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WWU response to consultation on funding the cost of preparing submissions for the Network Innovation Competition and the Governance of the Network Innovation Allowance

Dear Sam,

Wales & West Utilities (WWU) is a licensed Gas Distribution Network (GDN) providing Gas Transportation services for all major shippers in the UK. We cover $\frac{1}{6}$ th of the UK land mass and deliver to over 2.4 million supply points. WWU is the only company that focuses solely on Gas Distribution in Great Britain.

Innovation is a key enabler to the generation of value; and sustainable networks and we fully support the introduction of the Network Innovation Allowance (NIA) and the Network Innovation Competition (NIC) within the RIIO regulatory frameworks for regulated networks. Our responses and participation at innovation workgroup meetings are aimed to maximise the potential use of Innovation, including working with third parties.

One issue that has received a lot of discussion through the workgroup is how to deal with Intellectual Property Rights (IPR) and we acknowledge this is complex area to address. We hope our comments help facilitate an outcome that will promote participation and not impose barriers for third parties to participate within the valued Innovation schemes implemented within RIIO.

We note that Ofgem have issued the consultation to licensees and "other interested parties". At the June meeting of the Innovation Working Group, National Grid noted that the European Union Research Councils have very strict views on how Intellectual Property Rights (IPR) is dealt with. It is important to realise that the people who will really determine the IPR arrangements will be those people with the ideas out in the commercial world. If the IPR arrangements put in place by Ofgem are not acceptable to potential partners then these potential partners will choose not to work with licensees. Ofgem needs to ensure that the views of these partners are fully taken into account before any final decisions are made. We have sent the consultation to one organisation with which we have relevant links.

We note the first three questions relate specifically to the Network Innovation Competition (NIC) and our answers to these questions specifically relate to 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? If not please provide evidence to justify an alternative level of cap.

There are two key issues to address:

- Where the level of the cap is defined
- The size of the cap

Definition of level of cap

We do not think that it is sensible to put the value of the cap in the licence as this makes changing it difficult. There clearly needs to be some mechanism for setting and reviewing it and we would support some form of annual review and setting process outside the licence. To provide certainty and forward planning it seems sensible to set the value at least one year in advance. This would mean that the cap for year t would be set before the end of year t-2 giving a minimum of 12 months visibility of any changes. It may also be appropriate to be able to review this process as 12 months visibility of changes may not be sufficient for very large projects.

Size of cap

We recommend that the cap should be the larger of the two values. The table below shows that depending on which rule is used; and whether 5% of NIC funding is greater or less than £175k, there is the potential for anomalies between the GDNs owing to the fact that each GDN does not have a separate licence. We believe that this situation does not arise in electricity, for example WPD owns four electricity distribution networks and has 4 licences.

Organisation	Min funding if use lesser of 175k or 5% NIC funding		Min funding if use greater of 175k or 5% NIC funding	
	If 5%NIC > 175k	If 5%NIC < 175k	If 5%NIC > 175k	If 5%NIC < 175k
National Grid	£175k	5%NIC	5%NIC	£175k
Scotia	£350k	5%NIC	5%NIC	£350k
WWU	£175k	5%NIC	5%NIC	£175k
NGN	£175k	5%NIC	5%NIC	£175k

To overcome this problem we suggest the allowance should be allocated on a per GDN basis for gas rather than on a per licence basis. We believe that this will address the potential anomalies in gas caused by each GDN not having a separate licence.

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?

It seems reasonable that the funding for bid preparation costs for the NIC funding should be additional to the funding set aside for the NIC itself. We note that the NIC allowance was originally proposed at £30m but this has been reduced to £20m as networks could not provide evidence of the costs that would be incurred. Therefore now that this cost of bid issue has been identified we believe that some of the original proposed funding should be used for this purpose.

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

Ofgem proposes that projects that are bidding for NIC funding should have to pass two stages or gates.

The first gate is appropriate, namely that projects should either:

- Trial new technical, operational and/or commercial arrangements; **or**
- Undertake research and development to inform the development of new technical, operational and/or commercial arrangements

We have concerns with the criteria for the second gate that requires that projects must:

- Not lead to unnecessary duplication by companies;
- Have the potential to develop learning that could be applied across the GB Gas/Electricity Distribution/Transmission System; **and**
- Have the potential to deliver net financial benefits to current and/or future consumers

Our comments on each of these are as follows:

Unnecessary duplication

It is unclear what is meant by unnecessary duplication. If two projects proposed for NIC funding are identical in nature and approach and would be using the same external partner then clearly it is a waste of resource to pursue both. However, if the projects are looking at the same issue but using different approaches or different partners then there is likely to be a benefit in pursuing both. The nature of innovation is that it is often difficult to predict whether an approach will be successful; and if both are successful; they may each work best in different circumstances. Further, even if two projects are looking to address the same general area, there may still be benefit in going ahead with both if there is competition as it may stimulate further innovation as only the best innovation is likely to have commercial value. If one project is dropped there is less incentive to push the other innovation to its limits.

