

## Innovation Working Group

Notes and issues from the latest meeting of the Innovation Working Group.	From Date and time of Meeting Location	Stephen Perry 09 August, 1030-1430 Ofgem, 9 Millbank, London
---	--	--

### 1. Introductions

- 1.1. Anna Rossington (AR) welcomed attendees and outlined the agenda for the meeting – to provide feedback from the 2011 Low Carbon Network (LCN) Fund conference, to outline a timetable of issues moving forward, to discuss the Network Innovation Allowance (NIA) and to consider the governance arrangements for the Network Innovation Competition (NIC).
- 1.2. 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. Low Carbon Network Fund Conference

- 2.1. AR provided feedback from the 2011 LCN Fund Conference. She stated that overall she was impressed by the presentations made by the DNOs and was pleased to see that a wide range of interested parties attended the event. She noted that as projects develop the event would offer more opportunities for shared learning.
- 2.2. AR questioned how the event will work effectively when there are numerous ongoing LCN Fund projects and thought that the event might need to be organised more strategically. Stewart Reid (SR) anticipated that the DNOs might outline new mechanisms for shared learning within future LCN Fund submissions. Dave Openshaw (DO) agreed and believed that DNOs would share learning on a more "ad hoc" basis going forwards. AR suggested that subject-specific working groups or events could be a useful method of disseminating information to a more targeted audience. SG suggested using more flexible wording in the Network Innovation Competition (NIC) governance document/licence to allow for different methods of sharing new learning.
- 2.3. AR confirmed that the ENA will be looking for feedback from the session and invited all working group members to share their thoughts with them.

### 3. Timetable of issues

- 3.1. At the last IWG meeting attendees requested that Ofgem set out a list of issues to be discussed over next few meetings. AR presented the list, noting it was a first draft - and welcomed any additional potential issues.
- 3.2. Whilst discussing the list of issues, some of the attendees raised issues or questions – which are recorded below.

*Expert Panel – see later*

*Cross Sector Projects.*

- 3.3. AR stated that it is possible to envisage some potential projects where a gas and electricity network company would want to collaborate on a project or where a project

funded under one sector's competition produces some benefits for the other sector. Due to regulatory frameworks there are issues about the potential cross-subsidisation between gas and electricity. AR stated that Ofgem is consulting on this with their lawyers.

*Renegotiation of Projects after submission.*

- 3.4. AR stated that another topic for future discussion is the potential for the expert panel to renegotiate the details of projects following submission. SR stated that although he liked the idea, he was concerned that if projects are radically altered, then network companies could lose the support of vital partners who are only concerned with a small part of a project. SR also thought that this could lead to network companies offering the panel a suite of options to choose from. SG thought there would need to be a differentiation between redefining projects and renegotiating projects.

*Revisiting of SDRC after project start*

- 3.5. As part of the LCN Fund, DNOs can be awarded their ten percent contribution to the project funding if they implement their project successfully and satisfy specific successful development reward criteria (SDRC). AR questioned whether the working group wanted to replicate this approach in the NIC. DO stated that there is a challenge to develop a set of criteria that allow network companies to make appropriate changes during the implementation of a project, but reassures the Authority that a project is being executed successfully and as approved. AR noted that this links in to a broader discussion on how much a project can be changed during its implementation. It was agreed that this issue would be discussed in November.

*Award Process*

- 3.6. AR stated that this would be a discussion on the full competition process. During the course of the IWG there were several discussions about the timing of the NIC competition.
- 3.7. IW asked when the first competition would run. AR stated that her initial thinking was that the first competition would begin in April 2013, results would be announced by Nov/Dec 2013 and then funding would be recovered as part of the network company allowed revenues from 1 April 2014. The network companies asked whether there was any opportunity for these timescales to be moved forward. AR stated that until the new licence conditions are in place, (ie 1 April 2013) Ofgem cannot direct the companies to raise the funding. AR also reminded the companies of the considerable time pressures experienced in the first year of the LCN Fund when the governance was created and the competition was run in the first year. AR also reminded the DNOs that submissions would need a significant amount of preparation and that it might prove difficult to produce the submissions and finalise RIIO-T1 and GD1 at the same time.
- 3.8. The working group identified three options:
- Run competition in 2012, with funding starting 1 April 2013.
  - Run "fast-track" competition in 2013, with funding starting 1 October 2013.
  - Run competition in 2013, with funding starting 1 April 2014.

