ofgem Promoting choice and value for all gas and electricity customers

Innovation Working Group

22 March 2012

Agenda

1) IWG Terms of Reference

2) Update on current developments

3) NIC Governance document overview

Coffee break

4) NIC development discussion

- Assessing project benefits
- Cross sector projects

Lunch

5) NIA policy objectives

6) NIA Governance document overview

7) NIA development discussion

- Eligibility criteria
- Registration requirements

ITEM 1: IWG Terms of Reference

ITEM 2: Update on current developments

Overview

Milestone	Date
LCN fund two year review decision publishes	February 2012
NIC decisions published	March 2012
NIA consultation	May 2012
First consultation on licence conditions including innovation specific decisions	July 2012
Second consultation on licence conditions including innovation specific decisions	October 2012
Statutory consultation on licence conditions including innovation specific conditions	December 2012
Licence changes take affect	April 2013

- Document discussion and drafting iterations:
  - Next meeting 26 April
  - May and June meetings tbc

Summary of decisions

Topic	Specific issue	Decision
The competition	Scope of network licensee involvement	Keep the competition open to "non-RIIO network licensees" providing that equivalent licence and governance arrangements can be implemented in their licence
	Competitive process	Two-stage competitive process – review if future evidence suggests we are getting an "unmanageable" number of bids
	High level evaluation criteria	As proposed in September with two changes (to remain consistent with LCN Fund). 1. Merge the benefits criteria 2. Tweak direct impact criteria to refer to value for money No weighting for "SMEs or non-standard collaborators".
	Collaboration arrangements	Collaboration platform/website in conjunction with LCN Fund. At ISP additional requirement to demonstrate processes in place for identifying partners and ideas
Project Funding	Project funding mechanism	Transmission charges on a per usage basis
	Funding bid costs	A range of concerns were raised by stakeholders . Taking more time to review this issue further before making our decision
Risks and rewards	Successful delivery reward and cost overuns	Successful delivery reward of 10%, cost overun and unrealised direct benefits protection of up to 5%
	Ex-post discretionary reward	No ex-post discretionary reward, will review if evidence suggests this is hampering innovation
	Reward for commercial innovation	No specific reward for commercial innovation
Project learning	IPR requirements	Same default arrangements as IPR

Implementation of the Gas NIC

We have identified a potential issue with implementing the Gas NIC which could delay it's start

Issue

- The funding for winning projects would be raised by network operators through use of system charges, and transferred to the company implementing the project – ie no pot of cash
- However, the Gas Act as currently drafted does not allow the raising and paying of amounts to other Gas Transporters. This differs from the framework in the Electricity Act 1989 which allows for the raising and paying of amounts to all electricity licence holders.
- This means we wouldn't currently be able to implement the funding mechanism for the gas NIC

Finding a solution

- We have raised this issue with DECC and, together, we are seeking to find a solution at the earliest opportunity.
- DECC are actively considering the options for proposing an amendment to primary legislation.

ITEM 3: NIC Governance document overview

Introduction to the Governance Document

- Circulated an overview of Governance Document structure before meeting:
  - Provides an initial skeleton for the document
  - Highlights issues that we want to discuss with the group

- Are there any obvious omissions from the document that has been shared with you?
  - Issues that have already been identified will be discussed through this group.

Structure of governance document

Electricity NIC

Section A – NIC Processes
Chapter 1: Introduction
Chapter 2: Collaboration requirements
Chapter 3: ISP process
Chapter 4: Full Submission process

Section B – Electricity Transmission requirements
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge transfer

Section C – OFTOs requirements
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge Transfer

[Section D – DNOs – to be added for 2015]
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge transfer

[Section E – IDNOs – to be added for 2015]
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge transfer

Gas NIC

Section A – NIC Processes
Chapter 1: Introduction
Chapter 2: Collaboration requirements
Chapter 3: ISP process
Chapter 4: Full Submission process

Section B –Gas Transmission requirements
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge transfer

Section C – Gas Distribution requirements
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge Transfer

Section D –IGT requirements– to be added for 2015
•Project implementation
•Funding Direction
•IPR and Royalties
•Knowledge transfer

We circulated strawman to the group on Wednesday

Questions

- Any comments on the proposed structure (not detailed content) of the document?
- Is there anything missing from the document contents?
- Welcome your views on areas which you consider could be particularly challenging to draft

ITEM 4: NIC development discussion

Introduction

- Today's discussion recaps the evaluation process for projects submissions and seeks views on the evaluation of project benefits. We also have some questions for you on cross sector projects.

