

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

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Decision on 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) price control framework. Developing innovative approaches is essential for network operators to deal with the challenges they face. As part of RIIO, we¹ 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 during the price control period.

When we developed the governance arrangements for the NIA^{2,3} and NIC^{4,5} we indicated that we would occasionally propose changes to the Governance Documents. We consider that some changes are now necessary so that the Governance Documents are as clear as possible going forward.

This letter sets out our decisions on the issues on which we consulted at the end of 2014. We will incorporate the changes to reflect these decisions in the next version of the Governance Documents on which we intend to consult formally so that these are in place on 1 April 2015. We received 12 responses to our consultation.

Current issues associated with the Gas and Electricity NICs

A) Evidence of a competitive process when selecting partners

We are concerned that some licensees have not, at the initial screening stage, clearly explained the process they have used to select ideas and partners for projects. This

¹ The terms “the Authority”, “Ofgem”, “we” and “us” are used interchangeably in this document. The Authority is the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

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

³ The Gas NIA Governance Document is available [here](#).

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

⁵ The Gas NIC Governance Document is available [here](#).

concern relates to both the Low Carbon Networks (LCN) Fund⁶ and NIC processes. We also note that we were not asking licensees to provide information they should not already have been providing.

We intend to amend the Governance Documents to clarify the existing requirements. The amendments will make it clear that licensees need to provide detailed information on the processes and procedures they have used to identify project ideas and partners.

In our consultation we proposed requiring licensees to explain -

- how the idea being tested through the project was selected
- the process, criteria and the basis of the decision they took to select project partners and participants
- the process and criteria that would be used to select project partners and service providers yet to be identified.

Most of the respondents to our consultation agreed with our proposal or did not express a strong view. Some respondents noted that more space would be required if we expected licensees to provide additional information.

B) Clarification of the resubmission process following the second bilaterals

Following the final meeting between the Expert Panel and Project teams, licensees have the opportunity to amend their Full Submissions. 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. This is not what we intended the opportunity for resubmission to be used for.

We intend to amend the Governance Documents to clarify the existing requirements so that licensees:

(a) only make changes to the Full Submission documents which are required following discussions with us, the consultants or the Expert Panel during the evaluation process; and

(b) do not make changes to improve readability or add information which has not been discussed during the evaluation process.

In our consultation we proposed that: licensees should only make changes to their submissions where they are correcting errors or incorporating changes following the consultant's report or discussion with the Expert Panel.

Licensees generally accepted the proposal. Some noted that they might need to include significant amounts of new information, depending on the nature of discussions that take place during the evaluation process.

C) Deadline and Submission Materials

Deadline

We do not intend to change the timing of the initial screening process (ISP). Although we did not make any proposals on this issue, we understand there may be an appetite to change the timings of the initial screening and evaluation processes.

⁶ All capitalised terms not otherwise defined in this letter have the meaning given to them in the Governance Document.

Some respondents noted that they would like the initial screening stage to be brought forward. However, some licensees commented that while they would like more time between the screening stage and the Full Submission stage they did not want to move the screening stage forward. Some respondents noted that the process took too long for some potential partners and prevented them from participating as they needed funding in the shorter term. To ensure a robust evaluation we can not make the process shorter. If licensees wish to invest in projects with shorter time horizons, they may choose to do so using the NIA.

We feel the current timing of the process is appropriate. We need to make a decision on which projects to fund by the end of November each year so that licensees can give notice of their charges to suppliers. This means that the Full Submission date cannot be moved back. During the period of the LCN Fund we have reviewed and revised the Governance Document a number of times between competitions. This has allowed us to incorporate lessons learned from the previous year's competition and ensure a robust process. If the screening stage were to take place earlier in the year, we would not have time to undertake this process if it was necessary. Given these constraints, we do not think it is practicable to bring the ISP any further forward in the year.

Submission materials

We did not make any proposals in this area, but we recognise concerns have been raised by a number of organisations. We understand that licensees may wish to use images or tables to present information and that a fixed proforma may make using different formats more complicated. This is why we have chosen not to issue a proforma this year.

We will not issue a submission proforma or template this year for either of the NICs. However, licensees seeking NIC funds will still need to submit a Full Submission including at least one spreadsheet. Licensees will be able to develop their own documents. However, we will issue guidance to licensees on required page margins, font, font sizes, section headings and section lengths as well as other aspects of the submission. We will develop this guidance before the Full Submission stage. This work will aim to correct any errors in the submission spreadsheet and ensure definitions used in the guidance aligns with the Governance Document.

D) Gas NIC specific issues for future consideration

At this time we will not make changes to the governance of the Gas NIC specifically, other than the changes discussed above. We did not make any Gas NIC-specific proposals in our consultation. However, we recognised that there might be some concerns.

Some licensees noted that the requirement for projects to deliver carbon and/or other environmental benefits might act as a barrier to participation in the Gas NIC. We will consider this point further before we carry out a detailed review of the NICs in 2015/16. While we consider this to be an important issue, we note the importance of the carbon and environmental benefits delivered by innovation projects. We also note that these are requirements of the licence not of the Governance Document and were consulted on and implemented as part of the price control process.

E) Other issues

NIC project bank account – Interest rate

A number of respondents commented on the interest rate the Governance Documents presumes Project Bank Accounts will receive. The Governance Documents expect that licensees will receive the Bank of England base rate plus 1.5 percentage points. The Governance Document and the submission spreadsheet subtract the assumed interest from the funding request according to the year in which the funding is to be spent. This is because the interest payments should mitigate the resulting shortfall.

We recognise the concern raised and believe it to be a substantive change to the governance arrangements. We intend to consider this as part of the more substantive two year review of the NICs. As part of this review we will seek additional evidence from licensees, as well as other stakeholders and consider whether it is appropriate to make changes to the Governance Documents.

Who can seek funding under the NIC

One respondent made a number of comments about the NIC. They were concerned that licensees were the gatekeepers to NIA funding and the NIC application process. In October 2011 we published our decision on non-network licensee participation in the NIC.⁷ In our decision we set out our reasons for limiting participation in the NIC to network licensees as they were required to comply with the licence. We also noted that widening the field of those able to participate would require the introduction of a new licence. We are not minded to amend this aspect of the governance arrangements at this time. However, if third parties believe that licensees are not acting within the requirements of the Governance Document we encourage them to contact us.

IRM application window

As part of the consultation we asked gas network licensees and electricity transmission licensees whether they intended to make use of the IRM window. We would again ask licensees to contact us after confirming their intention to make use of the application window. We would also like to draw the attention of interested parties to a consultation we recently published on the possible methodology to be used when calculating the benefits of proposed IRM roll-outs.⁸

Next steps

We will undertake the substantive reviews of the NIC and NIA referred to in the Governance Documents in the next regulatory year. That review will address any substantive policy issues related to the both the NIC and NIA. Some of the questions we asked in our December 2014 consultation may inform the scope and content of that review.

We expect to undertake a learning review of LCN Fund projects early in 2016. This will allow us to make a decision and amend the Electricity NIC Governance Document in time for the 2017 competition.

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,



Andrew Burgess

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⁷ <https://www.ofgem.gov.uk/publications-and-updates/decision-and-further-consultation-design-network-innovation-competition>

⁸ <https://www.ofgem.gov.uk/publications-and-updates/consultation-assessment-benefits-roll-out-proven-innovations-through-innovation-roll-out-mechanism>