ofgem

Memo

Innovation Working Group

Notes and issues from the third meeting of the Innovation Working Group, held on Thursday 12 May 2011 at Ofgem's London office; 9 Millbank, London.	From	Melinda Anderson
	To	Innovation Working Group
	cc	
	Date	25 May 2011

1. Introduction

Anna Rossington (AR) welcomed attendees and outlined the purpose of the meeting - to obtain feedback on our January Open Letter Consultation on third-party access to the network innovation competition (NIC) and discuss issues arising out of the previous meeting.

These notes aim to capture the key points of discussion. They do not indicate or imply Ofgem's agreement to points made by attendees.

2. January open letter consultation

2.1 Project issues facing third parties

AR provided the group with an overview of responses received in relation to the consultation on third party access to the NIC. These will be published alongside our initial consultation on the innovation stimulus package, to be published in the near future. She then asked the group, in particular the third party representatives, for their view of the types of projects third parties might bring forward and to put forward any key issues related to third party projects.

One third party representative gave an example of some of the difficulties facing SMEs when working with large established companies. He explained that his organisation had applied for a competitively tendered grant, and was asked to find collaborators to progress a bid. At the last minute the collaborator asked him to change the collaboration terms in favour of the large company. The smaller company felt that if they did not accept they would lose their place as part of the consortium. The group member explained that unless a third party holds the money for a project it's unlikely they will hold the balance of power in such negotiations. Another attendee noted that this example did not relate to a regulated network company and therefore represented quite a different situation.

Denise Massey (DM) explained the role of the Energy Innovation Centre (EIC) in providing support to SMEs when dealing and working with the network companies on potential IFI projects. The EIC works alongside Distribution Network Operators (DNOs) and are able to draft short outline proposals on behalf of the SME where they don't have the resources or the capability. The EIC then circulates the proposal to the DNOs to ascertain the level of interest. This process reduces risk to third parties because the company is in effect the project manager. The EIC can also assist in negotiating project changes that are effective for all parties and can provide leverage at the feasibility phase if commitment cannot be obtained from DNOs.

Another member of the group noted the importance of support for smaller third parties to help build an ecosystem of companies that can work with each other.

AR asked the group about their views on differences between on- and off-network projects[1]. One member responded that innovation is most productive when it involves collaboration between third parties and network operators, regardless of whether a project is on- or off-network. A third-party representative also agreed with this view. The group noted the risk that without network-company involvement innovation could be less applicable to the network.

A third party representative noted that they face a huge learning curve to take off-network innovation and apply it to networks. Another member thought this was a reason for third parties to be engaged early on. One attendee highlighted the EIC's role, uploading information onto their website in order to get engage DNOs. This member felt that this role has helped DNOs and third-parties to collaborate from an early stage, and help third parties develop ideas in ways which are relevant and applicable to networks.

A third-party representative expressed the importance of providing smaller third parties with security against any harmful behaviour of larger companies. A network representative responded saying that network companies are bound by rules and regulations which govern their behaviour.

AR questioned whether it was correct that a third party having access to funding would change the balance of power, or that if a network operator was disinclined to work with the company, the funding would not make any difference. She questioned whether creating an innovation licence in order for third parties to participate directly would actually help, and noted that it would be resource intensive. One participant noted that any solution needed to be proportionate to the size of the problem. After a short discussion the main potential barriers to third party participation were identified as:

- Network companies (ie large companies) not playing fair
- Upfront cost of bid preparation versus likelihood of success, and overall bureaucracy of process
- Lack of transparency on the terms of collaboration/project implementation

One member noted that bespoke collaborative agreements can carry high costs (related to changing terms and conditions, for example) which can be prohibitive for third parties. He suggested that costs to third parties can be reduced by utilising standardised agreements instead.

A network representative thought that providing bid preparation money to third parties could help to alleviate some of their concerns and asked whether or not there would be a mechanism within the NIC for preparation funding to be extended to third parties.

AR noted that these issues would not be necessarily addressed by direct access to funding, and attendees observed that collaboration issues would need to be addressed much earlier in the process – waiting until submission (ie when an innovation licence might be awarded) would be too late. Therefore any solution should focus on reducing these barriers at the start of the collaboration process.

AR noted that the NIC will be significantly different from the LCN Fund in that the NIC covers all aspects of innovation including R&D and off-network projects whereas the LCN Fund is for trialling of innovation on networks only.

[1] We referred to off-network projects in our January open letter, as projects not carried out on a licensed network.

