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27th June 2012

Dear Sam

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

National Grid owns and operates the high voltage electricity transmission system in England and Wales and operates the Scottish high voltage system. National Grid also owns and operates the gas transmission system throughout Great Britain and, through its low pressure gas distribution business, distributes gas in the heart of England to approximately eleven million businesses, schools and homes.

As part of publishing our RIIO business plans we have shared our Innovation Strategies<sup>1</sup> with Ofgem and our stakeholders. These strategies set out our proposed focus and governance for the management and delivery of innovation within National Grid. We therefore do not consider that significant detail on this is needed within the Network Innovation Allowance (NIA) governance document but would recommend developing a revised Good Practice Guide<sup>2</sup>. In addition, the issues relating to transitional governance between the Innovation Funding Incentive (IFI) and NIA have not been addressed to date and we are aware that a number of projects within our portfolios are intended to carry on beyond March 2013.

In responding to the consultation questions, there are a couple of major concerns that we have raised. Whilst we encourage greater transparency in sharing information on projects, we believe that a careful balance needs to be made with respects to the regulatory and administrative burden of this process. Maintaining the ability to self certify, including projects with negative NPVs, is integral when viewing the role of innovation in delivering the suite of outputs and not just stand alone financial benefits. Finally, it is vital that flexibility with regards to Intellectual Property Rights (IPR) is retained. To maximise the quality of the projects and the value that they could deliver to customers, we need to attract the broadest number of third parties to collaborate with. Different groups of collaborators such as universities, research institutes and SMEs will require IPR terms that are specific to their business models. We expand on these points in greater detail within our question responses below.

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<sup>1</sup> <http://www.talkingnetworkstx.com/our-business-plans.aspx> and <http://www.talkingnetworksngd.com/>

<sup>2</sup> <http://www.energynetworks.org/>

We are grateful for the opportunity to comment on this consultation and would be happy to expand on any of the points we have raised.

Yours sincerely

*[by email]*

Paul Whittaker  
**UK Director of Regulation**

## **Consultation on funding the cost of preparing submissions for the NIC**

**Question 1: Do you agree with a fixed 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?**

In principle we agree that it is in consumers' best interest to have an annual cap on the allowance for bid preparation costs for each licensee, however, the actual value of applicable funding needs to reflect the expectations of the expert panel in what constitutes a robust bid. With a limitation of two bids per licensee per annum, this would only equate to £87.5k per bid. We have not been directly involved within the Low Carbon Network Funding (LCNF) process, but understand that the cost of funding bids within this mechanism have been considerably higher. Any bid cost allowance therefore needs to be set based on evidence from the DNOs, being mindful that some of the more complex innovative ideas for projects may need a significant concept development stage to prepare the proposals sufficiently for submission.

Our understanding of the Network Innovation Competition (NIC) process is that each licensee can submit five bids into the Initial Screening Process (ISP). Assuming that all of these pass then a decision needs to be made over which two are taken forward. What is not clear is how the costs are recovered for the three that are not taken forward. In addition, if a bidding group consists of two or more licensees, there needs to be a mechanism to define which NIA funding pool the bid costs are attributed to.

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

Our preference is that funding for NIC bids should be raised in addition to the annual NIC allowance for non-RIO network licensees. If this was not the case and for example, there were ten non-RIO network licensees (and assuming full utilisation of the proposed cap of £175k) the potential pot of funding will be reduced by £1.75m. With the possibility that non-network licensees will look to compete for funding in any given year, appropriate funding would need to be set aside to cover these costs, thus reducing the total potential funding pot.

## **Consultation on the Network Innovation Allowance**

### **Project eligibility criteria**

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

We agree with the eligibility criteria set out within the **first gate**. We also agree with the principles expressed for meeting the second gate criteria. We are however mindful that the ability for projects to deliver financial benefits needs to be viewed within a long term context, to the extent that benefits may only be realised in subsequent price reviews. The response to question four expands on this. An additional issue is how portfolio projects (such as with research institutes where a single supplier agreement covers a range of subprojects) should be categorised. Participation in these portfolios is beneficial as significant leverage and problem sharing/solutions are utilised.

