



To transmission companies,
distribution companies,
generators, suppliers, shippers,
offshore transmission owners,
independent network operators,
customer groups and other
interested parties.

*Promoting choice and value for
all gas and electricity customers*

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Informal consultation on the Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) governance documents

Following previous decisions on innovation policy¹, we have developed draft versions of the NIC and NIA governance documents. We have now published these documents for consultation. We would welcome stakeholder views on the proposed drafting by 21 November 2012. If an existing Offshore Transmission Owner (OFTO) is considering entering the Electricity NIC in 2013 they should signal this intention in writing to Ofgem by 25 October 2012.

This letter sets out the background to this consultation, explains the high level contents of both the NIC and NIA governance documents and also highlights our approach to finalising the Intellectual Property Rights (IPR) clauses of the governance document following stakeholder feedback.

Background

Innovation is a key element of the new RIIO (Revenue = Incentives + Innovation + Outputs) framework for price controls. As part of RIIO, we proposed an innovation stimulus which consists of three measures:

- a NIC – an annual competition to fund selected flagship innovation projects with low carbon and/or environmental benefits
- a NIA – a set allowance to fund smaller innovation projects
- an Innovation Roll-out Mechanism (IRM) – to fund the roll-out of proven innovations which will contribute to the development in Great Britain of a low carbon energy sector or have broader environmental benefits.

We have previously consulted and published decisions on policy regarding the innovation stimulus for the transmission (RIIO-T1) and gas distribution (RIIO-GD1)² price controls. We are currently consulting on implementing the innovation stimulus for the electricity distribution price control (RIIO-ED1)³ on a consistent basis to that of RIIO-T1 and GD1. We have set out that we will use governance documents as part of the implementation of our decisions into the regulatory framework. The governance documents will set out the regulation, governance, and administration of the NIC and NIA.

This consultation is intended to provide interested stakeholders with the opportunity to comment on whether the specific drafting in each of the draft governance documents adequately reflects our previous policy decisions.

¹ For decisions on the NIC see [here](#), for decisions on the NIA see [here](#).

² Further information on these consultations and decisions can be found [here](#).

³ Further information can be found [here](#) (see Chapter 10).

We have drafted the initial versions of the governance documents in consultation with the Innovation Working Group (IWG).

The licence and the governance documents

To implement the innovation stimulus, we will modify the electricity transmission licences and the gas transportation licences to introduce new NIC and NIA licence conditions as part of the wider implementation of RIIO-T1 and GD1 in April 2013. We also intend to modify the electricity distribution licence to implement the innovation stimulus for RIIO-ED1 (in April 2015).

The licence conditions set out the mechanism for recovering funding through the NIC and NIA and enable the creation and modification of the governance documents which are associated with the licence. We recently consulted on the first draft of these licence conditions for RIIO-T1 and GD1⁴, and there will be a second consultation at the end of October. For RIIO-ED1 we expect to start drafting licence conditions for the innovation stimulus after the publication of the Strategy Decision in late February, with the statutory consultation taking place in December 2014.

Licensees will be required by the NIC and NIA licence conditions to comply with the respective governance documents as though they formed part of the licence. We have attempted to make the governance documents accessible and informative to parties beyond the regulated companies, especially those who may be looking to partner with licensees to use the NIC or NIA to try out new technological or commercial arrangements.

We have used capital letters to signify defined terms in both documents to signal where the reader should refer to the definitions section for further information.

This letter now summarises each of the governance documents, before highlighting further development work which we are undertaking on the IPR section of both documents.

The NIC governance documents

The NIC is an annual competition that will fund large scale low carbon and environmental innovation projects. There will be an electricity NIC and a gas NIC. The electricity NIC will start in April 2013, but will only be open to transmission licensees until the start of RIIO-ED1 in April 2015, when we intend to include distribution licensees.

The governance documents for the gas and electricity NICs are broadly consistent with one another and we have used our experience from the Second Tier of the Low Carbon Network (LCN) Fund⁵ to develop the arrangements within the documents.

The NIC governance documents are each split into two sections:

- Section A: The process for running the gas/electricity NIC, including:
 - the annual competitive process
 - the initial screening process
 - the full submission process.

- Section B: Requirements on licensees implementing NIC projects, including:
 - the contents of the funding direction
 - the requirements of the project direction
 - the IPR requirements for NIC projects
 - the royalties requirements for NIC projects.

⁴ Further information on this consultation can be found [here](#).

⁵ More information can be found [here](#).

The gas NIC

In our March decision letter⁶ we identified an issue that could prevent the competition running in April 2013, without changes to the Gas Act 1986. DECC is actively considering the options for proposing an amendment to primary legislation. However, it currently appears unlikely that a legislative amendment could be provided in time for the start of the first Gas NIC, which is due to commence in April 2013.

