



Consulation Response

Proposed Innovative Delivery Incentive (IDI)
Guidance Document (RIIO-ET3)

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nationalgrid

Executive Summary

We welcome Ofgem's introduction of the Innovation Delivery Incentive (IDI) and recognise it as an important step in strengthening the regulatory framework needed to accelerate innovation across network companies. The nature of innovation is that we do not always know in advance which solutions will deliver the greatest value, and the process of testing and deploying new approaches inevitably involves risk.

While existing regulatory mechanisms have been highly effective in supporting early-stage research, development and pilot projects, they have been less successful in driving the large-scale deployment of proven innovations where the greatest customer value is realised.

Typically, regulatory incentives only endure for the remainder of a five-year price control period, reducing the reward for innovations whose benefits accrue over a much longer timeframe. Similarly, where cost assessments are undertaken relatively late in project development, there can be limited incentive to pursue innovative approaches that reduce costs, as those efficiencies may already be reflected in the baseline against which performance is measured. Together, these factors can discourage investment in potentially transformational solutions, despite the significant long-term benefits they may deliver for consumers.

This incentive has the potential to overcome this by encouraging companies to pursue ambitious opportunities, take proportionate risks and accelerate the deployment of innovations that have the potential to deliver substantial long-term benefits for consumers and the wider energy system. With the right design it has the potential to play an important role in driving new approaches to engineering, delivery, collaboration and supply chain management at a time when the transmission sector is facing unprecedented delivery challenges.

However, there are several proposed design features that undermine the potential of the incentive to achieve its objectives by incentivising the targeted behaviours and ultimately create value for consumers. We have explained these problems in this Executive Summary and set out actions Ofgem can take to resolve them:

- Effective Outage Management is inappropriately measured as it is based on factors outside of the Transmission Owners (TOs) control and therefore it will not achieve the policy intent
- Including a negative adjustment for the Effective Outage Management criterion undermines the entire innovation incentive
- Excessive subjectivity in how the Panel makes assessments risks undermining the effectiveness of the entire incentive
- Including NESO on the Panel without safeguards creates a conflict of interest (or perceived conflict) which would undermine the effectiveness of the incentive
- The Net Consumer Value (NCV) methodology is needed as soon as possible for TOs to prepare robust submissions
- The timing of the first panel submission risks assessing innovative projects before their positive impacts have been felt
- The incentive needs to recognise that innovation can come from collaboration between TO and other organisations and this has equal benefit for consumers
- The scope of the effective NESO Collaboration area is too narrow and overlooks areas of innovation that have the potential to generate significant value for consumers, including of strategic energy planning
- It is difficult to assess whether the incentive is calibrated effectively across the behaviours without further information on how the submissions will be assessed in practice; and
- There are wider innovation opportunities which would create benefits for consumers which could achieve demonstrable consumer benefits at a portfolio scale but are overlooked in the design of the incentive.

We recognise that designing an incentive of this kind involves difficult judgements, particularly in areas where the underlying data, definitions and methodologies are still developing. Our response is offered in that spirit. Where we suggest changes, our intention is to help the framework reflect the complexity and uncertainty involved, so that it recognises sustained improvement and genuine consumer value. In several areas we believe a more graduated approach would achieve Ofgem's objectives more effectively than the thresholds currently proposed, and we would welcome the opportunity to develop these aspects further with Ofgem ahead of the final guidance.

We firmly believe that addressing these challenges will strengthen the incentive and maximise value for consumers. As well as explaining these challenges in more detail, we have also highlighted in Part 2 to our response areas where further clarification would be helpful.

The greatest opportunity for consumers during RII0-T3 is the rapid deployment of innovations at scale across the portfolio. Achieving this requires investments in organisational capability, digital and data platforms, supply-chain transformation, systems integration and new delivery approaches. The IDI should therefore be designed to reward not only innovation itself, but the successful scaling and replication and institutionalisation of innovations that improve customer outcomes, system resilience, environmental performance and long-term consumer value.

The framework should also recognise innovations that create value across the wider energy system, including through improved resilience, optionality and strategic flexibility, rather than assessing value solely within individual projects or organisational boundaries.

Effective Outage Management is inappropriately measured as it is based on factors outside of the Transmission Owners (TOs) control and therefore it will not achieve the policy intent

We agree that TOs and NESO should be accountable for optimising system access and minimising avoidable outage disruption, and that there is value for consumers to incentivise TOs to develop and deploy innovations in this area.

However, the Effective Outage Management behaviour as defined in the Proposed Guidance Document is not currently an appropriate measure of innovative performance.

The economic theory of incentives is clear that they are only effective when:

- the subjected party is assessed against factors over which they have a high degree of control and that external factors can be identified and isolated from impacting the incentive outcome; and
- targets are set at a level which is stretching but attainable, often termed a “fair bet”.

