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Sent by email to: RIIO2@ofgem.gov.uk

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Dear Graeme,

Consultation on the RIIO-2 SIF Governance Document and the operation of the SIF

Thank you for the opportunity to respond to the consultation on the RIIO-2 Strategic Innovation Fund (SIF) governance document, and the operation of the SIF. This will be the basis of the innovation arrangements that will apply to Electricity North West and other DNOs when RIIO-ED2 begins in April 2023.

Electricity North West is the DNO covering the north west of England serving 5 million customers in 2.4 million premises, across a diverse range of locations, from urban Greater Manchester to rural parts of Cumbria, Lancashire and Cheshire. We are an innovative leader as is demonstrated by the development of CLASS which is now providing balancing services to NGENSO, delivering cost savings to all Great Britain's customers and reducing carbon emissions.

Our views set out below related to the operation of the SIF are based on our experiences of the Network Innovation Competition (NIC), and our consideration of how the proposed operation of the SIF might affect our innovation pipeline and specifically our ability to pursue certain types of innovation. We have also provided a separate list of observations on the drafting of the governance document using the template provided by Ofgem.

On the basis that licensees often benefit alongside customers from the rollout of innovation, we agree that as for the NIC currently, the SIF should require the licensee to contribute financially towards the cost of each project. However, if we are to avoid the situation where projects become unattractive, the level of this contribution must be justified at an appropriate value. Often the future benefits of an innovation to a licensee are not obvious, particularly where that innovation is aimed at supporting the transition to Net Zero. On other occasions, projects may not provide sufficient financial benefit to a licensee. If set at an inappropriate level, the contribution might represent a financial barrier for the licensee to the development of the project. In addition, if the outcome of the project then leads to a rollout into business as usual (BAU) in a future five-year price control period, then there is a limited window for the licensee to benefit from the rollout, or alternatively to contribute financially to the project, if Ofgem embeds the innovation project learning straight into the next price control.



The timing of funding of innovation projects under the SIF needs to be considered, as this may create a barrier to development of certain projects. Under SIF, owing to the need to traverse through each of the discovery, alpha and beta phases, the timescales for project development appear considerably longer than under NIC. If, due to the timing issue, interim funds need to come out of a licensee's central business plan to finance a project over a long period, there will be risks over the financeability of the project if it is uncertain when, or if, the money will be paid back at the end of the project. This is of particular significance after the first two years of RIIO-2, as projects are more likely to run into RIIO-3, where there is even more uncertainty if there will be a return on the investment in the project. A key benefit of the NIC is that it facilitates introducing large-scale trials of innovative ideas very quickly, allowing us to prove concepts and demonstrate benefits to customers. In contrast, the three-stage SIF process would appear to elongate the time it would take to get to the trial stage, requiring first successful transition through the discovery and alpha stages. The uncertainty this introduces may also put further strain on the viability of potential projects.

While we cannot comment on the costs, we support the principle of appointing of a body dedicated to the administration of the innovation programme, ensuring value of money for customers. With the primary focus of this organisation being on the efficient, targeted running of the innovation fund, we hope that this will make the innovation project development process quicker and improve the focus on the process for developing and funding of new ideas. Another benefit of the NIC is the level of independence afforded to licensees once a project has been approved. This light touch oversight facilitates efficient delivery of the project and avoids unwieldy administration during delivery. We hope that these principles can be maintained under the SIF. We would also support Ofgem if, in the future, it wishes to competitively tender the role of innovation service provider. It would be helpful to understand how the progress and performance of the appointed innovation body will be monitored over the course of the SIF.

The concept of introducing innovation challenges for companies to design its projects around is in principle a sound way of focusing the efforts of industry. However, the challenges need to be considered carefully so as not to preclude innovative ideas that may not have been anticipated by the body responsible for articulating the challenge. As well as providing a long-term vision of future challenges, necessary to allow a licensee to align its innovation strategy accordingly, it is important that there is transparency on what basis the innovation challenges are ultimately decided, and what they are intended to achieve. It would be helpful if licensees can gain assurance that innovation projects that might not strictly address a challenge can be considered for SIF funding if it can be shown that the project is likely to deliver benefits to customers, support the transition to net zero, advance learning or provide efficiency.

The Innovation Rollout Mechanism has been valuable for innovations which have been developed part-way through a price control and are not included within totex. It has allowed licensees to fund projects that would otherwise have not been able to access funding until the next price control period and so the delivery of cost savings, benefits to consumers or other improvements would have been delayed. For example, our Smart Street project demonstrated quickly how the 45,000 customers involved would benefit, which led to the benefits being realised rapidly. It would be beneficial if the SIF makes it possible to demonstrate projects at scale in the beta phase, this might include an initial rollout phase within the current price control (as the IRM would have achieved), which, if the business case is proven, would bring innovations to life much sooner than might otherwise be the case. It would be encouraging if one or more of the SIF phases allowed companies to deploy solutions, going beyond simply the process of simply innovating them.

We trust this will be helpful, and should you have any questions, please do not hesitate to contact me.

Yours sincerely

Tom Selby
Regulation Manager