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Our ref

Your ref

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Dear Mr Scott

Open Letter Consultation on the Innovation Funding Incentive and Registered Power Zones Schemes for Distribution Network Operators

I am writing in response to the Open Consultation letter of 5th October 2006 on the Innovation Funding Incentive and Registered Power Zones Schemes for Distribution Network Operators, on behalf of Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc, ("WPD" below, for brevity)

WPD agree with Ofgem that there has been good progress, particularly on the IFI scheme. The experience gained to date has emphasised the need for an early review of aspects of the schemes, and we are pleased that Ofgem has put this in hand.

The workshop held at Ofgem on 21st November has been helpful in hearing the views of a wide spectrum of interested parties including not only DNOs but representatives from Transmission, Universities, Consultants and Manufacturers. The level of agreement between these parties on the issues which need early attention was striking, and WPD's views align well.

WPD believe that for IFI and RPZ to continue, it is vital that Ofgem make a formal statement, before April 2007, to have a five year rolling commitment to the ongoing support of these schemes, with a flat % pass through level (80% striking a sensible balance). Without such a statement, WPD would be unable to support entry into any agreements spanning into the next Price Control period from 2010, and that would rule out entry into the larger, highly geared projects, such as Supergen. Instead, emphasis would move to short duration projects which closed by 2010, and the IFI scheme would quickly wither.



Turning now to the five questions posed in your letter;

1. The 15% cap on IFI internal expenditure

There was unanimous recognition at the above Workshop that the 15% cap on internal expenditure is inappropriate, and that is WPD's view.

It is proposed that there should be no cap, for the following reasons:

- In pursuing highly geared collaborative projects, it is very important that there is effective DNO participation to steer projects in directions that will best provide Customer benefit, input data and past IP knowledge and to agree deliverables. Consequently there will be high levels of engagement in proportion to external expenditure, particularly during early and late project phases. Our experience on Supergen Amperes has clearly illustrated this. University EPSRC grants are now more conditional upon obtaining such industrial partnership and input. Taking £12,500 external payment as an example, the 15% cap would be breached by attendance by one person attending two 2 day meetings involving travel and overnight costs.
- The cap discourages engagement in small, lower cost projects.
- The ratio of internal / external costs will not only vary during an individual project, but also according to the number of projects within an overall IFI portfolio and the relative timing of their phases. Consequently, the (justified) ratio will not only vary year on year within an individual DNO but also between DNOs.
- Given that DNOs already must have mechanisms in place to capture internal costs in order to report them as part of the existing arrangements, and that Ofgem already have the rights to audit IFI and declare costs ineligible, there is no significant risk of abuse of the removal of the cap. If desired, Ofgem could give some examples of the type of activity that would or would not be viewed as acceptable.

2. Eligibility criteria

Experience of the IFI to date has illustrated that the present definitions are too tightly drawn and inhibit R&D activity in other areas which are important to Government, Ofgem, Customers and DNOs such as network modeling (DWG / UoS issues) safety, physical security of substations, and environmental issues including climate change, sustainability and vegetation management (ESQC Regulations).

The definitions should thus be widened to –

- encompass whole life network infrastructure issues, and
- better define the extent of eligibility within projects into deployment phase

3 Benefit assessment requirements

There was extensive feedback during the workshop that a purely financial view and NPV approach was not an appropriate way to assess benefits, and warnings given by Manufacturing, Consulting and University participants against “over analysis”.

WPD favour a simple scorecard type approach which indicates the types of benefits which a project is intended to provide. The headings can be partly based on the risk management heading already incorporated into a PAS 55 and CBRM type approach, supplemented with some relating to knowledge.

We have in mind the following headings –

- cost
- safety – reduction in fatalities and injuries (in same manner as Govt.)
- network performance
- environmental (eg SF6 loss, oil loss, trees removed etc)
- IPR created
- leverage achieved
- knowledge acquired

(Benefits against these would be stated individually and not cross compared / valued.)

The need for industry to better communicate the successes of IFI to a wider public and Government audience is accepted, and WPD would be happy to feed into the production of some literature and / or web site which pulled together a composite of all IFI activity into a single document. We see ENA as being a suitable focus for this. Such communication would have the supplementary benefit of assisting in the promotion of the industry as wide and forward thinking, providing some added impetus to encouraging students to regard it as an exciting place in which to work and to engage in research.

4. RPZ constraints

Given the need for participation of generators to make RPZs as success and noting reports that 2 of the 3 schemes presently active in UK still have no connected generators, the reasons for lack of progress to date may be more complex than a perception of constraints imposed by the RPZ regime itself. However, the present requirements for generation to be connected by 2010 will inevitably now begin introduce a real constraint, and so consideration needs to be given by Ofgem to moving that date.

On a more general note, it may be desirable to broaden the RPZ concept to encompass “energy” solutions such as storage.

5. Future of IFI and RPZ

WPD believe that this is the most critical issue. Engagement in the type of longer term (typically 4 – 5 year), highly geared projects that are central to EPSRC, Govt and EU approaches will be badly impacted if there is ongoing uncertainty over the future of IFI and on the % pass through. At present there is no commitment past the 2010 Price Control, and this would mean that engagement with any new longer term projects would not be supported from this year end.

The 2010 timescale together with a reducing % pas through act as double dis-incentives for ongoing IFI engagement and that is not in the interests of any of the parties present at the workshop. Consequently, we strongly suggest that Ofgem provide a rolling 5 year ongoing commitment to support of the IFI and RPZ schemes and that a flat pass through rate of 80% is set.

Noting that some companies have hit the 0.5% IFI ceiling, it is appropriate for Ofgem to review that figure and possibly consider having a flexible ceiling, perhaps up to 1%.

There is benefit in an early revision and simplification of the Good Practice Guide ER G85, and for electricity transmission to be included. WPD support the idea that the ENA R&D Group should draft a revision and accept Ofgem's offer to input to this process.

I hope that our comments are helpful, please do not hesitate to contact Philip West on 0117 9332413 if you require any further information.

Yours sincerely



ALISON SLEIGHTHOLM
Regulatory & Government Affairs Manager