

Anna Rossington
Head of Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE

6th Floor, Dean Bradley House
52 Horseferry Road, London SW1P 2AF
+ 44 (0)20 7706 5100
www.energynetworks.org

23 November 2010

Dear Anna,

Open letter consultation on the development of gas and electricity innovation stimuli

I am writing on behalf of ENA members in response to the open letter above. As you know ENA is funded by the major licensed electricity and gas transmission and distribution companies in GB and as such will be subject to the proposed stimuli when they are applied in both the current transmission and gas distribution reviews and subsequently DPCR6 (RIIO-ED1?).

ENA has welcomed the new initiatives introduced by Ofgem at recent price controls to stimulate innovation. This has culminated in the introduction of the LCNF at DPCR5 and now the development of an enhanced innovation stimulus under the RIIO recommendations. We believe the success of these developments will be crucial in ensuring that the energy networks are able to meet the major challenges of delivering a low carbon future over the next twenty years and beyond.

We recognise that Ofgem's thinking on the proposed innovation stimuli is still at the formative stage and will be informed by the recent stakeholder workshop and ultimately the responses received to the December consultation paper. However, ENA members believe that it is important that before the publication of the December paper we should set out our concerns over a couple of aspects of the proposals which we feel very strongly about in the hope that you may review them before finalising the document. These concerns relate to, first, the proposed withdrawal of IFI, and secondly, the encouragement of non-network parties to lead on projects financed by customers under the stimulus.

Innovation Funding Incentive (IFI)

The IFI scheme has worked very well in encouraging innovation across the whole energy networks sector and ENA members are very concerned by its proposed withdrawal. It has taken some time to re-establish research and development as a valuable core business process within the sector and without the focus of IFI there is a danger that research associated with the provision of safe, reliable efficient and secure networks will significantly decline.

In particular, we do not believe that the route to innovation should be wholly dependent upon either well justified business plans or the competitive innovation

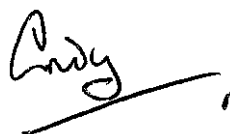
stimuli. It is likely that the former will only include "low risk", fully quantified projects that warrant Ofgem providing ex ante funding. The latter will be associated with high cost, high risk projects that will require a significant amount of work to prepare a winning pitch for competitive funding thus ruling out smaller but very valuable innovation projects. In the absence of a middle ground incorporating a flexible IFI-type funding arrangement that enables companies to react quickly to proposed R&D initiatives within an agreed framework and allows networks access to innovation funds on a UIOLI basis within the price control period, we fear that a significant element of innovation will be stifled. This arrangement would also allow projects to proceed where intellectual property rights are a key consideration. Furthermore, the IFI arrangement has already proved itself as a valuable "nursery" for larger more ambitious projects that then become prime candidates for a competitive funding process

Third Party Participation

While we fully support third party involvement and see that they have a valuable contribution to make we do not agree that Ofgem should enable them, via licence, to have independent access to our live networks. Given the ultimate safety and security of supply responsibilities bestowed upon us by primary and secondary legislation and indeed our existing licences we do not think it is appropriate for Ofgem to proceed as proposed. Rather, these parties should have access to the scheme by working in partnership/conjunction with network companies – an approach that on the basis of an admittedly small sample of potential third parties at the Ofgem workshop, would also be favoured by them. Experience of both the IFI scheme and, in particular, the LCNF has demonstrated that networks and third parties have, and continue, to work together to deliver innovative solutions. Hence, we have no reason to believe that Ofgem's concerns will actually arise. Nevertheless, in recognition of this, we would suggest that a more proportionate approach would be to proceed with the current arrangements that rely on partnerships etc, but to include a provision that enables a disgruntled third party to appeal to Ofgem as an arbiter if they believe that they are being denied the opportunity to work with networks. We also believe that this would be a more efficient route given the significant cost and time associated with creating and granting a new category of licence and integrating a new category of participant into the relevant industry codes.

I hope you find the response helpful. We would be happy to expand on any of the points raised.

Yours sincerely,



Andy Phelps

Director of Regulation

Energy Networks Association

Andy.phelps@energynetworks.org

Tel: 0044 (0)20 77065118