

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

Direct Dial: 020 7901 1851
Email: dora.guzeleva@ofgem.gov.uk

Date: 10 November 2014

Proposed changes to the Network Innovation Competition and Network Innovation Allowance Governance Documents

Innovation is a key element of the RIIO (Revenue = Incentives + Innovation + Outputs) mechanism for price controls. Developing innovative approaches is essential for network operators to deal with the challenges they will face. As part of RIIO, we introduced an Innovation Stimulus which consists of three schemes -

- A Network Innovation Allowance (NIA) – part of each licensee’s price control allowance to be spent on smaller-scale innovation projects.
- A Network Innovation Competition (NIC) – to fund larger scale flagship innovation projects.
- An Innovation Roll-out Mechanism (IRM) – to fund the roll-out of proven innovations with carbon and/or environmental benefits.

When we developed the governance arrangements for the NIA^{1,2} and NIC^{3,4} we indicated that we would occasionally propose changes to the Governance Documents. We consider that some changes are now necessary so that the documents are as clear as possible going forward.

Generally we consider that the NIA and NIC governance arrangements are functioning effectively. Reinforcing this opinion were the views we received from licensees and other stakeholders at the Innovation Working Group in February 2014. On the basis of this and our own experience of the process, there are a number of minor changes that we would like to propose to the NIC Governance Documents in time for the start of ED1. While we expect to make minor changes to the NIC Governance Documents we are not proposing any substantive clarifications of the NIA document. We will undertake a more substantive policy review after the NIC and NIA have been in place for two years.

In addition to the proposals to change the NIC Governance Documents as part of this consultation we have received some comments regarding the operation of the Gas NIC. We do not propose making any substantive changes to the Gas NIC governance arrangements at this time. However, we would like to understand the views of stakeholders regarding how those arrangements are working. Views expressed as a result of this consultation will

¹ The Electricity NIA Governance Document is available [here](#).

² The Gas NIA Governance Document is available [here](#).

³ The Electricity NIC Governance Document is available [here](#).

⁴ The Gas NIC Governance Document is available [here](#).

feed into a more substantive review next year as provided for under the NIC and NIA Governance Documents.

We welcome responses regarding any of the issues raised in this letter by **19 December 2014**. Please send responses to networks.innovation@ofgem.gov.uk.

Current issues associated with the Gas and Electricity NICs

A) Evidence of a competitive process when selecting partners

The first LCN Fund Second Tier competition was held in 2010. Since that time licensees have partnered with a number of different organisations who provide goods and services. Licensees have also gathered ideas for projects from a number of sources. However, we are concerned that licensees do not clearly explain the procedures they have used to do this as part of their Initial Screening Process (ISP) submission. We propose amending this criterion set out in the NIC Governance Document to clarify this requirement.

The current requirement of the NIC Governance Document is for licensees to explain "how Project Participants have been identified and selected including details of the process that has been followed and the rationale for selecting Project Participants and ideas for the Project." When including this requirement it was our intent that licensees should clearly explain how partners and ideas were selected. Therefore we propose making this requirement more explicit.

We propose amending the NIC Governance Document and requiring that at the ISP stage licensees should explain -

- How the idea that is being tested through the project was selected. This should explain the process, criteria and basis of the decision taken to choose the project. The licensee should explain how this fits into its innovation strategy and why other ideas were discounted.
- The detail of the process, criteria and basis of the decision that the licensee took to select project partners and participants (where these have been identified and finalised) and why the decision(s) taken represents good value for money.
- The process and criteria that will be used to select project partners and service providers that have not yet been identified or finalised and how this will ensure value for money.

Where the required information is not sufficient or does not adequately demonstrate a robust selection process then licensees may be deemed to have failed the ISP stage. If licensees feel the ISP page limit needs to be extended to achieve this we will consider this.

Question 1: Do you agree that this criterion should be clarified to make it clear that licensees must explain their processes for selecting ideas and partners? Please explain your answer.

