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for energy consumers

Distribution Network Operators

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Date: 18 December 2015

Dear Company Secretary

Low Carbon Networks (LCN) Fund - Funding Direction

We¹ issue a direction (the Funding Direction) every year pursuant to the provisions of Section Three of the LCN Fund Governance document, and pursuant to the provisions of the Charge Restriction Condition (CRC) 2J of the electricity Distribution Licence.²

This Funding Direction details how much each Distribution Services Provider (DSP) can recover from customers through Use of System Charges to cover the costs of funding Eligible LCN Fund Projects. It also details the net amounts to be transferred between DSPs to ensure that each DSP receives an amount (if any) equal to the proportion of the Second Tier Funding for the Regulatory Year that is attributable to the DSP's Eligible LCN Fund Projects.

The value that each DSP can recover includes Second Tier Funding and Discretionary Funding and is adjusted to take into account any funding returned to customers by existing projects, Halted Project Revenue and Disallowed Expenditure.

As of 2015, the LCN Fund annual competition no longer takes place, but DSPs can compete for innovation funding in the annual Electricity Network Innovation Competition.³ As a consequence, this Funding Direction only applies to funding for existing Eligible LCN Fund Projects.

As the potential learning from the Eligible LCN Fund Projects would provide benefits to all DSPs, the projects are funded by all DSPs through Distribution Use of System Charges. Therefore, we are amending the allowed revenues of all DSPs for the Regulatory Year 2016/17 and set here the amount each needs to transfer to the DSPs listed in Table 1. There are three categories of changes affecting funding that are applicable this year: Successful Delivery Reward; underspent budgets and other changes.

Successful Delivery Reward

In 2015, we conducted our first assessment of the Successful Delivery Reward (SDR) for the four completed LCN Fund projects that applied.⁴ The maximum available reward for each project is equal to the network company's 10 per cent compulsory contribution. We

¹ The terms "the Authority", "we" and "us" are used interchangeably in this document. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

² [LCN Fund Governance Document version 7](#).

³ <https://www.ofgem.gov.uk/network-regulation-riio-model/network-innovation/electricity-network-innovation-competition>.

⁴ Our SDR decision contains the reasons for our assessment and can be found [here](#).

assessed whether the projects had been sufficiently well managed and whether they met their Successful Delivery Reward Criteria (SDRCs) on the basis of quality, cost and time.

- We awarded UK Power Networks' (UKPN) Flexible Plug and Play (FPP) project the full £989,000 SDR as we considered the project was well-managed and met its SDRCs.
- We have reduced the reward to Northern Power Grid (Northeast) Ltd.'s (NPgN) Customer-led Network Revolution (CLNR) because of weaknesses in its management of changes and risk. This is based on evidence of how it handled the main change proposal. We awarded it £2,715,000 out of a total available £3,103,000.
- We reduced UKPN London's Low Carbon London (LCL) reward because of its project management, particularly when submitting a substantial change request. We awarded it £2,145,000 out of a total available £2,451,000.
- We reduced Western Power Distribution's (WPD) South Wales' reward for Low Voltage Network Templates (LVNT) because of an overspend of the budget which we consider was due to the way the project risks were managed. We awarded it £794,000 out of a total available £896,000.

Underspent budgets

A number of the completed projects underspent on their budgets; the unspent funds are to be returned to customers. Some of these Projects have yet to apply for the SDR. The completed Projects returning funding to customers are:

- Electricity North West Ltd's (ENWL) Capacity to Customers underspent by £1,683,000;
- UKPN LPN's LCL underspent by £5,506,149; and
- UKPN EPN's FPP underspent by £271,245.

The reductions in costs from these projects will be returned from these DSPs to the customers of all DSPs, as they originally funded the projects.

Other changes

Last year, when directing a change request to SP Distribution Ltd.'s (SPD) Flexible Networks for a Low Carbon Future Project, we made an error in calculating and directing the amount to be returned. On 16 October 2015, we wrote to SPD to acknowledge this error, which directed that SPD return £270,000 more to customers than it should have in last year's Funding Direction.⁵ We signalled to SPD that we would return the £270,000 to the SPD in this year's Funding Direction. The net effect is that the reduced need for monitoring equipment and the reduction in contingency for the Project resulted in £749,000 being returned to customers.