Application across Gas/Electricity Distribution/Transmission System

It seems likely that most projects will have the potential to develop learning that can be applied across GB gas/electricity distribution/transmission system so we agree that having this criteria is reasonable.

Potential to deliver net financial benefits

The criteria should be that the project delivers outputs valued by consumers and this should not be limited to projects that deliver net financial benefits because this would exclude innovations that delivered safety and environmental benefits. We therefore think that the third criteria should be changed to:

- Have the potential to deliver outputs that are beneficial to current and/or future consumers

We assume that all remaining questions within the consultation relate to the Network Innovation Allowance (NIA) and therefore our answers to all remaining questions are specific to the NIA.

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 do not agree with the proposed funding approach for projects with non-financial benefits. We believe that a project that is reasonably expected to deliver outputs that provide consumer benefits should be funded regardless of whether they are expected to produce financial or non-financial benefits,.

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 agree.

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 agree that there is benefit in having a central list of NIA projects that are being undertaken so that interested parties can see who is doing what; however we suggest that the NIA process needs to involve as little involvement from Ofgem as possible and that Ofgem should not have a role in approving which NIA projects go ahead. Our concern is that if Ofgem has a role in approving projects then delays will inevitably occur because process issues will have lower priority than new policy or other areas, this would mean that Ofgem may become a blocker to the NIA scheme.

In addition having an approval scheme for the NIA will raise questions about whether partners can be confident that their Intellectual Property Rights are being adequately protected. Limiting Ofgem's role to collating a central list will probably address most of the partner's concerns but we suggest that Ofgem should raise this directly with potential partners to determine their views. We comment in our answer to Question 14 on the implications of the Freedom of Information Act on Ofgem's ability to keep information confidential and we suggest that this would be seen as a risk by potential partners if Ofgem had any role in approving projects.

Ofgem has sufficient powers to disallow inappropriate expenditure, both currently and under the new RIIO regime to mean that there is no need for Ofgem to approve projects. As an analogy Ofgem's approval is not required each time a GDN undertakes "betterment" on a connections project, it relies on the Gas Act obligation on transporters to develop an economic and efficient system and disallows any expenditure it considers inefficient at the time of price control reviews. The fact that little or no expenditure is disallowed shows that GDNs are effective in ensuring that spend is efficient. We see no reason to doubt that GDNs will similarly ensure that innovation projects adhere strictly to the criteria. GDNs currently have to certify that we comply with licence obligations so there is no need for additional obligations.

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

We disagree with separate arrangements for NIA projects that do not have net financial benefits. Safety has always been the key consideration in gas distribution and environmental considerations are increasing in importance. In line with the RIIO principles our view is that innovation that deliver outputs that consumers, through stakeholder engagement have indicated that they value, should be allowed. These outputs could include better value for money, increased safety such as better publicity for Carbon Monoxide poisoning, reduced greenhouse gas emissions and so forth.

We argue below in our answer to Question 14 that there should not be default IPR arrangements, therefore we do not agree that there should be special arrangements for cases where the default IPR arrangements are not used.

We do agree that some scrutiny is appropriate where the project requires payments to be made to any undertakings with the same ultimate controller as the licensee.

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 suggest that a cap could be restrictive within the NIA and the principle should be that the most appropriate resource is used whether this is internal or external and that licensees should be required to explain why particular resources have been used. If the view is that a cap is necessary then Ofgem should have discretion to be flexible and ensure that if a figure is stated then it should be qualified by words to the effect that "save where Ofgem otherwise agrees" to deal with particular issues that may occur from time to time. It is important to avoid creating perverse incentives to use external resource which may be less skilled or knowledgeable than internal resource solely because if internal resource was used its cost would exceed the allowed expenditure cap.

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 line with our answer to Question 8, we suggest that there should be no limit on the proportion and the licensees should be required to explain why particular resources have been used.

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?

WWU produces a detailed annual IFI report in March every year, which follows the agreed template in the IFI guide. It is disappointing that Ofgem has never provided feedback on our reports. The dissemination of data and access to this data should be managed through a suitable body to which third parties have access. The Energy Networks Association (ENA) currently performs this role, however if a licensee ceases to be an ENA member then this will need reconsidering.