B) Clarification of the resubmission process following the second bilaterals

As part of this year's process we noted that licensees included additional information that had previously not been made available during the evaluation process or discussions with the Expert Panel. This is not what this process was intended for.

Licensees should only make changes to their submissions where they are correcting errors in their submissions or they are incorporating changes following the consultant's report or discussion with the Expert Panel. We intend to amend the Governance Document to clarify the purpose of this process to ensure only appropriate changes made. We will make it clear

that licensees should only be including additional information already discussed with the Expert Panel and that they should not be making changes to improve readability.

Question 2: Do you agree that this provision should be amended to clarify that licensees should only make changes to their submissions to correct errors and incorporate changes as a result of discussions with the Expert Panel? Please explain your answer.

C) Deadline and Submission Materials

Following discussion with licensees we understand that there is a desire amongst some to have more time between the ISP and full submission stages of the process. The current deadlines are intended to balance the needs of licensees and the requirements to allow sufficient time for project submissions to be prepared for ISP, as well as a sensible amount of time between the ISP stage and the full submission deadline. We welcome views on whether the current timing of the ISP stage is appropriate or whether licensees would like this to be moved to earlier in the year.

Some licensees have also commented that the submission proformas at both stages of the competition should be amended. They are concerned that the proformas do not allow them to adequately explain how their projects perform against the criteria. We welcome comments on the current proformas and other submission materials.

Question 3: Do you have any comments regarding the time frame of the NIC process or the submission materials?

D) Housekeeping changes

We are aware of some typographical, formatting and consistency issues that do not affect the intent of the documents; we will make changes to clarify these as part of the amendments to the Governance Document following the conclusion of this consultation process. We also intend to include a definition for 'customer' in the NIC Governance Document. This is likely to be similar to that currently included within the Low Carbon Networks Fund.

We would like to know if stakeholders have any comments on the Governance Documents regarding typographical, formatting and consistency issues. We also intend to review the drafting of the criteria, generally, to make these clearer without changing the effect of the criteria.

We will consult formally on the proposed revisions to the Governance Documents early next year. We will consult members of the Innovation Working Group informally before the formal Statutory Consultation.

Question 4: Are there any typographical, formatting or consistency issues associated with the NIC or NIA Governance Documents that you consider should be corrected?

Gas NIC specific issues for future consideration

It has been brought to our attention that some stakeholders may have concerns regarding the criteria applying to the Gas NIC projects.

We are aware some stakeholders believe that the focus on carbon and environmental benefits could prevent some projects which might deliver significant financial benefits alone from being funded. This is because there may not be the same scope in gas as in electricity projects to deliver carbon or environmental benefits. At the evaluation stage, the Expert Panel and the Authority consider the level of environmental, carbon and financial benefits delivered by a project in the round alongside all the other criteria. We would like to

understand the details of stakeholders' concerns, so we can consider this issue further as part of the two year review.

**Question 5: Do you have any concerns regarding any aspects of the Gas NIC?
Please explain your answer.**

The first opportunity for gas transporters and electricity transmission operators (TOs) to seek IRM funding is next year. Licensees will be able to seek funding for the roll-out of proven innovations with carbon and/or environmental benefits. To help us with planning we ask all relevant licensees to indicate in their response whether they intend to make use of the IRM next year. We intend to engage with stakeholders regarding guidance and process for the IRM later this year and in the early 2015.

Question 6: Please indicate whether or not you plan to make use of the IRM and if so how many applications you intend to make.

We welcome responses to the issues we have raised in this letter by **19 December 2014**. Responses should be sent, preferably by email, to networks.innovation@ofgem.gov.uk or in writing to:

Neil Copeland
Ofgem - Glasgow
107 West Regent Street,
3rd Floor,
Cornerstone,
Glasgow
G2 2BA

Unless marked confidential, all responses will be published by placing them on our website. We intend to publish a decision in January next year.

Should you wish to discuss the issues raised in this document, please contact Neil Copeland at neil.copeland@ofgem.gov.uk or on 020 7901 7193.

Yours faithfully,



Dora Guzeleva,
Head of Networks Policy: Local Grids