AR asked the working group to think through the pros and cons of each option.

- 3.9. The working group asked whether there was an opportunity to offset the two competitions for gas and electricity. AR recognised that this may be an option,

although she highlighted that the decisions from both competitions would need to be announced in time for the companies to provide notice of new charges.

- 3.10. One attendee questioned whether there would still be the same level of competition in later years, or whether it would be more collaborative. It was also questioned how the competition will work in transmission.

#### *Customer Engagement*

- 3.11. AR commented that traditionally network companies have only had limited interaction with customers. The NIC will increase customer exposure to network companies. AR wants to discuss the approach adopted in the NIC to ensure that this interaction is managed appropriately.

#### *Duplication*

- 3.12. DO suggested that there was a subtle difference between replication and duplication, because networks and customers do not behave in the same way across GB. AR noted that the main focus here is the generation of new learning.

#### *Other issues*

- Gaps in Innovation. The working group discussed how they would address any perceived gaps in innovation submissions from the industry. DO stated that providing too much direction to network operators could divert them from pursuing innovation in other more urgent areas. DM suggested that informal routes, like the IWG, would be the most appropriate channel of feedback and is in accordance with the spirit of the scheme. Kerri Matthews (KM) stated that similarities could be drawn with Ofgem's Discretionary Rewards Scheme, where the panel provides informal feedback to all entrants.
- External resources. The DNOs stated that it is difficult to instigate a project that utilises different grant funding, since co-funding has to be in place before the grant is awarded. SR commented that access to external resources was not limited to revenue and that the coordination of assets, technology and knowledge were also major issues. He thought that external funding should be encouraged, but that Ofgem should recognise the problems, and credit other strategies employed by companies.
- Intellectual Property. AR identified intellectual property as another issue that would need to be addressed as part of the IWG and suggested this could take place in November.

### **4. Network Innovation Allowance (NIA)**

- 4.1. AR stated that Ofgem are keen for network companies to collaborate with stakeholders in their NIA projects. Under IFI there has been a restriction on the amount of "internal" spend, to encourage network operators to look elsewhere for funding and partners. AR queried whether this might be useful for the NIA, or alternatively whether projects that were only being undertaken by the network company (with no partners) should be subject to a higher funding contribution from the network operator.
- 4.2. SR commented that perhaps these proposals were too focused on the inputs of the scheme. SW suggested incentivising the network operators to look at the output of the

scheme (eg encouraging DNOs to implement knowledge learnt through the scheme in their business).

- 4.3. IW noted that it would be unfortunate for a network operator to become constrained by arbitrary rules. DM stated that she was confident that the network operators would establish partnerships with external stakeholders as the majority of innovation is derived from external groups. SR stated that the network operators need external support since they don't have the skills, resources or specialist knowledge internally to deliver these projects.
- 4.4. KM noted that Ofgem will have visibility of internal spending as part of network operators "well justified business plans". The network operators noted that they would very rarely expect the percentage of internal spend to be higher than the limits specified as part of IFI.
- 4.5. AR welcomed the feedback from the working group and advised that further discussions must be had on the governance arrangements, processes and outputs of the NIA.

## **5. Expert Panel**

- 5.1. AR stated that the NIC will be reviewed by an expert panel similar to that of the LCN Fund, and asked if the NIC has the same requirements, and whether separate panels are required.
- 5.2. Ian Welch (IW) suggested that for the NIC a similar panel could be used for both gas and electricity as they require the same expertise (eg consumer issues, environment). However IW felt that separate gas and electricity technology experts would be required. AR stated that the LCN Fund process can be quite time-demanding for the panel as much of their work takes place over a two month period.
- 5.3. SR suggested that the NIC has a pool of expert panel members that Ofgem can select from each year. He believed that a pool of panel members would ensure that the same panel do not become overwhelmed by the process
- 5.4. DM stated that within the industry there is only a small group of people qualified to sit on the panel and that many individuals would be excluded due to potential conflicts of interest. DO noted that it would be unfortunate not to include the best candidates, just because there could be a potential conflict of interest. AR stated that Ofgem have been very concerned about any conflict of interest that could be perceived to compromise the objectivity or integrity of the panel. The working group stated that they would rather have someone who is informed and engaged with the industry (and thus might have a potential conflict of interest) rather than someone who is detached from the industry (and doesn't have a conflict of interest). SR suggested that if Ofgem were transparent and engaged the network companies in the panel selection process, then the network companies could accept any potential conflict of interest upfront (including working with third parties).
- 5.5. SG suggested that an expert panel member could take part in the process, but withdraw from voting if they had declared a conflict of interest.
- 5.6. AR reminded the working group that the expert panel only makes recommendations and that the Authority makes the final decision on which network operators should be rewarded. There was consensus from the working group that the size and structure of the panel works well.

