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Ofgem
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17th October 2011

Dear Neil,

Design of the Network Innovation Competition (NIC)

1. Thank you for the opportunity to comment on Ofgem's latest consultation on the innovation stimulus within RIIO-GD1 and T1. We believe a strong focus on encouraging innovation is crucial to facilitating the low carbon economy. This is a non-confidential response on behalf of the Centrica Group excluding Centrica Storage.
2. In our response we comment on the access to NIC by non-Network companies first, followed by the key design proposals, with our answers to Ofgem's questions in the appendix.

Access to NIC by non-Network companies

3. Although we favoured Option 2 in our response to Ofgem's open letter in March, we are comfortable with the decision to adopt option 3 for third party access to NIC funding at this stage. However we strongly advise that Ofgem review this option regularly, listening to non-network companies about their experience with Network operators. As explained in our letter in March, we have had mixed responses from GDNs with our proposals for biomethane projects. Biomethane projects should be at the heart of the innovation fund on the gas networks.
4. In terms of how Ofgem will review the effectiveness of network operators' collaboration, we recommend that Ofgem should seek to understand:
 - how the collaboration platform would work in practice,
 - how open the submissions are to third parties
 - the quality and transparency of the network operators' reasons for declining any approaches from third parties.

NIC Key Design Elements

5. We welcome the criteria, within the full submission, for involvement with other partners. However we do not feel it necessary to give extra weighting to differing sized companies or

non-standard, non-network companies. As there is no indication at this stage what the magnitude the extra weighting will be, it could be foreseen that an excellent project is superseded by a moderate project purely on using a different class of partner.

6. We are also unsure whether the criteria ensuring the project is “relevant to current network requirements” will encourage the innovative ideas that will lead the UK to a low carbon economy. Obviously we do not want energy network companies diversifying into non-network activities, but it would be helpful if Ofgem could explain how this measure will be used and what areas are out of scope for current network requirements.
7. We agree with the funding of NIC to be charged via the Transmission companies based on usage, as all consumers should benefit from the NIC projects and larger customers should see a greater share. We assume this will simply be added to allowed revenues and allocated to users via the current Charging Methodologies, but would seek clarity on this. An expectation of funding levels should be provided to the industry to ensure the impact on prices is understood well in advance.
8. As stated in our letter to Ofgem in February, in our response to the RIIO strategy consultation, we agree that projects should only be funded if not already covered by the price control and if they have as their objective the promotion of a low carbon future.
9. We are comfortable with the approach being taken on Intellectual Property. All UK consumers should be able to benefit from lower costs, royalties and the low carbon economy but it is sensible to allow parties to apply for variations if they can be justified.
10. We agree that overrun costs should be kept to a minimum and projects requiring additional funding will not be recognised as successful and not receive a successful delivery reward. We are keen to understand how Ofgem will manage network operators who continually fail or seek overrun funding, particularly as they could ask for funding for 8 consecutive years. We also agree that commercial innovation is currently not required to further reward the projects as this is a benefit to the network operators and they are incentivised through normal business to include this.
11. We agree that the risk protection and rewards should be taken from the NIC funds, thereby minimising the exposure of increased costs to the UK consumers.

Broadly we agree with Ofgem’s decision to pursue option 3 and the evaluation criteria within the consultation. We are keen to understand further details within the NIC funding and how this will impact our T&D charges.

We hope you find these comments helpful, and we are happy to discuss in more detail if you would find this useful. We look forward to seeing more detail on the evaluation criteria and the NIC governance.

Yours Sincerely,

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British Gas,
Legal & Regulatory Dept.

Appendix

Centrica's answers to Ofgem's NIC consultation

Question 1

Do you agree with our proposed two stage evaluation process and evaluation criteria?

Yes we agree with using the Initial Screening Process and Full Submission Stage as in the LCN fund as this helps with controlling the development costs and increases the chances of a successful project using the feedback from the expert panel. We also agree with the main evaluation criteria taken from the LCN fund.

However we only partially agree with the additional evaluation criteria. Our concerns are:

- "relevant to current network requirements" - we consider this could limit the incentives for innovation as it stops Networks thinking of the future and
- giving "extra weighting to projects which partner ... and new entrants", a successful project will need to partner with several organisations including standard non-networks (i.e. suppliers, generators etc.) and it would not be a good outcome if a better proposal lost out in funding to a lesser proposal due to arbitrary weighting.

Question 2

Do you agree with our proposals for facilitating non-network company participation in the NIC?

We agree that the collaboration platform has the potential to provide effective facilitation for non-network companies. In theory, if the collective guidance is clear, this should assist parties in their interaction with Network Companies and the guaranteed responses within set time-scales, and Ofgem oversight, are welcomed. Clearly, it is not possible to know how effective it will be in practice until the detailed proposals are fully developed.

Question 3

Do you agree that the transmission companies should raise the funding for the NIC, and that it should be borne by customers according to their network usage?

Yes, Centrica agrees all users potentially benefit from the NIC and therefore should input into the costs, their network usage will give a good proxy for the benefit the NIC will generate. However, there are some outstanding questions, in particular whether network usage be based on their proportion of peak demand or total throughput. It is unclear whether changes on Charging Methodologies will be required to facilitate this.

Question 4

Should network companies be funded to cover some or all of the preparation costs for the submission to the NIC? If so, is the Network Innovation Allowance (NIA) the best way to achieve this?

Centrica believes the collaborating parties should have access to the same preparation cost funding and each project should be assessed on its own merits for the level of allowance they receive.

The Network Innovation Allowance (NIA) looks a reasonable method for helping collaborating parties bringing ideas to the table, however if a project has significantly missed the ISP selection criteria no funding should be available.

Question 5

Do you agree with our approach to learning and intellectual property (IP) generated by the NIC? If not, please indicate how these arrangements could be improved.

All UK consumers should be able to benefit from lower costs or royalties through the knowledge being disseminated between the GB network owners.

Question 6

Do you agree with our proposals to offer a successful delivery reward and protection against cost overruns?

We agree that the reward and risk protection funding should be taken from the overall NIC, thereby minimising the consumers from failing projects. We also agree that projects which request overrun monies are not permitted to seek a successful delivery reward.

We feel it is important that companies who continually ask for overrun funding or fail to deliver the majority of benefits in their project plan should be reviewed by Ofgem or the expert panel during the RII0-GD1/T1 period and potentially stopped from receiving NIC until they have evidenced their ability to deliver in the future, rather than waiting until GD2/T2 to reclaim the funding.

Question 7

Do you agree with our proposal not to have an ex-post delivery reward or specific reward for commercial innovation?

We agree that commercial innovation will be high on the network companies' list are part of most projects and having it as part of the criteria seems sensible, but we do not believe it needs an additional reward.