The same project, SPD's Flexible Networks, did not make payments to customers under the energy efficiency work package. This work package included a £67,000 contribution from customers, which SPD will be returning in this year's Funding Direction.

On 2 March 2011 we issued our decision⁶ on the impact of the Interruptions Incentive Scheme (IIS) on Second Tier LCN Fund projects. In that letter we decided that Second Tier LCN Fund projects should be protected, through the Discretionary Funding Mechanism,

⁵ <https://www.ofgem.gov.uk/publications-and-updates/erratum-notice-low-carbon-networks-fund-amendments-project-direction-relating-flexible-networks-low-carbon-future-project>.

⁶ <https://www.ofgem.gov.uk/publications-and-updates/decision-impact-interruptions-incentive-scheme-second-tier-low-carbon-networks-fund-projects>.

from IIS penalties. At the same time, in order to maintain incentives to minimise the interruptions associated with these projects, we said that this protection would be contingent upon the licensee:

- demonstrating to us that these interruptions could not be reasonably avoided or mitigated; and
- providing us with a detailed plan of how customers will be informed of the interruptions to their service and how their needs will be handled (including how vulnerable customers will be treated).

WPD South Wales's LVNT Project applied for protection on 31 March 2015. In our letter, of 4 December 2015, we stated that we were satisfied that the Project had met the requirements and we approved WPD's request for £1,704,686.⁷

Net effects

We are amending the allowed revenues of all DSPs for the Regulatory Year 2016/17. Where a DSP has been affected by more than one change, we have calculated the net effect on its revenue. As a consequence, ENWL and UKPN London Power Networks (LPN) will need to transfer back funds to other DSPs in this Funding Direction.

To implement these amendments to DSPs' allowed revenues, in accordance with the LCN Fund Governance Document, the Schedule to this Funding Direction includes the below information for the Regulatory Year 2016/17:

1. It sets the value LCN2_t for each DSP. This is the amount to be recovered by each DSP through Use of System Charges in order to contribute to its own or another DSP's Second Tier Funding;
2. It identifies the net amounts to be transferred between DSPs in order to ensure that each DSP receives an amount (if any) equal to the proportion of the Second Tier Funding that is attributable to the DSP's Eligible LCN Fund Projects (taking into account any funds returned to customers by existing projects, Halted Project Revenue and Disallowed Expenditure); and
3. It directs the manner and timescale over which the net amounts are to be transferred.

In accordance with paragraph 2J.14 of CRC 2J of the electricity Distribution Licence and in accordance with the LCN Governance Document, the Authority hereby requires all DSPs to comply with the conditions in the Schedule to this Funding Direction.

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



Judith Ross
Head of Networks Regulation Policy
For and on behalf of the Authority

⁷ <https://www.ofgem.gov.uk/publications-and-updates/application-adjustment-charge-restriction-condition-8-igt-amount-respect-2011-12-performance-relation-low-voltage-network-templates-project>.

Schedule to Funding Direction

1. The value that each DSP can recover from customers to cover Second Tier and Discretionary Funding in 2016/17

Table 1 contains the amount that the DSPs must recover in the Regulatory Year commencing 1 April 2016. The amount that the DSPs must recover is based on the total Approved Amounts for Regulatory Year 2016/17 shared according to each DSP's customer numbers in 2014/15.⁸ This also takes account of the funding returned by existing projects. The amount each DSP must recover constitutes the value for $LCN2_t$ in the LCN_t Formula for the purposes of Part B of CRC 2J.

2. The net amounts that must be transferred between DSPs

Table 2 contains the net amounts that must be transferred between DSPs over the Regulatory Year commencing 1 April 2016. The DSPs named in column 1 of Table 2 must transfer the amounts contained in each of the columns 2 to 15 to the DSPs named at the top of each column.