2.2 Filtering projects

Having agreed that third party direct access to funding was not required, AR asked the group whether network companies should filter third-party ideas or whether the Ofgem should have a role in this as part of the competitive process. One group member said that it was important to maintain competition between the network operators and that letting Ofgem filter good ideas could dilute competition between parties. One member said that allowing Ofgem to filter good ideas was the equivalent of Ofgem being the procurer of innovation instead of the network companies.

AR asked the group about whether they thought that network companies would take up good ideas that would be costly for them but would reduce costs for customers. Network company representatives said they would, because if they didn't someone else would and they are incentivised through the price control to be more efficient. Network company representatives said they would take up any good idea. A third party representative felt is would be unlikely that networks would be keen to take up such projects, but could not provide any examples. AR noted that it's not expected that innovation will neatly slot into the existing boundaries and that many benefits will not be commercial benefits for the network companies. The group began to discuss the rollout of innovation and how to turn innovation into 'business as usual'. One member noted the vital importance of facilitating this transition.

AR turned the group's attention back to the question of filtering projects (and highlighted that transition to business as usual will be discussed at further meetings). She asked the group whether third parties should be allowed to submit ideas to the final stage of competition or whether networks should filter ideas before they are submitted to the expert panel. One third-party representative suggested that for non commercial projects it might be better for third parties to submit straight to Ofgem. A network company representative noted that not all innovation benefits are likely to accrue to network companies - some will accrue across the supply chain and therefore some benefits will accrue to other collaborators such as suppliers. Another group member noted that if the market structure resulted in network companies having no incentive to pursue some projects which would be beneficial to customers, then Ofgem may be better placed to screen those projects. A third-party representative said that Ofgem oversight is important to prevent non-commercial ideas being discarded by network companies.

2.3 Facilitating third party participation

AR asked the group if there should be a process that would protect third parties and allow them to lead innovation projects without having to have a network company on board. There was discussion among the group that Ofgem should look at problems if and/or when they arise rather than up front trying to anticipate the problems.

AR suggested a process whereby third parties come forward with innovative project ideas and if Ofgem thought the project had merit then it could endorse the project to help the third party find a network partner. Third parties could then take further problems to Ofgem. This idea was countered by the suggestion from a group member that this approach could result in less well developed ideas being brought to network operators and that Ofgem risked being inundated with submissions. A DNO representative stated that when they had held a tender as part of their LCN Fund proposal they had received thousands of responses. Another member felt there was value in network companies filtering ideas first. This would encourage further discussion between network companies and third parties about any issues the project could encounter that the third party or network company had not thought of. Another member asked whether a neutral body could filter projects rather than Ofgem. One third party representative felt that there already exists a natural filtering process because submitting bids is costly. AR raised another approach for the group to discuss. She suggested that there could be a ‘portal’ where third parties could upload their bids, giving all parties visibility. Network companies would filter the projects but Ofgem would have visibility and could assess whether the network companies were ignoring certain good ideas. There was some endorsement of this idea but one member noted that there was still a possibility that that the portal could be inundated with bids. One third party representative thought that third parties should say in their bid why they thought a network operator may not be interested i.e. for non commercial projects.

AR asked the group whether third parties should have the opportunity to submit projects to Ofgem if they believed the network companies were financially disincentivised from undertaking the innovation. One member commented that they didn’t think there would be much support for that approach. Another member offered to give evidence of their take-up rate for third-party proposals. Another member thought that if third parties approach Ofgem they should demonstrate up front why network companies had rejected their proposal. The group also asked what Ofgem would do with rejected bids, whether Ofgem could make a decision about the viability/suitability of the bid and whether Ofgem would accept the network operators’ reasons for not wanting to take up projects. AR noted that this would give Ofgem the opportunity to provide constructive clarification if regulatory issues were preventing projects being taken up. Network companies responded that they would welcome this.

3. Raising funds for the NIC

The group was asked whether funds should be raised via transmission customers or distribution customers. AR noted the importance of ensuring that no customers pay twice. One member asked whether every customer will pay the same or whether different customers will pay different amounts, or whether funding would be raised through the charging methodologies. AR responded that customers may be charged an equivalent share (similar to the way funds are raised for the LCNF) and that we will be exploring this further. Another member asked whether the funds would be raised from demand customers or all customers.

Some group members noted that some Transmission Network Use of System (TNUoS) customers benefit from TNUoS charges and that embedded generation has a negative demand. It was also noted that in theory the charging methodology was the fairest way to raise funds and that is made sense to use that method. Another member noted that gas storage customers don’t pay distribution charges. The group resolved to further consider these issues and return with some worked examples.

A member noted that the electricity NIC could not be raised through the DNOs’ charges until the next electricity distribution price control, which starts in 2015. Until that point the funds can only be raised through the electricity transmission companies.

Another questioned how funding for cross-sector projects will be funded. AR said Ofgem is looking into this issue further and considering legal advice, on which we will report back to the group.