In the recent RIIO-T1 and GD1 Initial Proposals, we set out two interim options to deal with the potential delay to the Gas NIC⁷. Under the first option, the competition would be delayed by a year. Under the second option, we would run the competition in 2013 but funds would be collected from the winning licensee's own customers.

The gas governance document has been drafted as if the competition would run "normally" (ie with socialisation of the costs of winning projects). However, we have also highlighted within the document places where changes to the text may be made if we decide to run the competition as outlined in the second option, with funding being collected from the winning licensee's customers only.

Non-RIIO network licensee participation in the NIC

We have previously stated that, in addition to RIIO network licensees (ie licensees regulated under the RIIO price control framework), non-RIIO network licensees (ie OFTOs, Independent Gas Transporters (IGTs) and Independent Distribution Network Operators (IDNOs)) can also choose to lead bids for NIC funding⁸. Non-RIIO network licensees who wish to participate will be subject to the same governance requirements as the RIIO network licensees. To be eligible to lead a bid, a non-RIIO network licensee will be required to accept a modification to their licence under Section 23 of the Gas Act and Section 11A of the Electricity Act to incorporate the NIC licence condition and to abide by the NIC governance document.

If an OFTO would like the option of entering the NIC in 2013, given the time it takes to implement a licence modification, **they should signal this intention in writing to Ofgem by 25 October 2012**⁹ so that the necessary licence modification process can be run prior to the start of the competition. The NIC Licence condition for OFTOs is expected to be similar to the RIIO-T1 NIC condition and the exact drafting will be consulted on in parallel. A licensee may request the NIC licence condition after this date, but they will only be able to lead bids in later competitions, once the condition has taken effect. In the future, our intention is that the NIC condition will be included in all OFTO licences at the point of licence grant¹⁰.

We will publish our decision on the Gas NIC in the RIIO-T1 and GD1 Final Proposals. In the meantime, **if an IGT is interested in finding out more about the process and competition, please feel free to email network.innovation@ofgem.gov.uk for further details.**

The NIA governance document

The NIA is a set allowance that each of the RIIO network licensees will receive to fund small-scale innovative projects as part of their price control settlement. We have used experience from the First Tier of the LCN Fund and the Innovation Funding Incentive (IFI) to develop the arrangements set out within the NIA governance. We have split the NIA governance document into an electricity and gas version.

⁶ More information can be found [here](#)

⁷ For more information see [here](#)

⁸ RIIO network licensees are licensees regulated under the RIIO framework for price controls. Non-RIIO network licensees are those regulated under a different framework.

⁹ IDNOs will be eligible to enter the Electricity NIC from 2015 with DNOs.

¹⁰ The condition is only relevant to the licensee if they choose to bid in the competition.

The NIA Governance Document sets out:

- requirements to make potential project partners aware of the NIA
- the eligibility requirements for NIA projects
- the requirements relating to eligible expenditure for NIA projects
- the knowledge transfer requirements for NIA projects
- the IPR requirements for NIA projects.

Intellectual Property Rights (IPR)

We have delayed consulting on the IPR clauses of both governance documents.

We explained in our August decision letter that we intended to include default requirements for licensees to follow when negotiating IPR arrangements for projects funded through the NIC and NIA. We also explained we would take time to understand any concerns stakeholders have with specific aspects of the IPR arrangements and seek to address any issues identified through the drafting and consultation process.

We therefore set out below our current thinking with respect to the principles that the IPR arrangements should meet. We intend to discuss these principles at the upcoming Innovation Working Group (IWG) on 12 October alongside drafting of the arrangements. Following this meeting, we intend to update the drafting of the IPR chapter of both the NIC and NIA governance documents and consult on this chapter separately (but in parallel) to this governance consultation.

Principles

Facilitating knowledge transfer is one of the key principles of the NIC and NIA. Consumers are funding this work and we want the learning generated to be disseminated as effectively as possible to ensure that all licensees, and therefore all consumers, are able to benefit from projects. As part of the governance arrangements for both the NIC and NIA we will introduce default IPR arrangements¹¹. These are intended to support knowledge transfer amongst licensees and deliver value for money for consumers without inhibiting third parties from collaborating on projects. In addition, we want to ensure that consumers do not pay excessively for innovations which they have funded.

IPR can be classified as “background” or “foreground”. Below, we have set out the key policy principles we are trying to achieve across both:

i) Background IPR

Background IPR is IPR generated before a NIC or NIA project. We believe that the owner of a background IPR should retain all rights to this, both during and following the NIC/NIA project. Our concern is that the project – which consumers have funded - increases the value of these rights, so it would be unfair to expect consumers to pay for the incremental value of the IPR, when the final product is sold back to them (ie when it is sold to network companies).

