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	129/10	0117 933 2175	19 th November 2010

Dear Anna

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

I am writing on behalf of Western Power Distribution (WPD) to provide a response to the above letter.

In addition to our responses on the specific questions asked in your letter set out below, there is one key area where we wish to comment further as follows;

Licensing for third party access

WPD do not believe that the proposals for licensing of non-network third-parties are either necessary or worth the extensive work and cost of development at this time for the following reasons;

- At the Ofgem stakeholder event held on 15th November all bar one of the third-parties present did not support the need for this, amongst an audience composed of some 21 third parties and 14 gas/electricity networks representatives.
- If a third party had a proposal that was so compelling as to warrant the effort of seeking a Licence, it is extremely unlikely that any of the network companies would not have taken up the proposal (when viewed against the same Licence obligations).
- We believe that there could be a need to amend utility legislation such as the Electricity Act to provide such Licensing. This would inevitably be very expensive and time consuming and would still not overcome the very real concerns of network operators relating to risk exposure arising from other legislation such as the Health & Safety at Work Act or the Electricity Safety Quality and Continuity Regulations. At present the situation is clear; network operators are responsible for the networks they own and operate.

- If the Licensing proposal were still to be pursued by Ofgem, it will be important to ensure that exactly the same obligations are imposed on the third party as would have applied to the network operator, for example in relation to Guaranteed Standards, IIS, funding, Governance etc since if it were not the case, it would distort the market process.

In the absence of any compelling third party support for the proposal, WPD believe that a proportionate way forward is the adoption of a very light touch mechanism whereby third parties, after they have had their detailed proposals reviewed and rejected by individual network operators, can seek discussion with Ofgem. If it were then Ofgem's view that the proposal, when viewed against the relevant Governance and Licence obligations of network operators was of merit, they could write to network operators and outline the case for support. Such an approach is simple and can be readily adopted without the inertia and expense of the proposed and un-supported Licensing. In the event that such an approach is demonstrably proven to have failed, there is nothing to stop Ofgem resurrecting the Licensing proposal.

Our views on each of the key areas outlined in the letter are as follows:

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?

Whilst WPD believe that the present LCNF criteria cover low carbon projects that involve on-network components, there is a need for greater flexibility to span cross network (e.g. multi-utility such as CHP/RHI) and off-network (e.g. home/behavioural) innovation.

It is extremely important not to lose focus on other areas of innovation, for example relating to aging assets, asset health, safety, environmental, cyber security and climate change. These have currently sat under the IFI scheme, albeit with some restrictions that have not been updated to reflect Ofgem's new obligations. The IFI scheme has served UK well; in addition to delivering outputs, it has encouraged R&D, supported University research, and lead to healthy collaboration on projects. Further comments are provided in response to the final question.

In debating future innovation mechanisms, considerable care is required to ensure that discussion based on initial open and high level definitions of coverage is not subsequently subsumed into tightly defined Governance that removes or constrains avenues that parties had taken to be included. The phrase "securing supplies as efficiently as possible" can be interpreted in many ways, at its broadest it could be taken to encompass long term (non-NPV justified) initiatives taken for the good of all, for example relating to environmental or sustainability issues, but conversely could be subsequently interpreted to mean something very different. It is important that this part of the debate is covered quickly to ensure that ongoing development of innovation stimuli is not compromised.

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

(It is understood that the innovation stimuli will also apply to Electricity Distribution Networks from the end of the present Price Control, when it will replace the current LCNF. Consequently the level of funding being compared would appear to be £100m p.a. rather than £64m)

The current round of LCNF Tier 1 and Tier 2 submissions from DNOs, taken together with IFI spend, provides an indication that this £100m p.a. scale of funding is of the right order for DNO activity. Transmission operations and assets span a different range of cover and complexity than most DNO assets, warranting some uplift in the overall “electricity” level of funding. If the discretionary reward element of LCNF were not considered, then the current overall £100m p.a. would appear to be of the right order overall.

However, there is a need to provide more flexibility in the phasing of funding than under the present LCNF arrangement; instances might arise where there was a range of sufficiently compelling projects that Ofgem might wish to approve in a given year that a rigid fixed annual budget would inhibit.

WPD have no comment to make on funding of innovation in the Gas sector.

Details of potential projects you consider could meet the objectives of the gas or electricity stimuli and the potential cost of these projects

Potential projects would include those falling under the present range of projects under LCNF and IFI, together with more holistic potential projects spanning RHI/CHP, customer behavioural, security, communications, environmental and in home/business devices. WPD believe that an overall £100m p.a. electricity sector national level of funding would permit such types of projects to be pursued.

It is pertinent at this point to refer to the RPI-X@20 July 2010 document (14.30 page 154) where reference was made to requiring network companies to demonstrate they had considered alternative sources of funding. Alternative sources will have their own governance, timescales and “call” coverage; there is no guarantee that a “call” will arise at a given time. Whilst network operators might seek direct funding for large scale projects, these mechanisms otherwise tend to present opportunities for network operators to participate as partners such as in the Plugged in Places initiative or the EPSRC supported Supergen project. Consequently the requirement to demonstrate consideration of alternative sources of funding should be subject to some project value threshold, probably of several £100k, to avoid inertia and the complexity of interdependency on projects.

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 – and the potential value and required justification for this speculative investment.

In his opening remarks at the Ofgem stakeholder event, Stuart Cook highlighted that “no one can paint an accurate picture of what networks will look like in five to ten years time”, and this is a key issue in the formulation and content of business plans. Under the RIIO proposals, Price Control periods would extend to 8 years, with business plans extending beyond that. Taken together with the time for preparation and preliminary submissions etc for a Price Control it indicates that Business plans would span some ten or more years, and it is not credible to suggest that companies would be in a position to have detailed innovation proposals with justification spanning such a period.

Business plans could contain generic descriptions of areas on forecast innovation but these will tend to reflect the level of description currently used to set eligibility criteria within LCNF and IFI governance. What is important is to provide flexibility, in the manner currently provided in IFI. The need for R&D in any particular area can arise in relatively short timescales, for example as a result of some Government stimulus or change in legislation. The outputs of some R&D can in turn point to a need for further work in another area, for example climate change work relating to precipitation has pointed to a need to examine impacts on earthing.

WPD believe that it is important to retain an IFI-like mechanism of the same scale in order to provide an ongoing flexible and rapid response, supporting collaborative working between network operators, academia and industry. Such an approach would not fit within an LCNF competitive Panel annual call mechanism. A modest revision to the present IFI Governance arrangements to reflect Ofgem's current drivers, with a spend cap of the same order as present (which could sit within the above £100m p.a. annual sum) is proposed,

If you have any queries with regard to this response, please do not hesitate to contact Phil West on 01179 332413

Yours sincerely

A handwritten signature in black ink, appearing to read 'AS', with a horizontal line underneath.

Alison Sleightholm
Regulatory & Government Affairs Manager