

Electricity North West

304 Bridgewater Place, Birchwood Park
Warrington, Cheshire WA3 6XG

Telephone: +44(0) 1925 846999

Fax: +44(0) 1925 846991

Email: enquiries@enwl.co.uk

Web: www.enwl.co.uk

Sam Cope
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Direct line: 01925 846851

Email: sarah.walls@enwl.co.uk

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Dear Sam

Consultation on funding the cost of preparing submissions for the Network Innovation Competition and the Governance of the Network Innovation Allowance

I welcome the opportunity to respond to this consultation to help define the governance arrangements for the new Network Innovation Allowance. In general we are very supportive of Ofgem's proposal to introduce the Network Innovation Allowance. I have made specific comments on the questions raised in your consultation letter in the attached Appendix.

Please do not hesitate to contact me if you have questions regarding my comments.

Yours sincerely,

A handwritten signature in blue ink that reads "Sarah Walls".

Sarah Walls
Head of Economic Regulation

Appendix 1 – Consultation Questions

Below are specific responses to the questions raised in the consultation:

Question 1 - Do you agree with affixed annual allowance for bid costs for all licensees and an annual cap per bidding group of £175k or 5% of annual NIC funding request, whichever amount is the smaller? If not please provide evidence to justify an alternate level of cap.

We believe that the current funding arrangements in the LCN Fund scheme unfairly disadvantage smaller licence holders and external parties as there are no intrinsic reasons why a licence holder with a large revenue would efficiently incur higher bid submission costs than a smaller one. A cap is sensible and should act to focus bids on content and value rather than superfluous activities thereby driving efficient use of funds in the interests of customers. Our view is that the cap for individual projects should be set at 5% of the bid cost, up to a maximum cap of around £250k; this being sufficient to prepare medium to large scale projects in a manner compatible with the requirements of the Expert Panel. We have previously submitted evidence of our bid submission costs from previous years to demonstrate the need for and make up of such costs.

Given the need for innovation projects to respond to technology drivers and the needs of customers and other stakeholders against a background of UK policy we would recommend that the value of caps should not be hardwired into the licence condition, but detailed in the governance documents. This approach has been proposed as we have some concerns over the definition of a project particularly in the context of cross industry projects and would require clear definition of the funding/ lead party and participant parties and total cap applicable. We would be pleased to work with Ofgem to establish such suitable definitions.

Question 2 - We welcome views from stakeholders on whether the funding for bid preparation costs should be funded from existing funding set aside for funding the NIC, or alternatively, should it be raised in addition to the annual NIC allowance?

We believe the inclusion of bid preparation costs within NIA is a sensible extension of the proven mechanisms in DPCR5 for RIIO licensees. We further believe that the total value of NIA should be capped by group rather than licensee as it has not been established that the innovation costs of a large licensee are greater than a smaller company. In our experience, the development of the required network technologies is broadly similar across network companies and not proportional to their customer or asset base. The provision of larger allowances to larger groups unfairly enables those companies to undertake larger R&D programmes potentially allowing out performance of general allowances and dominating the R&D space to the detriment of others.

We expect the bid preparation costs for non-RIIO licensees to be raised by the annual NIC allowance.

Question 3 - Do you agree with the proposed high level eligibility criteria? If you do not agree then please explain why.

Question 4 - Do you agree with our proposed approach to funding projects with non-financial benefits? If you do not agree then please explain why.

Innovation at low Technology Readiness Levels (TRLs) is by definition more of an investigative process and the value to customers of further detailed level regulation of project approvals given the relatively small component of R&D funding versus total investment is questionable. For example safety, environmental or service focused projects may not generate a positive NPV. We welcome the maintenance of the structural qualification based around G85 with a collaborative approval mechanism via Ofgem for non-financially justified projects. We are mindful of the timescales involved in such approvals and would therefore suggest a face to face discussion to expedite such projects.

Question 5 - Do you agree with our proposal that licensees should self certify projects against the eligibility criteria? If you do not agree then please explain why.

Question 6 - Do you agree with our proposal that licensees should register projects with Ofgem before they begin? If you do not agree then please explain why.

Question 7 - Do you agree that in the three sets of circumstances detailed above, licensees should require Ofgem's permission before registering the project? If you do not agree then please explain why.