3. The manner and timescale over which the net amounts will be transferred

The transfers must be made on an equal monthly basis, for the entirety of the Regulatory Year commencing 1 April 2016 such that the total amount transferred over the Regulatory Year commencing 1 April 2016 equals the net amount set out in Table 2.

The DSPs that will be receiving funding from other DSPs must provide their bank account details to the DSPs that will be transferring funding by 1 March 2016. DSPs will make transfers to the specified bank accounts on the day of the month agreed by the DSP making the transfer.

Table 1

DSP	Number of customers	LCN2 _t £
Electricity North West Limited (ENWL)	2,375,305	87,207.13
Northern Powergrid (Northeast) Ltd (NPgN)	1,590,615	58,397.96
Northern Powergrid (Yorkshire) plc (NPgY)	2,284,044	83,856.57
Southern Electric Power Distribution plc (SSES)	3,000,058	110,144.36
Scottish Hydro Electric Power Distribution plc (SSEH)	757,906	27,825.82
Scottish Power Distribution Ltd (SPD)	1,998,881	73,387.07
Scottish Power Manweb plc (SPMW)	1,499,500	55,052.76
Eastern Power Networks plc (UKPN EPN)	3,581,606	131,495.36
London Power Networks plc (UKPN LPN)	2,298,560	84,389.51
South Eastern Power Networks plc (UKPN SPN)	2,271,189	83,384.61
Western Power Distribution (Midlands East) plc (WPD EMID)	2,613,507	95,952.50
Western Power Distribution (South Wales) plc (WPD SWALES)	1,117,685	41,034.77
Western Power Distribution (South West) plc (WPD SWEST)	1,579,687	57,996.75
Western Power Distribution (Midlands West) plc (WPD WMID)	2,455,914	90,166.62
Total	29,424,457	1,080,291.81

⁸ Approved Amount has the meaning given in CRC 2J Part F.

Table 2

DSP	ENWL £	NPgN £	NPgY £	SSES £	SSEH £	SPD £	SPMW £	UKPN EPN £	UKPN LPN £	UKPN SPN £	WPD EMID £	WPD SWALES £	WPD SWEST £	WPD WMID £
ENWL	-	310,148.74	130,641.19	171,595.27	43,350.19	130,717.91	85,767.38	262,799.39	-	129,905.92	149,485.59	264,829.09	90,353.86	140,471.69
NPgN	-	-	-	-	-	-	-	-	-	-	-	31,403.35	-	-
NPgY	-	210,749.16	-	-	-	15,757.67	-	55,715.00	-	-	-	193,181.76	-	-
SSES	-	276,815.90	-	-	-	20,697.47	-	73,180.83	-	-	-	253,741.38	-	-
SSEH	-	69,932.12	-	-	-	5,228.81	-	18,487.70	-	-	-	64,102.80	-	-
SPD	-	173,463.42	-	-	-	-	-	24,049.40	-	-	-	161,352.07	-	-
SPMW	-	138,359.14	-	-	-	10,345.08	-	36,577.51	-	-	-	126,825.95	-	-
UKPN EPN	-	291,675.35	-	-	-	-	-	-	-	-	-	275,692.86	-	-
UKPN LPN	139,859.08	393,784.14	260,905.82	342,695.94	86,575.43	244,189.54	171,287.54	465,195.12	-	259,437.40	298,540.31	322,082.41	180,447.29	280,538.50
UKPN SPN	-	209,563.02	-	-	-	15,668.98	-	55,401.42	-	-	-	192,094.50	-	-
WPD EMID	-	241,148.77	-	-	-	18,030.64	-	63,751.63	-	-	-	221,047.35	-	-
WPD SWALES	-	-	-	-	-	-	-	-	-	-	-	-	-	-
WPD SWEST	-	145,758.01	-	-	-	10,898.30	-	38,533.52	-	-	-	133,608.07	-	-
WPD WMID	-	226,607.63	-	-	-	16,943.41	-	59,907.45	-	-	-	207,718.32	-	-