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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 write on behalf of SGN and SSE in response to your letter of 29 May 2012.

As highlighted previously, we support Ofgem's work in this area. We have actively participated in discussions, particularly through the Innovation Working Group. We are pleased to give further comments on the specific issues raised in the latest consultation paper on Network Innovation Competition (NIC) funding and Network Innovation Allowance (NIA) governance arrangements.

While we are supportive of the overarching framework and the individual innovation packages, we remain concerned that the level of detail and preparedness expected at the early stage of a project combined with the level of fixed annual allowance proposed for bid preparation and submission costs is inappropriate and could discourage participation in the NIC or the submission of good quality, well developed proposals. We also continue to believe it is essential that such costs are separately funded, rather than recovered through the NIA. The NIA has been developed to cover projects of a very different nature but with the potential to deliver value in their own right and as such NIA funding should be ring fenced and protected.

Similarly, based on experience under the IFI and the Low Carbon Network Fund (LCNF), we believe the cap proposed in relation to internal costs is too low. It does not reflect the level of internal resource and expertise likely to be required under the NIC. We believe higher levels of internal support are likely to be required in the next phase of innovation and a cap of 35% to 50% is likely to be more appropriate.

Our more detailed comments on all aspects of the consultation are set out in the document attached. I hope they are helpful and look forward to receiving Ofgem's further thoughts in due course.

Yours sincerely

Beverley Grubb
Regulation Manager

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? If not please provide evidence to justify an alternative level of cap.

As set out in our letter dated 17 October 2011, we believe it is essential that appropriate allowances are made to ensure network companies are able to adequately fund bid preparation and submission costs. Experience shows the costs incurred by SSE electricity distribution under the Low Carbon Network Fund have been significant at around £500k. Therefore, while we agree it may be appropriate to cap funding, we believe the level proposed is too low.

It is essential that funding is set to encourage participation; ensure good quality well developed submissions; and encourage effective competition. Funding caps should not artificially constrain the size or nature of projects.

Based on SSE's experience under the LCNF, we believe a cap of the lesser of £500k or 10% of the annual NIC funding request would be appropriate.

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?

As raised in our responses to previous consultations, we are concerned by the suggestion that bid preparation costs for RIIO network licensees should be recovered through the NIA. We believe the NIA should be retained in its entirety to cover equally valuable but very different innovation projects.

If NIC preparation costs are funded through the NIA this will reduce the amount available for NIA projects which are of an entirely different scope and nature. As the NIA is set relative to network size it is also likely to have a disproportionate impact on smaller networks and introduce significant uncertainty and volatility in relation to available NIA funding as networks will not know how many NIC projects will require funding each year or the level of funding required. This could vary significantly year on year.

We would prefer that NIC bid preparation costs should be funded separately through an additional funding mechanism or, as a compromise, through the NIC. It is important that there is no cross subsidy between the NIC and NIA as both are equally valuable and designed to attract different forms and scale of innovation.

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

While in general we agree with the proposed high level eligibility criteria for the NIA, as set out on page 4, we are concerned there could be situations where innovative projects could be identified to address network specific issues (particularly in relation to the Scottish distribution networks). They could meet the criteria listed under the first gate and have the potential to deliver net financial benefit to current and future customers on specific networks but may not meet the requirement under the second gate which is to have the potential to develop learning that could be applied across GB. While this requirement may be appropriate as a general principle it could be unnecessarily restrictive if it had to be applied in all cases.

As an alternative we believe projects that are capable of delivering network specific benefits could be accommodated by requiring Ofgem approval before registering, as is proposed for projects with no clear expectation of financial benefit or do not conform to the default intellectual property arrangements. In such cases it is important that sufficient Ofgem resource is available to quickly respond to such requests in order to allow projects to proceed in a timely manner.

We also agree that only those projects that pass the initial screening process should be eligible to recover bid costs.

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.

We believe it is important that the innovation stimulus package also recognises and encourages projects aimed at delivering wider benefits such as improved safety or environmental performance. In such cases it may be more difficult to quantify or prove net financial benefit. As such we believe it is appropriate that such projects should require the Authority's permission but where wider benefits can be identified they should still be allowed to proceed.

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.

We support the proposal. We believe this has worked well with IFI.

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.

While we agree that visibility of all NIA projects is required at an early stage to identify possible duplication and opportunities for collaboration, is important that registration arrangements are proportionate and tailored to the size and nature of the project. As such we believe lighter touch arrangements are appropriate for NIA relative to the current LCNF First Tier approach. In particular we believe shorter pre-registration periods are required.

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

We support the proposed approach.

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.

We agree that a cap should be retained to encourage efficiency and collaboration.

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

As highlighted to Ofgem previously, based on our experience under the IFI and LCNF, we believe the level of internal resource required to develop and test commercial, operational, safety and regulatory aspects of future NIA projects is likely to exceed the level of cap proposed. We believe a cap of between 35% and 50% would be more appropriate in the majority of situations. In exceptional cases a higher level of internal funding may be required e.g. where internal expertise is critical or as we move closer to "business as usual" type applications. We believe arrangements should provide flexibility in such circumstances such that the cap could be lifted on an ex ante basis with Ofgem's approval.

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?

We believe the current reporting framework provides a good overview of projects, covering all aspects at a fairly high level. As such the reports are effective in raising awareness or identifying projects of potential interest. However they do not and should not be expected to provide the level of detail required to allow replication or collaboration within other organisations or networks. We believe the additional information required in such cases is likely to be case or party specific and likely to require other more effective forms of communication e.g. supplemental reports, presentations, bilateral meetings, seminars etc.

While the annual report provides a useful platform for further discussion and dissemination, we believe it is also essential that each business is able to innovate in the way in which it shares knowledge and is able to tailor this to the project and potential audience.

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?

We support the proposal to require licensees to share reports through the dissemination portal being established by work stream five of the DECC / Ofgem Smart Grids Forum, to be made available on the ENA web page and are participating in discussions through the ENA.

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

We agree with Ofgem's view that an annual conference may not be as appropriate given the nature and scope of the NIA. Also, we believe that similar to the IFI reports, it would only allow high level dissemination of information and would not address the project or network specific questions likely to be of interest to any party seeking to collaborate or replicate a project. The cost involved in supporting an annual conference is also significant, particularly in terms of internal resource. This would need to be considered when setting any funding cap. If funding is constrained we question whether this would be an efficient means of disseminating information, particularly in the early stages but we would be happy for arrangements to remain flexible to accommodate conferences in future if this was considered necessary and efficient.

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.

We support Ofgem's proposal to oblige licensees to share relevant learning on a bilateral basis when asked to do so by any network licensee, subject to undertakings relating to confidentiality or commercial sensitivity.

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

We agree, where relevant licensees and their customers should be able to access and benefit from knowledge generated to the extent it is funded by the NIA. We support the proposal to introduce default IPR arrangements but believe arrangements similar to those that apply under the IFI would be more appropriate for the NIA. In particular, we believe it is important that projects with early or lower technology readiness levels are not stifled with overly complex or restrictive IPR arrangements. We believe flexibility is required.

Question 15: should a carve out for commercial products be included with the default IPR arrangements?

For the reasons set out under Question 14, we believe a carve out should be included.

Question 16: Should the carve out be limited to projects focusing on lower technical readiness levels?

Yes