The proposal in this area of the incentive falls short of these requirements. As such the incentive will not meet its stated aim of incentivising innovation in this area, with the ultimate impact of not improving consumer outcomes. This is because the assessment criteria under this behaviour measure against a target which TOs have limited control and fail to reliably measure innovation performance.

Action required:

The Outage Management behaviour requires fundamental redesign to clearly define how genuine innovation is expected to be distinguished from operational performance.

Ofgem should provide greater clarity on how innovation within this behaviour area is expected to be evidenced and how these broader outcomes will be recognised within the assessment framework.

The Guidance should also recognise that the benefits of outage-management innovation are not best captured through a single measure of net consumer value.

Including a negative adjustment for the Effective Outage Management criterion undermines the entire innovation incentive

We were surprised with the inclusion in the text of the Final Determination for a proposal of a negative adjustment as part of the IDI – something which was never discussed or consulted upon with stakeholders.

It brings unintended consequences for the entire incentive and would result in a worse outcome for consumers than would otherwise be the case.

We have explained above how the measurement in this area does not meet the principles for an effective incentive. The proposal extends the problem to every aspect of the incentive. For example, the practical effect of Ofgem’s proposal is that the incentive for deploying innovation in relation to – for example – supply chain management would be calculated on the basis of how NESO interprets weather conditions, the impact on the system in the three weeks prior to a planned outage and the consequential impact on churn in the TO’s plan.

It is apparent that it would be an irrational decision to design an incentive in this manner, i.e. where the outcome bears no relationship to the input/actions taken by TOs in a particular area,

Setting the potential negative adjustment at such a high materiality of 30% across every targeted behaviour in the IDI due to factors which are outside of their control fundamentally undermines the behaviour changing properties. The rational response to an ineffective incentive is for a company not to invest the time, money and management attention on achieving the desired policy outcome for consumers, because they simply cannot influence it.

Action required:

Ofgem must remove the Outage Management beta factor needs or fully re-evaluate its materiality and application (this is in addition to the required redesign of how that area is measured).

Any retained beta adjustment should be proportionate, transparent and linked only to the specific innovation activity being assessed, rather than reducing rewards earned through unrelated innovation performance across other behaviours.

Excessive subjectivity in how the Panel makes assessments risks undermining the effectiveness of the entire incentive

The incentive reward relies on qualitative Panel assessments. Following the theory of good incentive design, subjectivity means less control for the party being incentivised to influence the outcome, which dampens the behaviour inducing effects.

We recognise that in the context of innovation it is difficult to remove all subjectivity. Therefore, it is important that the Guidance goes as far as possible to limit this subjectivity and to make the process more predictable. This will deliver a better outcome for consumers because the incentive will be more effective.

However, the current Proposed IDI Guidance Document provides limited certainty as to how the Panel will apply the assessment criteria in practice. The Proposed IDI Guidance Document explicitly states the criteria are not intended to be prescriptive and serve only as a guide for the Panel's assessment.

While we recognise and support the role of expert judgement, TOs will make investment and resource allocation decisions based on the expectations set out in the guidance. It is therefore important that the Panel demonstrates a clear and consistent application of those principles and is held accountable for doing so.

Investment decisions and resource commitments may need to be made several years before assessment, and a predominantly judgement-based approach risks undermining confidence in reward outcomes.

Action required:

There should be greater transparency over how decisions are reached, to give confidence to TOs to devote the necessary resources and management time to drive innovation.

The Panel needs to be held to account to follow the guidance as the TOs will be making decisions based on it. This would provide companies with greater confidence when making investment decisions and help ensure the incentive delivers the intended behavioural signals.

Including NESO on the Panel without safeguards creates a conflict of interest (or perceived conflict) which would undermine the effectiveness of the incentive

We recognise the value that NESO could bring to the Panel through its expertise in system operation, network planning and whole-system coordination. However, given that NESO has a direct role and influence in assessing some behaviours or outcomes but also has an impact on whether a TO hits the defined assessment criteria, (such as with Outage Management and Effective NESO collaboration) there is a potential conflict, or the perception of conflict.

This is more than a presentational issue. If a TO perceives that the Panel's assessment could be influenced by factors other than those within their control, it is another reason why the incentive would not have the desired effects because it falls short of good incentive design and economic theory.

Action required:

Where NESO is assessing behaviours or outcomes in areas in which it has a direct role or influence, such as Effective Outage Management, clear conflict-of-interest arrangements should be established by Ofgem to define transparent governance and decision-making boundaries. Where such safeguards cannot be demonstrated, NESO should not participate in scoring or reward recommendations relating to those areas.

The safest approach to preserve the effectiveness of the incentive and the associated consumer benefits would be to recuse the NESO panel representative from all assessment on Outage Management. On NESO collaboration, the NESO panel representative should be able to provide information should not be involved in agreeing the final scoring.

The Net Consumer Value (NCV) methodology is needed as soon as possible for TOs to prepare robust submissions

Several elements of the proposed framework depend on the methodology for calculating NCV, which has not yet been published. This limits the TO's ability to evidence submission requirements fully.

