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21st November 2012

WWU response to informal consultation on Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) governance documents

Dear Dora,

Innovation is a key requirement to deliver economically sustainable and environmentally sustainable energy for UK customers. We fully support the "I" for innovation within the RIIO principles and we welcome the inclusion of the Network Innovation Allowance (NIA) and the Network Innovation Competition (NIC) within the the detailed proposals for the regulation of energy networks.

It is essential that we deliver an innovation framewrok that encourages third parties to invest as we recognise the value they can bring into the energy sector.

Our business plan has outlined our innovation strategy and we have committed fully to the industry workgroups that have contributed to the NIA and NIC consultation drafts. The industry workgroup has provided Ofgem with valuable input and we are dissapointed that some of the key points from this group do not appear to have been taken into account in the current drafting.

We recognise that appropriate arrangements need to be put in place to ensure customers of the network companies benefit from the innovations; however we do not believe that the arrangements proposed by Ofgem deliver this.

Within this response, we address some of the key questions and where appropriate provide some alternative proposals for consideration that we think would provide a more appropriate framework to better faciliate the agreed desired outcomes from Innovation.

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.

We believe the drafting does reflect Ofgem's policy decisions; however we believe these decisions have not fully reflected the feedback given at the industry industry workgroup.

Intellectual Property Rights

We have serious concerns about the proposals on Intellectual Property Rights (IPR) and believe that these are inflexible and are likely to lead to low level of innovation. This will be seen as a failure by the networks when in fact it is a failure to put in place appropriate IPR arrangements. While we note that Ofgem would be willing to consider applications for derogations from the standard position we are concerned that, with all the other calls on Ofgem's time that the RIIO regime will entail, consideration will not be able to be given in commercial timescales by suitably knowledgeable staff, in what is undeniably a very specialist area.

We believe that the requirement to share innovations IPR without charge will discourage third parties and will mean that the networks and companies that do innovate may not gain the full benefits from exploiting the innovation in the UK and worldwide to the detriment of both the innovating parties and their customers, and the customers of the networks that funded the innovation. It is possible that potential innovation partners will decide not to use the NIA or NIC and may seek innovation partners in geographies outside Ofgem's jurisdiction that have more favourable IPR regimes. This would result in detriment to customers of networks who would not be able to benefit from the exploitation of any IPR they might otherwise develop. We note that there has been recent publicity regarding companies that have relocated headquarters to the Eire owing to the more favourable corporation tax regime.

Learning from the Low Carbon Network Funding Mechanism (LCNF)

There is an opportunity to learn from the Low Carbon Network Fund work within electricity and not just carry over the IPR arrangements from this mechanism. We do not believe Ofgem has fully assessed whether the IPR arrangements from the LCNF was the best arrangement, in particular for the NIA. The Network Innovation Allowance has a much wider application than either the LCNF or the Innovations Funding Incentive which it replaces.

Engagement with third parties

Within the Industry workgroup we have suggested that Ofgem could have consulted more directly with existing and potential third parties. To promote third party input with regard to the issues raised within the Innovation consultation issues we have discussed and encouraged relevant third parties that we engage with of the work. We think Ofgem should consider this issue in future communications.

WWU proposals for Intellectual Property Rights (IPR)

We have made our views on the IPR proposals at length in previous responses and at the industry workgroup. We do not think our views have been reflected within the current drafting proposals.

Our key point is that, apart from the funding for innovation for the NIA and NIC being from the network's customers rather than shareholders, the process for innovation should be the same as for other industries. Since the customers of networks fund the innovation, a mechanism is required to ensure that they benefit from any external exploitation of innovations they have funded but apart from this the networks and their partners should be left to exploit the innovation as they see fit.

Currently, and in the future, networks can; and do pursue innovations using shareholder funds and they are able to make appropriate arrangements in respect of the IPR generated taking account of the risk they wish to bear and the potential benefits that may arise. The only difference between the current arrangements and the NIA and NIC is that under the NIA and NIC the funding comes from customers through transportation charges.

As long as there is an appropriate and robust process for ensuring that the customers that fund the innovation benefit from its exploitation to third parties then we see no difference between innovation funded by shareholders and innovation funded by the NIA and NIC. In particular there should be no requirement to share the benefits of the innovation free of charge with networks whose customers have not funded the innovation.

Should Ofgem believe with reasonable grounds that the networks have not made appropriate use of the NIA or NIC funding then it seems reasonable that this expenditure could be clawed back in a subsequent year.

Therefore we believe that the only requirement on networks should be that they should put in place IPR agreements that, at the time they are put in place are efficient and are calculated to provide value to the parties funding the innovation.

This is a flexible arrangement that enables appropriate arrangements to be put in place taking the individual circumstance of each innovation. For some innovations the network may be best placed to exploit the IPR, in others the innovation partner may be able to exploit it more effectively perhaps in other markets such as water in the UK or internationally.

The current proposals for default IPR or a one size fits all approach lead to the following risks:

- Innovation will be discouraged because the default arrangements are not suitable
- Parties think that the work involved in getting approval for alternative arrangements are too time consuming

Ofgem's view that the IPR from the innovations should be shared around free of charge is presumably based on the assumption that overall it will all balance out. We suggest that this is not correct for the following reasons:

- Some networks have a higher percentage allowance than others and therefore they may perform more innovation than other networks.
- Some networks may concentrate on innovations that are of particular benefit to that network and not those that are of general interest. For example a project to address

the challenges of gas risers in high rise buildings would only be of interest to networks with this type of building.

- Some networks may decide that the optimal strategy is to allow others to innovate and then free ride on the successful innovations developed by others. This may be optimal because customers then do not fund the NIA and therefore benefit from lower prices and this benefit may be worth more than the loss caused by rolling out the innovation later than the innovating network.

We do recognise that there are differences in the NIA and NIC that need to be taken into account but for the NIA in particular the arrangements proposed are not likely to encourage the its use.

Question 2: Do you think that 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?

The restrictions in the regime on projects which are or appear to be the same receiving funding could result in valuable innovation being missed. There may very well be competing ideas in the market place which share certain characteristics or objectives but which approach the problem from different perspectives – one only has to consider VHS and Betamax of some years ago. The regime should not be permitted to exclude such competition in ideas or technology.

Yours sincerely



Steve Edwards
Head of Commercial and Regulation
Wales & West Utilities