- Part 1
  - Topic 1 – Evaluation of projects
  - Topic 2 – Assessing project benefits

- Part 2
  - Cross sector project discussion

Topic 1 - Evaluation of projects

Initial Screening Process (PASS/FAIL)

Entries permitted
-Max 5 submissions per ownership group

Eligibility criteria
-Must have met at least one of the eligibility criteria to pass ISP

Evaluation criteria
-At ISP the project will need to qualitatively demonstrate how it expects to meet the first 4 high level evaluation criteria and also set out the business processes in place for considering collaborators

Full Submission (FUNDING AWARD)

Entries permitted
-Max 2 submissions per ownership group

Eligibility criteria
- Must have passed ISP to be eligible at Full Submission

Evaluation Criteria
-At Full Submission the project will need to demonstrate the extent to which it meets all the high level evaluation criteria in more detail than ISP

Additional information
-Derogation requests or changes to regulatory arrangements
-Any interaction, or engagement with a customer or customer premise or any direct impact on a customer during the project

High-level process for evaluating projects – discussion focused on detailed implementation of criteria.

Topic 1: Eligibility and evaluation criteria

A project should involve *at least one* of the following:

- A specific piece of new (i.e. Unproven in GB) equipment (including control and communications systems and software) that has a direct impact on the transmission or distribution System
- A novel arrangement or application of existing transmission or distribution system equipment (including control and communications systems software)
- A novel operational practice directly relates to the operation of the distribution or transmission system or
- A novel commercial arrangement

Project submissions will need to demonstrate that the proposal can:

- accelerate the development of a low-carbon energy sector and/or deliver environmental benefits whilst having the potential to deliver net financial benefits to existing and/or future network customers
- provide value for money for gas and/or electricity network customers.
- create knowledge that can be shared across energy networks in Great Britain (GB) or create opportunities for roll out for a significant proportion of GB networks
- are innovative (ie not business as usual) and have an unproven business case where the innovation risk warrants a limited trial research, development or demonstration project to demonstrate its effectiveness. Network companies will need to demonstrate that the incentives within the price control period are not sufficient to justify the project.

We will also measure the extent to which projects:

- are relevant to current network requirements
- demonstrate a robust methodology and readiness for implementation
- involve other partners and external funding

We will follow the LCN Fund example for drafting unless good reason not too – i.e. Broader basis of NIC

Topic 2: Assessing project benefits

- The first evaluation criterion assess project benefits
  - Three elements – carbon, environmental and financial

- LCN Fund already assesses carbon and financial benefits
  - how the proposed project solution makes a contribution to the UK Government's current strategy for reducing greenhouse gas emissions as set out in the document entitled "the carbon plan" more efficiently than current method
  - how much capacity will be released if the project is successful and how much quicker
  - the potential financial benefit the proposed solution can bring by comparing the cost of the current method used against the costs of replicating the project solution if successful

Is there any reason to diverge from the LCN Fund approach for carbon and financial benefits?

Topic 2: Assessing project benefits continued..

- NIC is first time we will assess potential wider environmental benefits
  - reduction of leakage of SF6 and other gases
  - improvement of visual amenity
- New part of the evaluation criteria ie divergence from LCNF
- Environmental benefits may be difficult to quantify and assess

- What other examples of broader environmental benefits might your projects expect to deliver?
- How could you demonstrate wider environmental benefits as part of a project proposal (qualitatively or quantitatively)?

