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Dear Neil

**Decision and further consultation on the design of the Network Innovation Competition**

Many thanks for the opportunity to respond to the consultation on the future development of the Network Innovation Competition. We recognize the value and importance of the current Low Carbon Network Fund (LCN Fund) for facilitating the transition to the low carbon economy and we expect the proposed Network Innovation Competition (NIC) to further support this objective. These mechanisms allow network companies with the support of partners to develop the future operating models and commercial solutions to respond to the challenges of a low carbon economy and will potentially save customers millions of pounds.

We have consistently led the industry in terms of innovation and have used a number of regulatory mechanisms (including the Innovation Funding Incentive, Quality of Supply incentive and the tier 1 and 2 LCN Fund processes) to develop our network to respond to customer requirements and improve the flexibility of the current assets. We therefore recognize the importance of ensuring that the NIC allows companies to optimize its potential. We have provided feedback to Ofgem throughout DPCRs 4 & 5 on the construction and appropriateness of the LCN Fund. We will therefore provide some comments on the behaviours we have noted through our participation in the scheme rather than answer all of the questions raised in the consultation as we feel this will be of greater benefit to you at this time.

We do have some specific comments relating to the two tier approach adopted for the LCNF and proposed for the NIC. The future governance process for the NIC may be put under a considerable strain given the volume of expected traffic for both gas and electricity bids. Ofgem should review the whole process and consider if there may be benefits to adopting an alternative approach (possibly involving set dates throughout the financial year for either ISP or FS submissions).

The decision to require non-network companies to work with network companies when preparing bids is on balance, the correct one. We have worked with a number of non-network companies in our bids and recognize the value and innovative approaches they provide. It is important that we recognize that the aim of the competition is to develop future network models/solutions and therefore requiring network participation is essential to ensure the viability of potential solutions. We do believe that non-network companies should be leading projects (and consortiums) with the support of a network company.

The success of the LCN Fund is in part attributable to the competitive process which drives innovation and the generation of viable value for money business cases. Economic theory recognizes the many benefits of competition including innovation and efficiency. These characteristics are vital to the success of the fund and have driven a number of positive

behaviours. We have also noted that the competitive element of the LCN Fund has driven a number of issues which Ofgem should consider.

- 1) The competitive nature of the fund will not deliver collaborative bids between network companies

The NIC naturally encourages companies to seek to win funding to allow the detailed investigations of the new technologies required by the UK. The process allows but does not necessarily encourage multiple companies to investigate similar areas or techniques. The resultant combination of these factors is to encourage companies to compete for an ever narrowing band of investigation topics. In addition, there is the potential for companies to utilise the information they derive from early funded research to formulate follow on research. This interaction of drivers in its present form is unlikely to produce collaboration between network companies. The lack of cross-DNO involvement in the first two years LCN Fund bids illustrates this point and we would ask that future evolution of NIC should consider how to more fully encourage sharing of ideas and resources between network companies.

- 2) The competitive nature of the fund is unlikely to create collaboration between transmission and distribution companies

The NIC is only likely to encourage vertical collaboration across transmission and distribution networks where there is a win-win scenario for both parties. This situation is unlikely to occur in many cases and there may be a number of scenarios which may benefit from cross-network collaboration but will not be completed because both parties cannot benefit. We would also encourage Ofgem to consider how the NIC could incentivise generation operators to participate as we recognise their importance in future low carbon network solutions.

- 3) The final solutions will be adopted by companies who will effectively “pick winners”

The NIC / LCN Fund will create a number of methods to resolve network issues. Companies will then be required to utilize a solution to address a known problem. If a company is required to “pick a winner” they are more likely to use their own fully understood methods rather than that of another company. This behaviour may create perverse incentives.

We also consider that Ofgem needs to develop its plans for both the LCN Fund and the NIC. The consultation notes Ofgem's intention to merge the two funds together after DPCR5. We suggest that the transmission and distribution companies would benefit from an early view of the governance, structure and scale of the merged funds. We also recognise that the NIC could benefit from the proposed LCN Fund review in 2012. Arrangements must be made to incorporate any critical developments into the NIC to optimise the mechanism.

I hope these comments are useful. Please contact me if I can be of any further assistance.

Yours sincerely,



**Paul Bircham**  
**Customer Strategy and Regulation Director**