We suggest that the communication of IFI projects needs to be improved and that for NIA reporting one option would be for Ofgem to produce an annual report to the industry based on the reports completed by networks, this could cover:

1. Overview of innovation projects
2. Outcomes from projects
3. Funds spent
4. Who to contact in each GDN for more information

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 agree that there should be NIA annual reports, but in line with our views on IPR we believe that these should only be sufficient to inform other parties of the innovations developed.

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

We agree that an annual conference could be useful as this will provide a focal point for communication and increase awareness of the NIA and its successes; however the same restriction on content as for the reports would need to apply.

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.

As stated earlier, we agree that general awareness and learning should be shared but the concept of sharing detailed information with other licensees may cause problems in that the sharing licensee will effectively be sharing the partnering organisations' Intellectual Property (IP) for which normally the partners would expect payment. In practice, most contracts restrict the use of the IP to the party paying for it and their sub-contractors. Our main objection to the detailed sharing is that other GDNs will benefit from the investment made by the original GDN without having incurred any cost.

We do not agree that licensees should be obliged to share the detailed learning without charge to other parties. We suggest that licensees should be able to use normal commercial processes to benefit from innovations and that the working of the TOTEX regime will ensure that some of these benefits accrue to consumers in recognition that they have funded the NIA.

The NIA:

- Is funded through transportation charges and is therefore paid by the shippers/consumers of the relevant network;
- The cost is excluded from the TOTEX totals

If WWU consumers fund a successful innovation this could have two benefits:

- Financial or non-financial benefits to those shippers/consumers

- The potential to sell the innovation to other gas network operators in Great Britain and to organisations operating in other industries and/or operating outside Great Britain

Ofgem's proposals are to put in place rules around sharing that in our view create problems with Intellectual Property Rights (see our answer to Question 14). Furthermore the proposals for licensees to share the detailed learning free of charge means that it creates two different classes of customer and also poses problems. For example GDNs compete directly with IGTs in new connections and requiring GDNs to share innovations with competitors free of charge is unreasonable, particularly as there will be no corresponding obligation on IGTs.

We suggest that where an innovation has been developed by a GDN in conjunction with a partner then the IPR owner should be able to exploit the innovation in the way best calculated to provide maximum value. Where the IPR is owned by the GDN the GDN should be able to sell the innovation to other gas network companies and to other non-gas companies. The price agreed would reflect the value of the innovation to the other companies. The revenue would be deminimus revenue. If the cost associated with this innovation activity was separately identified and allocated to deminimus cost then consumers would benefit from a reduction in the regulated cost base from which they would benefit by means of the operation of the TOTEX regime.

We suggest that this approach offers the following advantages over Ofgem's approach:

- It provides direct value to the consumers who have funded the innovation by its use on the GDN network;
- It provides indirect value to the consumers who have funded the innovation through sale of the innovation to other parties;
- It treats all companies the same whether they are inside or outside the gas industry;
- It address the problems of IGTs competing with GDNs;
- The same arrangements apply whether the Intellectual Property Rights are owned by the licensee or the innovation partner

Ofgem's argument is that if the Intellectual Property has been developed by funding through the NIA then it should be available to all. This has some superficial appeal; however there is no reason why consumers on one network should benefit free of charge from work done by another network. That approach may encourage networks not to put any effort into innovation and just wait to benefit from successful innovations done by others. No one would suggest that if one GDN spends to reduce ongoing costs that they should be obliged to share those savings with other GDNs yet this is in effect what is being proposed by the obligation to share the IPR without charge. Clearly, if other GDNs spend money they too can benefit from reduced ongoing costs, the corollary is that other GDNs can benefit from the innovation either by developing it themselves or by purchasing the rights to use it.

The concept of RIIO is that revenues should be dependent on, amongst other things, innovation so therefore it is reasonable that GDNs should be able to receive higher revenues as a result of innovation. We realize that if GDNs innovate then it is likely that different GDNs may have different approaches to some aspects of their operations and Ofgem's work on analyzing business plans will need to become more sophisticated in identifying best practice and not rely just on analyzing costs but also understanding the justification behind the proposals.

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

In our view the decision on ownership of Intellectual Property Rights should be the subject of negotiation between the licensee and the innovation partner as in the case for innovation in other industries. The decision on who should own the Intellectual Property Rights for each innovation will depend on:

- Who is the most appropriate party to own the IPR based on
 - The risk each party bears in the development of the innovation;
 - How widely the innovation can be applied and which party is best placed to exploit it
- The cost borne by each party taking into account
 - The risk borne by each party in the development of the innovation
- Any other constraints on the parties such as restrictions imposed by any external funding. For example EU funding for University based research.