Part 2 - Cross sector projects

Cross sector projects

Issue

- Two separate NICs - one for gas and one for electricity
- Some projects could potentially have benefits across both sectors – ie “cross sector projects”
- Currently reviewing the legal and regulatory issues associated with including cross sector projects in the NIC

Considerations

- We would like to better understand the type of potential cross sector projects that could come forward – can you give high level examples?
- How easy would it be to identify, demonstrate and apportion benefits to each specific sector in these examples?

We would welcome your views on this issue

Agenda

1) IWG Terms of Reference

2) Update on current developments

3) NIC Governance document overview

Coffee break

4) NIC development discussion

- Assessing project benefits
- Cross sector projects

Lunch

5) NIA policy objectives

6) NIA Governance document overview

7) NIA development discussion

- Eligibility criteria
- Registration requirements

ITEM 5: NIA Policy Objectives

High level policy intent

- Certain innovative activities unlikely to be funded by shareholders of regulated utilities:
  - Innovation projects may be high risk with uncertain commercial return.

- NIA is provided to fund projects where this is the case – i.e. projects that by their nature are risky and will not be progressed by an individual company.

- NIA provides a source of funding to de-risk projects:
  - Consumers are taking on additional risk, in the expectation of improved future outputs or lower future costs.

- Previous set out:
  - The NIA is to be used to fund smaller scale research, development, trials and demonstration projects.

  - It can be used to cover commercial, technological and operational innovation.

Policy Implementation Principles – what are we looking for NIA to achieve?

- Projects that are funded through the NIA should:

1. Deliver relevant innovative solutions.
2. Generate knowledge that can be shared amongst licensees.
3. Deliver value for money to present and future consumers.

ITEM 6: NIA Governance document overview

Introduction to the Governance Document

- Circulated an overview of Governance Document structure before meeting:
  - Provides an initial skeleton for the document
  - Highlights issues that we want to discuss with the group
- The next slide provides an overview of the document – and highlights the policy principles that we are seeking to achieve with each section.
- Are there any obvious omissions from the document that has been shared with you?
  - Issues that have already been identified will be discussed through this group

Governance Document Structure and Mapping to our Principles for implementing the NIA

Chapter	Contents	Principle
1. Introduction		
2. NIA Projects	Eligible NIA Projects	1, 2 & 3
	Registration requirements	2 & 3
3. Allowable NIA Expenditure	Allowable set up expenditure.	3
	Eligible Project expenditure	3
4. Regulatory Reporting for NIA projects	Requirements for Network Innovation Annual Report	2 & 3
5. Project Audits	Ofgem ability to Audit Projects	1 & 3
6. Knowledge Transfer / Intellectual Property	Knowledge Transfer	2
	Intellectual Property	2

ITEM 7: NIA development discussion

Introduction

- Today's discussion covers those issues already identified under Chapter 2 of the draft Governance document.

- Part 1 – Eligibility Requirements
  - Considerations:
    1. Deliver relevant innovative solutions;
    2. Generate knowledge that can be shared amongst all licensees; and
    3. Have the potential to deliver value for money for consumers.

- Part 2 – Project Registration Requirements
  - Considerations:
    1. Generate knowledge that can be shared amongst all licensees

"The Innovation Allowance will fund smaller scale research, development, trials and demonstration projects, and will cover all types of innovation, including commercial, technological and operational."

Ensuring the NIA funds Innovative Activities

- AIM: We want to ensure that the NIA is used to fund innovative activities.

- PROPOSAL: NIA Projects should involve one of the following:
  - *a new or untried (in GB) piece of equipment;*
    - *(eg, the trial of new energy storage solutions)*
  - *a new arrangement (in GB) of existing equipment;*
    - *(eg, combining existing technologies to operate together in novel ways)*
  - *a new operational practice (in GB); or*
    - (eg, *dynamic monitoring to make more efficient use of existing headroom*)
  - *a new commercial arrangement (in GB).*
    - *(eg, demand side management)*

DISCUSSION: Does this limit any innovation that will not be funded by BAU?

Delivering new learning that benefits all

- AIM: Consumers will be funding NIA projects, because of the perceived risk in undertaking these projects, therefore we want to ensure that customers see the benefits and the consumers money is spent cost effectively.