**Question 4: Do you agree with our proposed approach to funding projects with non-financial benefits?**

We disagree with the proposed approach of seeking Ofgem permission for funding projects that are projected to have non financial benefits. Under the RIIO regime we are funded to deliver the specific outputs that our customers and stakeholders require such as maintaining network reliability and safety levels. Within our innovation strategies we outline how innovation will help deliver the levels of outputs that our stakeholders value and require. Inherently, some of these benefits that will be delivered cannot be readily translated into financial benefits such as schemes that innovatively address adherence to working at height regulations. Instead, the benefits and value of innovation should be more holistically viewed in terms of delivery of the RIIO outputs, post RIIO-T1/GD1 longer term financial benefits and for their contribution to delivering aggregate efficiencies that we have embedded within our submissions.

With the volume of likely projects to be progressed through NIA, (currently, we have over 150 live IFI projects across National Grid) any process to seek permission to fund non-NPV positive projects will be detrimental in terms of the regulatory burden and the speed with which they can be progressed. The current criteria used within the IFI mechanism has worked well and should be maintained. Under this mechanism, projects that show positive NPV benefits and those that are likely to deliver non-financial benefits are balanced so that the overall portfolio of projects has a positive NPV.

We have a robust internal sanctioning and governance process (as recognised on a number of occasions during PAS 55 assessments) in place to apportion funding to projects, and this will serve us well when we switch to the management of the NIA scheme. If there is still concern about the appropriateness of specific projects then Ofgem retain the ability to audit any project. This strikes a balance in the retention of a mechanism to protect consumers whilst avoiding excess regulatory burden. The existing IFI arrangements have served the industry and end consumers well to date and should be retained.

**Project registration process**

**Question 5: Do you agree with our proposal that licensees should self certify projects against the eligibility criteria?**

Yes, licensees should self certify. Our rationale is given in greater detail above and supported by our PAS55 audit reports. This is particularly necessary for government (e.g. EPSRC) or EU funded projects where the approval processes are already significant and nationally or internationally agreed. Again we would recommend that a jointly produced Good Practice Guide, rather than detailed licence governance documentation, could be used to outline any associated procedures around certifying the eligibility of projects.

**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?**

We believe that there is merit in registering projects with Ofgem prior to initiation so as to promote visibility and transparency although we would urge a minimal administrative burden and inclusion of costs in set up funding. For example, it would be appropriate to register project inception documentation only once agreed by internal governance groups. In doing so, there does need to be a balance between transparency, the burden of registration and

the publication of information that in some cases may initially be commercially confidential. We suggest that within the registration process the following details are captured, as they are likely to prove beneficial for sharing learning and protecting against unnecessary industry duplication:

- A list of the objectives and benefits that the project sets out to achieve
- A Key word description of project work that allows quick reference for all projects covering a particular topic
- The names of third party collaborators
- Estimation of costs and timescales

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

We disagree with the requirement to seek explicit approval for all projects that are likely to have non- financial benefits. Our response to question 4 gives further details of our reasoning. With regards to intellectual property we have concerns around the overall process as discussed later on in this consultation response. Finally, we agree that there needs to be careful consideration around business separation issues, assuming that this is what is meant by the circumstances outlined in the third bullet.

### **Internal expenditure**

**Question 8 and 9: Do you agree with our proposal to include an annual cap on internal expenditure? What proportion of a licensee's NIA do you consider would be an efficient level of internal expenditure?**

We agree with the rationale for having an annual internal expenditure cap and agree that network companies should be encouraged to collaborate with third parties to deliver innovation. However we propose that the 15% limit on internal expenditure should be increased to 50% as proposed by members at the June 2012 Innovation Working Group (IWG). As outlined in our innovation strategies, our approach in delivering innovation relies on collaboration with external parties but also relies on harnessing internal innovative capabilities. As we further empower our staff to innovate, it is likely that there will more 'home grown' innovation that will require internal expenditure. In addition, the 15% does not fully reflect the cost incurred in managing projects for items such as internal engineering time, project management, deployment costs, legal fees and knowledge dissemination. It is also likely that with the broadening of the definition of innovation into commercial and operational projects, these are by their nature, likely to be more internally focussed. Finally, any cap should be leveraged at a portfolio level rather than on single projects, allowing for the differences in specific demands of individual projects.