WWU is currently involved with projects that build on Intellectual Property owned by a partner but seeks to develop this to use in live gas pipes. Whilst we note that Ofgem's proposals seek to protect background IPR we suggest that the proposals as they stand could be perceived as creating a risk that the partner's background IPR will become publically available.

We give two examples of considerations that may affect the allocation of IPR. First, if the innovation has applications outside GB then it may be inefficient for the GDN to own the IPR as GDNs are not well placed to exploit IPR internationally or even across utilities, such as Water in the UK. Second, if the partner organisation is small and is essentially an organisation that develops ideas but which has not the means of developing them practically then it may be appropriate for the IPR to be owned by the GDN. The GDN might develop it and then sell the rights to international exploitation or cross utility exploitation in the UK to a third party.

The above are just two possibilities and there are many more permutations that could occur. Rather than have prescriptive arrangements it would seem more sensible to require the GDN to ensure that the IPR arrangements reflect value for money and benefit the GDN's consumers when judged at the time the arrangements were agreed. This allows the GDN and the innovation partner to negotiate the optimal solution taking into account the nature of the innovation and the nature of the innovation partner. If the GDN does not ensure value for money then the innovation funding could be clawed back. We suggest that Ofgem will need to take advice on what constitutes value for money as Ofgem has limited commercial expertise and probably no experience in delivering innovation.

If partners expect that their IPR will be shared with others then it is likely to have two effects:

- Some partners may decline to work with NIA and NIC funding
- Costs are likely to rise substantially because partners will want to be paid for allowing their IPR to be disseminated.

Ofgem also needs to consider that GDNs and DNOs have to comply with section 105 of the Utilities' Act, this restricts what information can be disseminated. In addition Ofgem and DECC, being public bodies, are subject to the Freedom of Information Act and therefore partners run the risk that competitors of innovation partners will be able to use the Act to obtain information about innovations being developed by those partners. Although the Act allows for refusal to

release information in certain circumstances we think that potential partners will still see this as a considerable risk.

Finally we comment on the “paying twice” issue. In reality it is not the case that consumers pay for the innovation and then get charged again by the partner. If the GDN negotiates properly with the partner then the amount the GDN pays will reflect how much of the IPR it acquires for a particular scheme. There is therefore a balance between upfront cost paid and the ongoing cost paid for each use of the developed innovation. An efficient GDN will ensure that consumers do not pay double for an innovation. However it may be that the appropriate risk sharing mechanism for a particular innovation is an upfront fee with a further per use payment to the partner for each use of the developed innovation together equating to the value that would have been paid had the IPR been totally acquired by the GDN. It may be that neither party was willing to bear the whole risk i.e the GDN was not willing to buy all the IPR upfront in case the innovation did not work and neither was the partner willing to bear all the risk by funding the development. In this case the NIA will provide benefit by sharing risk and allowing innovation to occur that otherwise would not have done.

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

The fact that this question is being asked shows that the approach proposed by Ofgem is too prescriptive. All the products will be commercial, Ofgem’s definition is presumably innovations that could be sold to other parties outside the gas and electricity industries. Our proposed solution deals with this issue.

Our view is that if a company innovates and that innovation provides net benefit (financial or non-financial) to its customers then the customers are better off and the innovation has been successful. If the licensee or the innovation partner (depending on IPR ownership) decides to exploit that innovation then they should be free to do so. If the licensee exploits the innovation then it is reasonable that some benefit accrues to consumers and some to the shareholders of the licensee.

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

In line with our previous points about IPR ownership and exploitation of the innovation beyond the consumer of the licensee, we do not believe that special arrangements need to be put in place for projects focussing on lower technical readiness levels. We suggest that negotiation between the licensee and the innovation partner will result in arrangements that are satisfactory to both parties and it is inappropriate for an economic regulator with no experience in innovation to seek to impose arbitrary rules. Other industries negotiate suitable arrangements for innovation and subject to suitable sharing of costs and benefits between customers and shareholders we do not see why gas and electricity licensees cannot negotiate in the same way.

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

We disagree that carve outs are required but as we state in our answer to Questions 13 and 14, we believe that the licensee should have general obligation to ensure that the arrangements it puts in place with the innovation partner provide value for money for customers at the time they were put in place.

We hope that our comments and participation at the innovation workgroup facilitates maximum use and benefit from the valuable innovation schemes implemented within RIIO. Should you require any clarification on any of our responses please do not hesitate to contact us.

Yours sincerely



Steve Edwards
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