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Your ref

Our Ref

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Contact / Extension

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Dear Anna

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

I am writing on behalf of SP Energy Networks (SPEN) in response to the open letter issued on 12 October. We welcome the opportunity to comment on the issues raised.

SPEN has played an active role in applying the IFI and LCN mechanisms, and believes that a new process that caters for projects at any stage in the innovation cycle could play an important part in supporting the transition towards low carbon energy networks.

Our responses to the particular questions you have asked are set out below.

(1) *What innovation might be required to facilitate a low carbon economy and securing supplies as efficiently as possible in each of gas distribution, gas transmission and electricity transmission sectors.*

SP Energy Networks (SPEN) has developed a number of projects both at transmission and distribution voltages to trial or research technical solutions that have a bearing on a low carbon economy. These include projects to facilitate connection of renewable generation at a range of voltage levels, and trialling of technology to integrate embedded generation and demand side management.

As part of the ENSG 2020 transmission network vision SP Transmission is heavily involved in the development and future implementation of the Western HVDC interconnection between Scotland and England and offshore generation connections. The challenges of this project are immense and several IFI projects have been developed to ensure new technological advances are utilised to ensure successful delivery. We have a joint venture with NGET to plan and develop the Western HVDC Link, and we are working closely with our JV partner on innovation related to this project.

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We believe that some of the learning from the current LCNF regime in electricity distribution may be applicable to the wider transmission system (particularly given that 132 kV is a transmission voltage in Scotland). Possible areas that may be relevant include Dynamic Thermal Rating, demand side management and energy storage. However, it is important that the right funding mechanism is in place to allow trialling of such solutions on the transmission system before wider deployment takes place.

With an increasing focus on combined heat and power projects, we also expect to experience some convergence of the gas and electricity systems, and possible cross-sector innovation projects.

Innovation outside the areas of low carbon and security of supply should also be taken into account. Projects of potential benefit to customers in terms of, say, quality of supply or environmental amenity, may also be at risk if the scope of the innovation stimulus is too narrow. Neither of these measures may yield significant carbon benefits on their own, but are key to the interests of electricity customers.

We believe that the benefits of collaboration with academic institutions should be recognised. This applies not only in relation to the development of specific projects, but also because of the wider benefits to network innovation of relevant academic research being encouraged as a result of links between network operators and universities.

(2) How the annual level of funding to facilitate the innovation in each sector should compare to the £64m available annually under the LCN Fund.

We believe that it is important that some element of discretionary ‘use it or lose it’ funding such as for IFI and LCN ‘tier 1’ should continue. This allows companies to act quickly to select, amend and manage projects outside the more formal competitive process. This will help to ensure that small scale, collaborative projects encompassing network companies, technology providers and academia that explore the development of new tools and understanding of new areas for further work can continue under the RIIO regime. As under the existing arrangements, the value of this fund should remain in the order of 1% of revenue (combined IFI and LCNF). We do not believe that these projects should be constrained solely to ‘Low Carbon’ initiatives as much of the valuable work delivered under IFI does not fall under this category.

The LCN ‘tier 2’ fund in electricity distribution is equivalent to approximately 1.5% of allowed revenue in DPCR5. At this stage we believe that available funding in each sector should be at least comparable to that under the current LCN, after taking IFI into account. We think that an annual allocation of funding should be retained as opposed to front loading expenditure, in order to maintain an even flow of projects throughout the price control. The progress and delivery of projects will create new opportunities which should be developed as they become available.

For electricity transmission we would question whether an annual process is practicable, as it is expected that these projects will be larger in scale and take longer to deliver. Therefore we would suggest that the electricity transmission initiative should be in the order of £128m every second year. Having only three electricity transmission operators it is less likely that a sufficient number of unique projects could be developed and delivered on an annual basis.

In addition, we see merit in a stimulus mechanism that allows some flexibility in the annual/biennial funding arrangements – for example, there could be an element of carry forward of over- or under-run between years (perhaps limited to circa +/-10%) to avoid significant changes to use of system charges). This would help to limit the occasions when an otherwise worthy project was rejected due to a small shortfall in funding, but also avoid available funding being used up within, say, 2 or 3 years.

(3) *Details of potential projects you consider could meet the objectives of the gas or electricity stimuli and the potential cost of these projects.*

We do not at this stage have estimates of potential costs of projects in electricity distribution or transmission that would meet the objectives. As noted above we are actively involved in a number of IFI projects linked to the ENSG 2020 objectives and the Western HVDC interconnection link. Significant investment in innovation will be needed to ensure that we maintain security and quality of supply as networks evolve. As suggested in our response to question 1, we would be keen that an innovation stimulus exists for activities that relate to projects other than reducing the carbon impact of the network.

Commercial projects are also a potential area for trialling, such as exploring new forms of relationships with customers to deliver demand side management or to reduce the requirement for load related investment. We believe that as tier 2 projects are delivered over DPCR5, these will give rise to new concepts to be trialled in future years.

(4) *what speculative investment companies should include in their business plans to be funded through the price control, versus what they should compete for through the stimulus*

In our view there are a number of reasons why it may be appropriate for companies to include in their business plans expenditure (which may be capex or opex) that is related to innovation. The 'tier one' element of the LCN mechanism and the IFI give companies a relatively non-bureaucratic route to explore and test in-scope technical and commercial ideas, but these will not always be foreseen at the FBPQ stage. In some cases, a quick turnaround may be needed that renders a project unsuitable for a competitive bidding process. The FBPQ should allow companies to plan for an element of non-specific revenue that allows flexibility in the timing and level of support for projects. In addition, we believe that roll-out of technology that has already been subject to successful trialling should be a matter for the FBPQ rather than competitive funding,

There should be clarity in the RIIO regime regarding treatment of funding for innovation that 'fails'. We believe that the LCN framework is helpful in this respect, and this should be taken into account in the innovation stimulus package. A company should not be at risk of clawback of funding if the submission, reporting and auditing requirements set out have been met.

It should also be borne in mind that for electricity transmission, as there is only one System Operator, competitive funding for projects associated with that activity is not likely to occur.

Other points

- (i) Third party funding and licences.

We think that it is very unlikely for there to be a strong case for funding a third party directly to carry out a project. We work closely with a wide range of third parties in our current portfolio of innovation projects, including technology providers, energy suppliers, generators and academic/research bodies. Any control of part of our licensed network by a third party that is not directly responsible to us would raise a number of safety, legal and regulatory issues, including our need to carry out our responsibility to users and customers for the duration of the project.

(ii) Timing of competitive tenders

We think that in the transmission sector (both for gas and electricity) projects are likely to be on a larger scale than for distribution, so that consideration should be given to funds being made available every second year.

(iii) Collaboration and other design issues

There may be some projects where collaboration between gas and electricity companies, or between transmission and distribution sectors is possible (in the latter case, particularly given that 132 kV is a transmission voltage in Scotland). Our comments above on collaboration with our JV partner on innovation in relation to the Western HVDC Link are also relevant here.

(iv) Alternative sources of funding

We believe that in practice it is likely to be difficult to predict alternative sources of innovation funding up to 8 years ahead for the purpose of the FB PQ, or to co-ordinate these with timescales for the innovation stimulus package.

I hope that this is helpful, but please contact me if you have any queries.

Yours sincerely



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SP Energy Networks