4. Transition from Innovation Funding Incentive (IFI) to NIA

The network companies had concerns about the scope of projects allowed under the NIA and whether IFI projects which ran into the next price control would still be eligible to be funded under the NIA. They noted that without clarity, the companies would ramp down on new IFI projects (which are often multiple years in length). It was noted that IFI funding is used for post graduate studies and for funding the EIC.

A DNO representative noted that similar transition issues will apply for First Tier projects at the end of DPCR5.

The group raised the treatment of intellectual property (IP) and noted that they would want it to be treated consistently between IFI and NIA. They noted that under the LCN Fund there are set IP conditions, which do not apply to IFI. AR noted that IP will in principle be dealt with along the lines of IP treatment within the LCNF in that the funding is socialised and therefore the learning has to be disseminated across the industry. Therefore Ofgem cannot allow any IP arrangements that would prevent this, or would enable one party to profit from the customer funded innovation. Another member commented that the best way to socialise the benefits is to ensure the benefits flow to everyone, in some circumstances this might be achieved by maximising incentives to generate IP rather than by forcing companies to share IP. AR noted that under the LCNF approach IP could still be sold abroad. A group member questioned how customers would benefit if an IP originator does not wish to commercialise it.

One member thought that a case study on IP implications would be useful. AR confirmed that there will be further opportunity to discussion IP at future IWG meetings and that we could also learn lessons about IP from the LCNF. She agreed to circulate the IP arrangements for the LCN Fund to inform future discussion.

One member questioned whether NIA money could be used for bid preparation, as is currently allowed for under the LCN Fund tier 1. AR responded saying that it would depend upon how the competition was structured but NIA would only facilitate funding for network companies. A DNO representative noted that the current arrangement under the LCN Fund Tier 1 has some weaknesses in that the same amount is available irrespective of the size of the bid, and that the amount available depends on the number of DNO customers

A network-company representative suggested that network companies would be prepared to pay those that contribute to the bid from the NIA. A third-party representative questioned network companies' incentive to do so. Network company representatives responded that this already happens in relation to the LCNF. Another said it should be up to third parties to negotiate bid-preparation funds with collaborators and that network companies would be prepared to contribute to third-party bid preparation if their ideas were good.

AR asked whether bid-preparation costs could be included as project costs in project submission, so would only be recovered for successful projects. One member said that network companies and third parties alike would be against this, because it increases downside risks associated with preparing bids. AR suggested that commercial companies would probably set aside money for the bid process.

A third-party representative said it was important for small companies to know how likely it is that they might win a project e.g. how many submissions were received in comparison to the number of projects chosen.

Network company representatives said that the IFI works well. Another issue discussed by the group included the differences between transmission IFI criteria and distribution IFI criteria and whether this should be the case going forward under the NIA. The group also thought that the broad nature of the IFI was a significant contributor to its success. AR informed the group that there is still a lot of work to be done in regards to criteria for NIA and that the group will be involved in that work.

In relation to the transition phase, the network companies said they would like assurances now that the NIA criteria won't exclude any current IFI projects if there is and overlap particularly in regard to 3 year projects. AR noted that ultimately it was network companies' own responsibility to ensure they haven't overcommitted financially.

The issue of rewards was also raised but AR indicated this would be the subject of discussion in the future.

4. Technology Innovation Needs Assessment (TINA)

Jason Eis, Carbon Trust, gave a brief overview of this work, and agreed to circulate his presentation.

5. Further issues going forward

The group was asked what it would like to discuss in the next working group meeting. The following issues were agreed:

- Intellectual property
- Rewards
- Turning innovation into business as usual
- Incentives and wider system benefits
- LCNF review
- Project timeline

Actions:

- Circulate LCNF governance on IP
- Members to develop worked examples of funding via transmission/distribution customers

6. Close and next meeting

AR summarised the key points of discussion and thanked attendees for their participation. The next meeting was tentatively scheduled for mid June 2011.

Appendix

List of Attendees

Iain	Welch	National Grid Transmission
Martin	Hill	SP Transmission
Stewart	Reid	SSE Transmission
Richard	Buckley	Scotia Gas
Nigel	Winnan	Wales and West Utilities
Gaynor	Jones	National Grid Gas
John	Christie	DECC
Alex	Murley	Renewable UK
Jason	Eis	The Carbon Trust
Taco	de Vries	Intellect representative
Dave	Openshaw	DNO representative
Martin	Atkinson	SBGI
Mark	Wagner	Isentropic
Alec	Breen	NGN
Sean	Gauton	ENA
Craig	Dennet	CHPA
Denise	Massey	Energy Innovation Centre