- PROPOSAL: NIA Projects should:

  a) *Not lead to the unnecessary duplication by companies;*

  - (Clarification: We are aware that different operators run their networks in slightly different ways, and there may be cases where similar projects need to be undertaken by different groups).

  b) *Have the potential to develop learning [that can be shared with other network operators.]*

Should NIA Projects have the potential to share learning with other network operators? Should this be a requirements?

"We consider it important that the Innovation Allowance incentivises efficient expenditure."

Ensuring the NIA provides value for money

- AIM: We want to make ensure that NIA Projects have the potential to deliver value for money for consumers,
  - eg by reducing future connection costs for demand or generation customers compared to the most efficient current method.

- PROPOSAL: NIA Projects should:
  - *Have the potential to deliver net financial benefits to current and/ or future customers;*

DISCUSSION: We recognise, some projects may deliver non financial benefits such as social or environmental benefits – To what extent should these be considered?

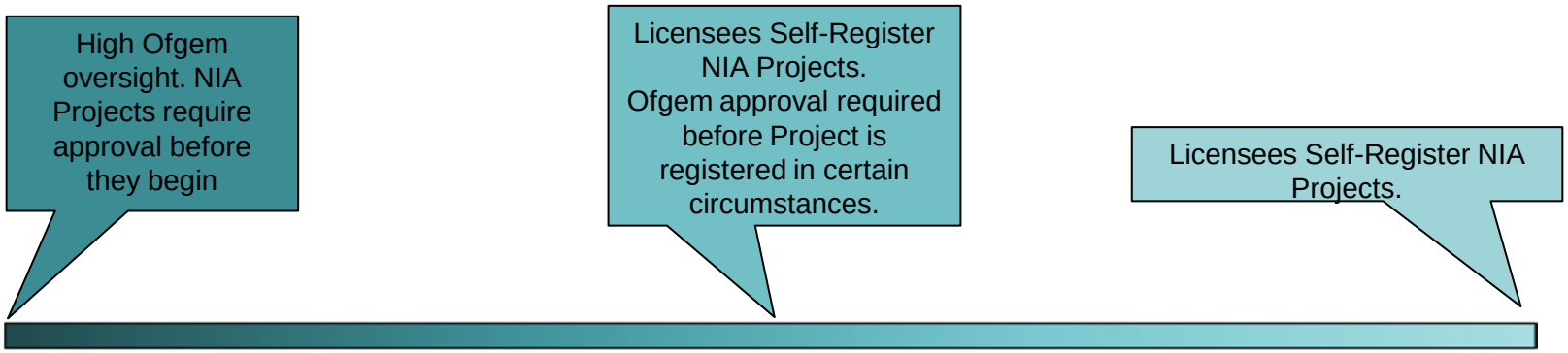
A possible approach is that we could require licensees to submit a business case setting out the net benefits for approval by Ofgem before the project can go ahead.

Part 1 - Summary

- Bringing this together, there would be two gates through which eligible NIA Projects must pass:
  - Gate 1
    - An eligible NIA Project will have to involve either:
      1. *a new or untried (in GB) piece of equipment;*
      2. *a new arrangement (in GB) of existing equipment;*
      3. *a new operational practice (in GB); or*
      4. *a new commercial arrangement (in GB).*
  - Gate 2
    - In addition an eligible NIA Project will:
      a) *Not lead to the unnecessary duplication by companies;*
      b) *Have the potential to develop learning [that can be shared with other network operators;]and*
      c) *Have the potential to deliver net financial benefits to current and/ or future customers;*

Part 2 - Project Registration: Benefits

- Registration allows other network companies and licensees to see what other companies are doing.
  - This means learning can be shared more quickly.
    - This is in line with our principle that NIA Projects should: generate knowledge that can be shared amongst licensees.
  - This should reduce the amount of unnecessary duplication that takes place.
    - This is in line with our principle that NIA Projects should: have the potential to deliver value for money for consumers.



Level of Ofgem involvement at Registration

Discussion: Do you see other benefits to Project Registration?
What are views on registration requirements in light of costs and benefit?


ofgem
Promoting choice and value
for all gas and electricity customers