part of this condition.

Part E: Procedure for issuing the LCN Fund Governance Document

2J.24 The Authority will issue, and may modify, the LCN Fund Governance Document by issuing a direction for that purpose to every licensee in whose licence this condition has effect.

2J.25 A direction issued by the Authority under paragraph 2J.22-24 will be of no effect unless, before issuing it, the Authority has:

- (a) by Notice to all licensees in whose licence this condition has effect, set out the text of the proposed LCN Fund Governance Document (or modifications to it) that it proposes to direct;
- (b) specified in the Notice the reasons for the Authority's proposals;
- (c) specified in the Notice the date on which it proposes that the provisions of the document (or modifications to it) should take effect;
- (d) specified in the Notice the period (which may not be less than 28 days from the date of the Notice) within which the licensee may make representations to the Authority about its proposals; and
- (e) considered any representations duly received in response to the Notice.

2J.26 The requirements of paragraphs 2J.22-24 and 2J.23-25 may be satisfied by action taken before, as well as by action taken after, the commencement of this condition.

2J.27 For the purposes of paragraph 2J.22-24 the reference to issuing the LCN Fund Governance Document includes issuing any revision of it and the procedure provided for in paragraph 2J.23-25 will apply to any such revision.

Part F: Interpretation

2J.28 For the purposes of this condition:

Approved Amount	means an amount approved by the Authority in relation to a claim submitted by a Distribution Services Provider to receive funding for an Eligible LCN Fund Project under the Second Tier and Discretionary Funding Mechanism, where such claim complies in all respects with such requirements as are imposed by the LCN Fund Governance Document.
Data Services	means the totality of: <ul style="list-style-type: none"> (a) Metering Point Administration Services provided under and in accordance with the provisions of the Master Registration Agreement; and (b) Data Transfer Services provided by the Data Transfer Service.
Directly Attributable Costs	has the meaning given to that term in paragraph 2J.12.
Disallowed Expenditure	has the meaning given to that term in paragraph 2J.10.
Discretionary Funding	has the meaning given in paragraph 2J.8.
Eligible LCN Fund Project	means a project undertaken by a Distribution Services Provider that in the Authority's view satisfies such requirements of the LCN Fund Governance Document as are necessary to enable the project to be funded under the First Tier Funding Mechanism or the Second Tier and Discretionary Funding Mechanism (as the case may be).
First Tier Funding Mechanism	has the meaning given to that term in paragraph 2J.3(a).
Halted Project Revenues	has the meaning given to that term in paragraph 2J.9.
LCN Fund Governance Document	means the document issued by the Authority under Part D of this condition including matters relating to the First Tier Funding Mechanism, the Second Tier and Discretionary Funding Mechanism and related matters, subject to the requirements of Part E.
LCN_t Formula	has the meaning given to that term in paragraph 2J.5.
<u>LCN Fund Returned Project Revenues</u>	<u>has the meaning given to that term in Part C of this condition.</u>

**Legacy Metering
Equipment Charges**

means the charges levied by the licensee for the provision of Legacy Metering Equipment in accordance with the relevant Charging Statement prepared by the licensee under standard condition 36 (Charges for the provision of Legacy Metering Equipment and Data Services).

Project Direction

means a direction issued by the Authority pursuant to the LCN Fund Governance Document setting out the terms to be followed in relation to the Eligible LCN Fund Project as a condition of its being funded pursuant to the Second Tier and Discretionary Funding Mechanism.

**Second Tier and
Discretionary Funding
Mechanism**

has the meaning given to that term in paragraph 2J.6.

Second Tier Funding

has the meaning given to that term in paragraph 2J.7.