

Innovation Stimulus stakeholder event

Summary of proceedings



Location: Ofgem, 9 Millbank, London
Date: 15 November 2010

Introduction

On Monday 15 November 2010 Ofgem held a stakeholder event to provide stakeholders with an overview of the RIIO Innovation Stimulus and to consult on specific aspects of its development. The event was part of our open letter consultation of 12 October 2001¹.

Following introductory presentations from Ofgem and a network company, participants were asked to discuss the following questions in groups. These questions are based on those in the open letter.

1. What innovation might be required to facilitate a low carbon economy and secure supplies as efficiently as possible in each of gas distribution, gas transmission and electricity transmission sectors?
2. Please provide details of potential projects you consider could meet the objectives of the Innovation Stimulus in gas or electricity and the potential cost of these projects.
3. How should the annual level of funding to facilitate innovation in each sector compare to the £64m available annually under the Low Carbon Networks (LCN) Fund? How should funding be profiled over the 8 year period of the RIIO price control?
4. What speculative investment should companies include in their business plan to be funded through the price control (versus what they should compete for through the stimulus)? What should be the potential value of this speculative investment? What justification should be required within the business plan?

Each group was asked to submit their key issues to the panel comprising network companies and Ofgem staff. The panel provided a summary of key issues arising from these discussions before opening debate to the floor.

This note summarises the key issues from group discussions and the wider debate.

Group Discussions

Type of innovation and potential projects

A key question was raised as to the future role of gas distribution given the view that innovation in gas currently trails innovation in electricity. However, there is potential scope for increased gas innovation in a number of areas including biogas in localised networks, strategic storage, shrinkage, gas quality or using the gas network for Carbon Capture and Storage (CCS).

Participants thought that generally transmission projects are likely to be larger and may

¹ This can be found at the following link:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Innovation%20Stimuli%20%2012102010%20Open%20Letterpdf.pdf&refer=Networks/Policy>

take longer compared to distribution projects. Transmission projects may include increasing throughput, undergrounding, intermittent supply (including commercial aspects), AC versus DC. Distribution projects may need more testing for differences across a range of distribution networks.

Groups highlighted that innovation comes in different forms. These range from technical to development of new skills and collaborate research and development.

One group felt that more cross-sectoral innovation is needed. Examples include micro-generation household units switching between gas and electricity, renewable heat projects, demand response, storage, cross-sectoral communication structures and behavioural innovation. Criteria for funding should therefore allow comparison between gas and electricity.

Level of funding

On the level of funding, two groups felt that the LCN Fund annual funding of £64m would be appropriate to fund innovation in the other sectors. . Another group felt the LCN Fund is too small – referring to the fact that in the first year it has been over-subscribed. It was felt that the annual cap on funding is therefore limiting innovation.

Comparing relative levels of funding, one group felt that a lower level of funding for gas under the Innovation Stimulus could be interpreted as favouring the electricity sector over gas and prejudging outcomes before knowing future developments.

On the profile of funding, one group pointed out that profiling funding towards the front end of the period would allow learning to be incorporated into the business plans for the next price control. Another group believed that innovation will not tail off before 2020. The over-subscribed first year of the LCN Fund was put forward as evidence that funding should be flexible.

Multiple groups mentioned the importance of flexibility, which might include removing caps on funding for each year, depending on quality and volume of bids received in that year. They considered that this might allow the level of funding to better reflect variation in the quality and quantity of ideas and projects from year to year. Banding was suggested as one way to achieve flexibility.

Some attendees felt that funding might be better provided through loan-guarantees or loans with performance-related forgiveness of loans.

Innovation in the business plan versus the Innovation Stimulus

One attendee argued that the scope for including projects in the business plan should be as wide as possible. Multiple groups supported the existing Innovation Funding Incentive (IFI) and suggested that small 'speculative' projects could be included in the business plan. Others suggested the continuation of an IFI equivalent. One group member raised the difficulty of justifying speculative investment ex ante for an eight year price control period. An attendee felt that larger transmission projects could be included within the business plan.

One group suggested qualifying criteria for the Innovation Stimulus. These included roll-out

/ testing within the price control period, demonstration of benefits beyond the price control and to other parties and riskiness of projects – a view expressed in a number of groups. Another group believed the Innovation Stimulus should be used for projects which cannot be commercially justified on a Net Present Value (NPV) basis. This view was supported by second group which felt that projects in the business plan should provide a return on investment for the network company. Another indicated that projects which are more risky should be included in the Innovation Stimulus.

One group member expressed the view that the Innovation Stimulus should not just be used for trials, but also for 'business transformation'.

Question and answer session

Debate focussed on the role of third parties and the need or otherwise for an innovation licence. One attendee felt that it may be legally infeasible for Ofgem to create a new licensable activity for the purpose of Innovations Stimulus.

A DNO representative argued that creating a licence for third parties is unnecessary, citing the example of the LCN Fund where all third parties (relating to electricity distribution innovation) are already engaged with DNOs. Network companies would wish to collaborate with third parties cooperatively rather than under duress. A third party representative agreed with this approach, indicating that they had no desire to be a licensee due to the potential burden involved and because in the interests of getting their product rolled out they would want a trial to be a collaborative venture.

A number of attendees agreed with the view that technology companies already have an incentive to innovate by taking their products to network companies. Others felt therefore that commercial arrangements between DNOs and third parties should provide sufficient access to funding provided by the Innovation Stimulus.

Several present believed that a form of dispute resolution between third-parties and network companies would provide sufficient 'safety net' if third parties felt that network companies were not fairly considering their ideas. Other additional measures might be sufficient without resorting to licensing. These might include, for example, requiring DNOs to tender for expressions of interest from third parties.

In contrast, one attendee expressed the view that third parties may take a more cross-sectoral approach than the network companies, justifying third party access to the funding without network company collaboration. Countering this view, another attendee indicated evidence from the LCN Fund that network companies and third-parties do take a cross-sectoral approach.

Network companies expressed concern at the prospect of being forced to allow third parties to use their networks, at risk to their RIIO outputs and given that ultimately networks are responsible for security of supply.

One attendee expressed the view that competition for funding under the Innovation Stimulus would be harmful and that competition between third parties for network operators' custom is sufficient. However this was countered by the view that the LCN Fund is demonstrating the effectiveness of competition. Some attendees wondered whether the requirement for competition might be phased out over the price control period.

Two parties expressed the view that incentives under the Innovation Stimulus should extend to deployment and roll out of new technologies as well as trials.

An attendee highlighted that the potential for 'learning guarantees' to promote innovation, as implemented in the US, could be explored.