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Dear Dora

Update and further consultation on the design features of the Network Innovation Competition

I write on behalf of SGN and SSE in response to your letter of 4 January 2012. For clarity, our response also includes the views of our affiliated iGT, IDNO and OFTO businesses.

We welcome and support Ofgem's work in this area. We have provided views in response to previous consultations on the innovation stimulus package and are pleased to give further thoughts on the specific design features raised in this consultation in relation to the Network Innovation Competition (NIC).

We believe the NIC is an essential element of the innovation stimulus and price control packages and is critical to ensuring a step change in the level of innovation necessary to address the issues faced by RIIO network licensees in the transition to a low carbon economy.

The consultation seeks views on two specific issues associated with the design of the NIC:

- Non-RIIO network licensee participation in the NIC; and
- Funding for network licensees' bid submission costs.

We have limited our comments to these aspects but we look forward to receiving Ofgem's further thoughts on the issues raised in our response to the September 2011 consultation in due course.

Non-RIIO network licensee participation in the NIC

Our detailed response to the six questions set out in the Ofgem letter dated 4 January 2012 is set out in the Appendix attached; but in summary we are very keen to encourage the participation of all parties, including, but not limited to independent iGTs, IDNOs and OFTOs. However, arrangements must be proportionate, avoid unnecessary complexity and ensure funds are used efficiently to support those projects most likely to deliver wider network benefits under the NIC.

Many of the comments we made in response to the October 2011 consultation in relation to facilitating non-network company participation also apply to non-RIIO network licensee.

Discussions with our affiliates and feedback from other industry work group participants indicates there is very little appetite amongst non-RIIO network licensees to access NIC funding and develop projects in their own right. Also, given the nature of their business, type of project areas they are likely to be interested in and the requirement that projects must have an impact on wider networks and be capable of creating knowledge that can be shared, we believe collaboration with RIIO network licensees will be essential. We also believe it is the most efficient method of non-RIIO network licensees accessing funds and developing ideas.

We are keen to work with such parties to explore and where appropriate develop ideas that could be beneficial to networks. There is already growing evidence of a number of good collaborative projects in electricity and gas and we see no reason why this should not continue under RIIO. Evidence from previous projects demonstrates it is through collaboration that wider benefits and efficiencies are most likely to be realised.

We are concerned the measures proposed by Ofgem to allow non-RIIO network licensees to participate in their own right are disproportionate and introduce unnecessary risk. We are also concerned that they will act as a barrier to those parties it is designed to encourage and protect. We do not believe there is evidence that they are required.

Funding RIIO licensees

As set out in our response to the September 2011 consultation, to ensure a wide range of good quality submissions it is essential that appropriate funding is available to allow companies to recover reasonable costs incurred in preparing a NIC submission. Our experience of the Low Carbon Network Fund in electricity distribution demonstrates costs can be significant. We also believe it is inappropriate that the Network Innovation Allowance (NIA) should be used to fund NIC submission costs.

The NIA is an important element of the innovation stimulus package and it has a distinct role to play. It is designed to cover smaller scale, lower risk projects that are capable of delivering innovative solutions and benefits in a shorter time frame. If NIC submission costs are to be recovered from the NIA this reduces funding for NIA projects. This would be detrimental, reducing potential benefits that could be delivered to customers in the short to medium term through NIA.

In our response to the September 2011 consultation we also raised concerns that as the NIA is proportionate to the network's allowed revenue, funding would vary by licensee. To address these concerns Ofgem has proposed a sliding scale capping mechanism. While this would address the issues raised, it adds an additional and unnecessary level of complexity that could be avoided. We also note that numbers proposed in the consultation letter do not appear to provide an appropriate level of funding; they provide a much lower level of funding than is currently available under the LCNF. Rather than utilise much needed NIA funding, we believe a fixed proportion of NIC funding should be set aside to cover all bid submission costs, in the same way as is proposed for the successful delivery award. An equivalent fixed allowance should be allocated to all participants to cover submission costs.

To allow for this addition costs NIC funding should be increased to cover bid submission costs, funding for successful bids and successful delivery awards.

We hope these comments are helpful and look forward to receiving Ofgem's further thoughts in due course.

Yours sincerely

Beverley Grubb

Appendix: Network licensee participation in the NIC

i) Appetite for entry

From discussions with our affiliates and participants at the industry work group we do not believe there is the appetite amongst non-RIIO network licensees to warrant development of arrangements to allow them to participate in their own right. Furthermore, we do not believe this would be appropriate. As set out in the covering letter and our response to the previous consultation in relation to non-network company access, we believe a more appropriate and efficient approach would be to encourage access through collaboration, particularly in the early years when experience of the NIC will be developing.

ii) Potential Benefits

While we believe both licensed and non-licensed parties have much to contribute and should be encouraged to participate, we believe the most appropriate and efficient way of delivering a wide range of good quality ideas that are likely to be capable of delivering benefits for networks and customers is through collaboration with RIIO network licensees. A collaborative approach is also essential to ensure adequate protection for customers and efficient use of funds. Indeed, our experience is that non-licensed parties referred to in this consultation would prefer to participate in this way as resource and financial implications associated with developing and delivering innovation in their own right is likely to be prohibitive and there are likely to be technical and operational issues that will require the input and cooperative of network licensees.

iii) Meeting the evaluation criteria

As set out in ii) above, we believe it would be very difficult for the network licensees referred to in this consultation to demonstrate that they could meet the evaluation criteria and be eligible for funding. We believe any innovation that has a direct impact on the network and is capable of creating knowledge that can be shared is best developed and delivered in collaboration with the RIIO network licensees.

iv) Potential barriers

From discussions with our affiliated non-RIIO network licensees the greatest barrier is access to resource, funding, knowledge and the potential risk if projects are not successful. Their view is that all of these issues are best addressed by working in collaboration with RIIO network licensees. They are keen to avoid complex mechanisms and arrangements, particularly in the early years of NIC, as are we. If we are to deliver a step change in innovation, arrangements must be proportionate and efficient.

v) Funding bid submission costs

We are concerned that proposals to introduce separate funding arrangements for non-RIIO network licensees add a further and unnecessary layer of complexity and potentially create a distortion. For instance, it is not clear how such arrangements would be implemented but we believe it would require a licence change to ensure adequate protection for customers and ensure parties act reasonably and only efficiently incurred costs are recovered. It is not clear how costs would be recovered or from which customer base. As above, we believe these issues could be avoided through collaboration with RIIO- network licensees.

vi) Halting projects

We believe the risk of non-RIIO network license projects developed in their own right failing to meet the criteria is higher than for RIIO network licensees. To mitigate this risk we believe it is essential that such parties participate through collaboration with RIIO network licensees, at least in the early years. Alternatively a mechanism similar to that proposed for RIIO network licensees would be required, to allow Ofgem to halt projects and recover funds. This adds a further layer of complexity to arrangements for non-RIIO network licensees and will require a licence change. We are concerned this will act as a barrier to participation and also impact on timescales for implementing the NIC. This could be avoided by adopting a collaborative approach.