However, we also recognise that third parties who bring pre-existing IPR to projects should expect to receive a return for their past investment. We would be concerned were this return to be raised to an unreasonable level. We consider that licensees’ should ensure that a reasonable rate is secured for background IPR which is accessible to all licensees on a consistent basis.

For the NIA we consider that the licensee should confirm that such an arrangement is in place as part of registration. For the NIC we consider that the licensees should set out the basis of this arrangement as part of the full submission documentation.

¹¹ We already have default IPR arrangements under the LCN fund and we have used these as the basis for NIC and NIA IPR arrangements

ii) Foreground IPR

Foreground IPR is IPR developed through the NIC or NIA project. We want to ensure that network licensees have good access to information generated through these projects and that they are not charged excessively for products developed through the projects. However, we also recognise that third parties may have made financial contributions to the project which they need to recover.

There are two markets for foreground IPR - the market for sale to GB network licensees and the market for sale to other parties (eg internationally). There are also two types of IPR which can be generated through the projects. Firstly there is 'know-how' and secondly there is 'product' IPR (ie the IPR within a product).

Given that knowledge dissemination is a key aspect of the policy principles behind the NIC and NIA, we believe that 'know-how' IPR generated through NIC/NIA funding should be made freely available to GB network licensees.

Where third parties are likely to develop IPR through NIC or NIA projects we expect them to provide funding or contributions to the projects which reflect the benefits they expect to receive through the project. Given that third parties are not funding these projects entirely, it is likely that in some cases consumers are contributing to the development of related products. Where consumers have contributed to the development of the foreground IPR related to products, we do not consider that they should be charged excessively when other network licensees are using the IPR.

As such, we believe that the foreground IPR should be sold to network licensees at a reasonable rate, which is negotiated on their behalf by the network licensee leading that NIC/NIA project. We believe that a key consideration in this negotiation would be the level of project funding provided by the third party. In the extreme, where consumers have funded the entirety of a project we would expect the foreground IPR to be made freely available for network licensees (ie the third party only charges for background IPR). For clarity, there should be no constraint on pricing when selling the foreground IPR in other markets (but the royalties mechanism should enable the pass through of the benefits back to consumers in the proportion they have funded it).

We intend to discuss these principles at the upcoming IWG on 12 October. Details of this meeting are set out at the end of the letter.

Energy Efficiency

Some stakeholders have raised concerns that the current drafting of the LCN Fund Governance Document (which we based the NIC and NIA on) may prevent projects focussed on innovative energy efficiency solutions being considered by licensees. We consider these types of solutions should fall within the scope of the NIC and NIA. Therefore we welcome views from stakeholders if there are any barriers within the current drafting that may inhibit innovative energy efficiency solutions receiving funding.

Questions

Question 1: We invite stakeholders to comment on the proposed drafting of the NIC and NIA Governance Documents. Does the drafting reflect our policy decisions?

Question 2: Do you think there are any barriers within the current drafting of the NIC and NIA governance documents which could prevent innovative energy efficiency solutions receiving either NIC or NIA funding?

Responding to the consultation

We welcome responses to the questions we have raised in this letter by **Wednesday 21 November 2012** and a template for responses to our proposed drafting is provided as a

subsidiary document to this letter. Responses should be sent, preferably by email, to networks.innovation@ofgem.gov.uk or in writing to:

Neil Copeland
Ofgem - London
9 Millbank,
London,
SW1P 3GE

Respondents who wish to have their responses remain confidential should clearly mark the documents to that effect. Unless marked confidential, all responses will be published by placing them on our website.

In the meantime, we intend to hold an IWG meeting on 12 October 2012 as a further opportunity for interested parties to express their views directly to Ofgem. The meeting will be held at Ofgem's offices in London from 10am to 3pm. There is an open invitation to attend the IWG. If you would like to attend this working group meeting please contact networks.innovation@ofgem.gov.uk for further details.

Next steps

We recently consulted on the RIIO-T1 and GD1 draft licence conditions for the first time¹². We intend to publish a second consultation on the licences on 30 October 2012. These consultations will be followed by the requisite 28 day statutory consultation in December 2012¹³ on both the licence conditions and the NIC and NIA governance documents.

Should you wish to discuss the issues raised in this document regarding the NIC, please contact Nicola Meheran on 020 7901 0515. Should you wish to discuss the NIA, please contact Neil Copeland on 020 7901 7193, or email networks.innovation@ofgem.gov.uk.

Yours faithfully,

Dora Guzeleva,
Head of Networks Policy: Local Grids

¹² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=RIIOT1>

¹³ Following implementation of the Third Package Regulations the procedure for making licence modifications has been amended. Under the revised procedures, any proposed licence changes no longer require Licensee consent, but can only come into effect at least 56 days after we have published our decision to make those licence changes.