### **Knowledge transfer**

**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?**

The current IFI annual reports offer a comprehensive overview of the innovation portfolios and are available to internal and external stakeholders via our websites. Sharing the report

via the ENA works well in enabling us to discover what other networks are working on, helping avoid duplication and allowing the sharing of knowledge. Whilst there is definitely merit from the publication of an annual report a balance needs to be struck between the administrative burden and the value of the information shared, especially if initial project registration is already required. The valuable information is the statement of progress. As our portfolios of innovation projects increase, there needs to be a rationalisation of the information given within the reports. If the requirement to register initial projects is adopted, then we think it would be appropriate that an annual report should focus on the following key points and be presented through a user friendly searchable platform (supported through set-up funding) such as via the ENA portal.

- Overview of the innovation portfolio strategy
- Progress report on the projects that were registered
- Project highlights

**Question 11 & 12: 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? Would an annual NIA conference be a useful tool?**

We agree that NIA annual reports should be shared between licensees and would encourage both utilisation of the ENA web site as well as individual licensees internet sites. This is an important part of fostering collaboration and learning from best practice. A variety of different tools need to be explored to do this. Not only does learning need to be disseminated to other interested networks but we need to make sure that the wider stakeholder community is aware of progress. Suitable formats need to be created to do this. We therefore recommend that the means should differ dependent on the recipient needs. Greater details of this should be developed within a good practice guide. Whilst in principle an annual conference is a good way of sharing knowledge, initial observations from the LCNF process suggest that these are very resource intensive. More bespoke sessions between interested parties may prove a viable alternative.

**Question 13: Do you agree with our proposals requiring licensees to share the learning from NIA projects?**

As outlined above, we encourage the sharing of knowledge and learning about our innovation programme. However, there needs to be careful consideration in terms of balancing transparency whilst still respecting (where appropriate) intellectual property rights.

### **Intellectual property**

**Question 14, 15, 16 & 17: Do you agree with our proposed approach on Intellectual Property Rights (IPR) and should a carve out be limited to different Technology Readiness levels (TRL) or just for commercial products?**

In applying IPR to NIA projects we need to be mindful of how the benefit is shared between the end consumer, the network licensees and third parties. A flexible approach needs to be adopted so that the balance of sharing benefits, whilst not deterring the development of new technologies within the UK, is met. For example, in some of our projects we are a minority partner. This has the benefit of allowing us to leverage our spending but at the same time means that we need to maintain flexibility in the IPR terms that we can apply. Therefore the

application of default IPR arrangements would be detrimental to the overall development of our innovation portfolios.

Within the new NIA arrangements the scope of applicable projects has been enlarged for some licensees in comparison to the IFI regime. Consequently, there is likely to be a greater diversity of projects both in terms of the type of innovation they are delivering but also with respects to the associated TRL level. To maximise the quality of the projects and the value that they could deliver to customers, we need to attract the broadest number of third parties to collaborate with. Different groups of collaborators such as universities, research institutes and SMEs will require IPR terms that are specific to their business models. Our response to the April IWG actions, sent on 12<sup>th</sup> April, expands on these giving greater details of the different types of IPR terms that have been deployed to date.

With respect to longer term applied research, in particular related to EPSRC or EU projects, the funding requirements set out certain IPR arrangements. Having flexibility in the IPR approach under NIA will allow continued participation in these applied research projects where knowledge transfer, rather than a specific product, is the defined output.

To summarise, flexibility needs to be retained in the application of IPR and we believe that this has worked successfully throughout the IFI scheme. Without this flexibility, potential collaborators are likely to be discouraged from participation. If inflexible default terms are applied then the likelihood is that third parties will pass on the lost opportunity of not being able to market the innovation through to the initial costs of researching the initial innovation.