## **6. Balance between Government Document and Licence Drafting**

- 6.1. AR provided an overview of the LCN Fund governance arrangements and advised the working group that a similar governance structure is required for the NIC. She queried what information should be set out in the licence condition, versus what information should be included in the governance document(s).
- 6.2. The working group acknowledged that they would need separate governance documents for gas and electricity but agreed that they would like to have one common governance document for both transmission and distribution.
- 6.3. AR reminded the IWG that there are several different types of licensed gas and electricity distributors (eg Independent Distribution Network Operators (IDNOs), Independent Gas Transporters (IGTs) and Offshore Transmission Operators (OFTOs). AR raised the issue of whether all these types of licensees are eligible to enter the NIC.
- 6.4. SG noted that he would expect all NIC submissions to be subject to the same regime. SR stated that there would need to be a rigorous assessment of these submissions to ensure that learning can be applied onshore and would benefit all GB customers. DM commented that it would be important to ensure that these OFTOs would not be being cross-subsidised by other governmental departments. The working group identified that under the current framework all submissions would require an allowed revenue term and therefore different mechanisms would need to be established for IDNOs and OFTOs. IW believed more analysis of this topic is needed.
- 6.5. It was recognised that it may be more difficult to get misspent or unspent money back from licensees that don't have regulated allowed revenues. Attendees therefore considered that there is a trade-off between the desire to get additional entrants (and therefore increase the quality of ideas) and the additional framework required to enable them to participate.

## **7. Innovation Roll-out Mechanism (IRM)**

- 7.1. In the March Decision Document, Ofgem stated that the costs associated with rolling-out successful innovation would be funded where it met certain criteria. However AR clarified that this mechanism is not meant to be interpreted as a backdoor re-opener.
- 7.2. AR stated that she thought the intent of the March document was that the mechanism should be forward looking rather than backward looking (with logging up). DM stated that both options should be available, so that network operators can push forward with innovation. She noted that this would encourage network operators to take a risk, innovate and then receive funding. AR was concerned that with a backward looking mechanism, some network companies could be aggrieved if they invest in innovation which fails to satisfy the eligibility criteria. DO commented that some projects would require immediate investment and thus a mechanism to receive this funding retrospectively is appropriate.
- 7.3. AR also noted that if the criteria set out in the March document (and the current version of the draft licence) were considered to be principles, this would imply Ofgem discretion around their application – which would imply a forward looking mechanism since companies would not want to take a risk on something that involves Ofgem discretion.
- 7.4. In the March Decision Document, Ofgem stated the IRM would have annual application windows. However elsewhere in the document Ofgem set out the decision to have two re-opener windows. AR therefore suggested that the IRM could have two re-opener windows in 2015 and 2018 (aligning with RIIO re-opener windows) –

especially since the March document set out that we expected there wouldn't be applications in the early or latter years.

- 7.5. SG commented that it would take several years to prove innovation. KM and SR believed that the IRM required more than just two re-opener windows. The working group discussed the options available (eg biannual windows) and identified that all parties would need notice of re-opener windows. Consensus formed that having only two reopener windows was too restricting.
- 7.6. There was a discussion around whether if one company applies to roll-out an innovation we would expect the other companies to follow suit – and therefore whether we should ask the other companies to apply for roll-out at the same time (similar to ESQCR or street works). However it was recognised that not all companies would be ready to roll-out on the same timetable. It was agreed that it would be good to provide early visibility of the IRM submissions to enable others to submit at the same time.

## 8. Date of next meeting

- 8.1. Ofgem will circulate a list of potential dates for the next IWG meeting – towards the end of September.

## Appendix

### List of Attendees

Euan Norris	SP Transmission
Sean Gauton	ENA
Alec Breen	Northern Gas Networks
Stewart Reid	SSE Transmission
Kerri Matthews	National Grid
Ian Welch	NG Transmission
Dave Openshaw	ENA
John Christie	DECC
Richard Buckley	SGN
Nigel Winnan	WWU
Eric Lounsbury	Carbon Trust
Denise Massey	Energy Innovation