We agree with the proposals outlined and agree that the proposed registration process would complement the annual reporting requirements; allowing early sight of projects at the inception stage. The format needs to focus on objectives and techniques and the existing IFI PID provides a useful existing template. Self approval criteria are already well established and subject to audit by Ofgem, as such we believe that governance of approvals is robust. For non-financially justified projects any approval process requires an appropriately timely response from Ofgem given the short duration and gestation periods associated with such projects.

Question 8 - Do you agree with our proposal to include an annual cap on internal expenditure? If you do not agree then please explain why.

Question 9 - What proportion of a licensee's NIA do you consider would be an efficient level of internal expenditure? Please include evidence and justification of your view.

In the early stages of IFI, the projects initiated tended to focus on very low TRLs as technology is developed for potential deployment on networks. During RII0-ED1 we believe that this will evolve to develop the techniques to deploy these technologies at scale. As such, we believe that it is in the interests of customers for network companies to have an adequate level of understanding and expertise in these deployment techniques as opposed to product technology development work and hence the component of internal costs should be allowed to rise from the current actual level of around 25% to a maximum of 50%. We have previously submitted evidence to show the makeup of our current expenditure typically comprising a 20-25% internal cost component.

Question 10 - What elements of the current IFI annual report work best; and what would you improve to make these reports more effective as knowledge dissemination tools?

Question 11 - Do you agree with our proposal for sharing the NIA annual reports? In addition, what other means are there of disseminating this learning to all interested parties?

Question 12 - Would an annual NIA conference be a useful tool for disseminating the knowledge gained from NIA projects? Why?

Question 13 - Do you agree with our proposals requiring licensees to share the learning from NIA projects? If you do not agree then please explain why.

The dissemination of learning from research, development and deployment projects is a central requirement to ensure that all network customers and stakeholders benefit equally from the innovation funding mechanisms. In our experience dissemination will inevitably comprise two main components: general awareness of the areas of activity and detailed explanation of techniques and technologies explored. In the case of the former it seems appropriate to utilise the existing requirement for annual reports and annual conferences supported by the proposed ENA learning portal which is specifically designed to address the issues outlined in the consultation. These cross industry exercises allow for customers and stakeholders to access the broad range of project learning activities in a standard format to gain awareness of activities and approaches. This should be underpinned by a general requirement on licensees to disseminate activities funded under NIA or NIC.

Whilst we support the sharing of reports and attendance at annual conferences, in our view the method of delivery against this requirement should not be constrained or prescribed to allow for the development of best practice in this area. Detailed dissemination of technology and techniques would require detailed one to one discussion the format of which, by their nature, cannot be fully anticipated. We believe it appropriate to place a requirement to facilitate such discussions with appropriate parties; however consideration needs to be given to which parties qualify for such dissemination. We would consider it inappropriate for example to spend time and hence network customers' money on responding to international enquiries.

Question 14 - Do you agree with our proposed approach on IPR?

Question 15 - Should a carve out for commercial products be included within the default IPR arrangements?

Question 16 - Should the carve out be limited to projects focusing on lower TRLs?

Question 17 - If a carve out is provided, should other requirements be placed on the licensee to ensure best value for customers?

In considering the proposed arrangements on IPR we believe it is necessary to separate the arrangements under NIA from those under NIC.

NIA projects will in the main focus on low TRLs where licensees seek to bring technologies or other arrangements to prototype status and potentially deploy at small scale. In our experience such developments contain considerable risk for project partners and hence without funding and a balance of IPR retention partners are unlikely to adequately engage. In particular, risks around viability of the concept and market size can dissuade investment. In setting out IPR arrangements we are mindful that the interests of customers are primarily served by innovation

to reduce unit costs, improve service levels or meet future needs and to a lesser extent by exploitation of IPR. We believe that the existing flexible arrangements have provided a robust framework in which licensees have demonstrated a variety of approaches and achieved a reasonable balance of risk and reward for customers.

For NIC we believe that the guidelines under the LCN Fund trials have again proven robust allowing considerable contributions from partners to be secured and a wide range of trials to be undertaken.

In the event that any significant changes are proposed, clarity on IPR is required by all parties. Guidance and conditions should be such that all parties are clearly aware of the criteria without subject to further negotiation under any bid or approvals process. For example principles around cost recovery or cost plus a reasonable rate of return should be quantified.