Again, if a TO does not understand how they will be assessed under an incentive, they will perceive having less control over the outcome, which in turn will reduce the effectiveness of the incentive and yield a worse outcome for consumers.

Action required:

Ofgem needs to publish a transparent and standardised NCV methodology alongside the final Guidance and explain how it aligns with established network-investment appraisal approaches.

The timing of the first panel submission risks assessing innovative projects before their positive impacts have been felt, which undermines the potential of the incentive

The timing of the first panel submission in year 2 of RIIO-T3 creates a risk that innovative projects are assessed before sufficient evidence of consumer benefits has materialised. As a result, the framework may under-recognise innovations where value emerges over time, despite those benefits being delivered within the RIIO-ET3 period.

This risks making the incentive less effective at incentivising the desired behaviours in TOs.

Action required:

If TOs cannot evidence enough Net Consumer Value (NCV) by the first submission window in September 2027, any unsecured/unrealised reward should not be permanently lost.

Unused reward should be accessed at the second submission window in September 2029 (or potentially through a later true-up), provided additional NCV can be demonstrated and evidenced.

The incentive needs to recognise that innovation can come from collaboration between TO and other organisations and this has equal benefit for consumers

We agree that the incentive should only reward a TO where they are taking action to develop or deploy innovation. However, this does not mean that the TO must always be “leading” an innovation.

However, the Design & Engineering Criterion 2 requires evidence that the TO actively led the innovation and did not adopt a supplier-led solution. This would unintentionally penalise collaborative innovation models across the supply chain.

Action required:

Ofgem should clarify that innovation developed jointly with suppliers remains eligible provided the TO can demonstrate adoption, active sponsorship, deployment leadership and scaling regardless of the origin of the innovation.

The scope of the effective NESO Collaboration area is too narrow and overlooks areas of innovation that have the potential to generate significant value for consumers, including of strategic energy planning

We support the inclusion of this behaviour as an assessment area within the IDI but consider that Ofgem should reframe the assessment to better recognise the outcomes enabled by effective whole-system collaboration such as planning excellence and delivery of strategic planning outcomes rather than focusing on submission timing.

Furthermore, the assessment criteria should reward novel or materially improved approaches to TO-NESO collaboration and the behaviour broadened to consider collaboration on activities beyond the first CSNP submission.

Action required:

Ofgem should work with TOs to define meaningful outcome focused and proportionate performance metrics across a range of TO-NESO collaboration activities, and consider how the consumer value test can be applied wherever benefits are inherently unquantifiable.

It is difficult to assess whether the incentive is calibrated effectively across the behaviours without further information on how the submissions will be assessed in practice

It is difficult at this stage to determine whether the current weightings are appropriately calibrated, as there is not yet a clear understanding of how submissions will be assessed in practice, nor how NCV will be evidenced and evaluated across the different behaviours.

Given this uncertainty, we would be cautious about concluding that specific behaviours are either over- or under-weighted before these areas are addressed.

Action required:

Ofgem should set out more clearly the rationale for the selected weightings, and commit to reviewing the calibration should the incentive prove to be ineffective in either over- or under-rewarding TOs. Consumers will not benefit from an incentive which is calibrated in a way that a target is not achievable (in line with good incentive design) as TOs will not invest in trying to achieve the outcome.

Any review should be evidence led. We recognise that this may result in adjustments in the targets in either direction.

We think stakeholders would benefit from greater transparency on how the current allocation reflects expected consumer value.

There are wider innovation opportunities which would create benefits for consumers but are overlooked in the design of the incentive

We think that the current five behaviour areas may be too narrow and risk excluding innovative activities that could deliver significant consumer value. For example, enhanced workforce productivity, strengthened portfolio management and ways of working.

These improvements can deliver substantial benefits for consumers through reduced delivery risk, improved efficiency, better resource utilisation and safer project execution.

Action required:

Ofgem needs to expand the scope of the IDI behaviours to capture a broader range of innovative delivery outcomes. We welcome further discussion with Ofgem on this point.

We would welcome further engagement with Ofgem, NESO and industry to develop these proposals collaboratively where additional detail or alternative approaches are required.

Overall, we support Ofgem's objective of encouraging innovation that delivers tangible consumer value. However, the current proposals will not achieve this objective.

We would welcome the opportunity to work with Ofgem to resolve proposed design features that undermine the potential of the incentive to achieve its objectives by incentivising the targeted behaviours and ultimately create value for consumers.

Our proposals are intended to support Ofgem's objectives for the IDI while providing sufficient flexibility for licensees to pursue the innovations capable of delivering the greatest overall net consumer value. They build on the framework and information provided by Ofgem in the Proposed IDI Guidance Document, and illustrate practical approaches through which the Guidance could be refined.

We have sought to answer each question as fully as possible, but in some areas the level of detail currently available limits the certainty we are able to provide.

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