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Dear Neil

Consultation on the assessment of benefits from the roll-out of proven innovations through the Innovation Roll-out Mechanism.

Thank you for the opportunity to respond to the above consultation.

It is important to continue with the excellent progress made on stimulating innovation within the industry by considering the transition of proven innovations into business as usual. We hope to see the Innovation Roll-out Mechanism (IRM) enable this.

A reasonable approach to the requirements of the IRM and the points on which Ofgem is consulting is critical to achieving this. Providing access to IRM funds will support the widest uptake of successful solutions, delivering value for money to all customers within GB.

Please find our responses to the specific consultation questions in Appendix 1.

If you have any questions regarding our response, please do not hesitate to contact me or a member of the team.

Yours sincerely

Steve Cox
Head of Engineering
Electricity North West Limited

Appendix 1 Detailed responses to questions raised in consultation

Please find below our responses to the specific questions raised in the consultation.

Question 1: What methodology should licensees, on the basis of robust evidence, use to demonstrate significant carbon and other environmental benefits of each proposed roll-out? Provide as much detail as practicable.

We expect that the business case for the roll-out of Proven Innovation will be similar in detail to the Second Tier LCN Fund or the Network Innovation Competition business cases, in that it would include, at least:

- Net benefits derived from comparing the Base case (for the current business as usual approach) and Method case (for the Proven Innovation), with both defined at the appropriate scale of roll-out;
- Carbon benefits monetised using the values derived in an agreed cost benefit analysis template;
- Value of visual amenity/ social interruption/ any other externality without a direct financial benefit ; and
- Sensitivity of volumes and time – with plausible scenarios modelled to show the sensitivity.

The use of a common methodology for assessing the benefits of different techniques in developing the Well Justified Business Plan (WJBP) proved critical for comparison of licensees' RIIO-ED1 submissions. A similar Cost Benefit Analysis (CBA) approach developed specifically for the Innovation Rollout Mechanism (IRM) evaluation should enable DNOs to provide consistent and robust analysis for proving carbon and other environmental benefits for the roll-out of a Proven Innovation.

A CBA template could contain initial reference values suggested by Ofgem and we see value in applying these consistently to future assessment of IRM applications. This could be supported by continued collaboration by the network licensees through the ENA in the development of an extended NIA benefits guide covering IRM. We expect these documents to provide background assumptions against which to base initial analysis of the Proven Innovation, so that we could present a version of results which conforms to an agreed CBA approach for IRM evaluation.

As the IRM will apply to a Proven Innovation only, it is assumed that the wider business and carbon case has already been evaluated. Therefore, it is also assumed that the robust evidence required is simply to confirm that the Proven Innovation will still deliver carbon and other environmental benefits when rolled out at individual licence operator scale. This could depend upon such factors as volumes, customer demographic, legacy assets, network topography considerations and projected LCT uptake relative to the geographical region.

Question 2: How should licensees demonstrate that projects will deliver long term value for money to consumers? Please provide details to support your answer.

The evaluation criteria developed for the competitive Second tier LCN Fund and Network Innovation Competition governance requires that organisations undertake detailed analysis of how the project delivers net financial benefits for customers and we would recommend this consistent approach to demonstrating long term value for customers of a Proven Innovation roll-out.

LCN Fund governance does not seek to mandate a methodology as, given the breadth of project activities, a single methodology may not be appropriate in all circumstances. It is important that this flexibility is maintained when demonstrating long term value for money to consumers for the IRM funding applications.

As with the response to question 1, demonstrating long term value for money to customers will include the use of a base case and a method case defined at the appropriate scale of

roll-out. Modelling of the sensitivity of volumes and time will show how long term value for money will be achieved by customers under differing scenarios. A Net Present Value (NPV) calculation will help to further demonstrate that the Proven Innovation will deliver financial returns for customers over a time period appropriate to the Proven Innovation and value of investment.

Question 3: How should licensees demonstrate IRM funding is necessary to fund a roll-out? Please provide details to support your answer.

We expect DNOs to disseminate learning on all innovation work; however we note that dissemination is not necessarily sufficient to allow a technology to be adopted at commercial scale. For this reason the IRM is an integral part of the strategy to allow the delivery of smart benefits to customers across all DNOs.

We can envisage two scenarios where IRM funding would be needed.

In order to enable a DNO to adopt a Proven Innovation developed by another DNO there may, in some instances, be a technology hurdle to overcome to allow the adopting DNO to realistically deploy the Innovation. Normally the adopting DNO will wish to utilise the Innovation as it offers lower costs or higher benefits. Whilst the marginal cost to deploy the innovation per intervention will be the same for both DNOs, the adopting DNO has a 'barrier' cost to overcome before it can deploy. This is not faced by the developing DNO which has been funded under innovation allowances to overcome this barrier.

Without IRM, the business case for the adopting DNO may not be sufficiently strong to overcome the barrier cost and hence justify the innovation adoption. This may in some instances become a permanent barrier and hence disadvantage customers. It is essential that the IRM allows funding in these instances.

Secondly, when setting allowances for future periods we expect Ofgem will use tried and tested benchmark intervention costs. These in turn will be based on the lowest intervention costs used by the various DNOs. If a DNO is unable to fund adopting of an Innovation within period due to the barrier cost, then it would be unable to deliver its obligations in the following period. The IRM is therefore critical to allow DNOs to deliver best value for customers within a given price control period and to enable them to attain the efficient cost targets of the next period.

In demonstrating that IRM funding is necessary for roll-out of a Proven Innovation, we believe that DNOs will need to show that additional specific IRM funding is required beyond funds obtained from any incentive mechanism. It is of note that for the connection and operation of Distributed Generation customers, the incentives on DNOs are weak and hence it is more likely that IRM funding will be needed to implement innovation benefits.

As Ofgem is expected to set output targets and cost allowances for future price control periods taking into account expected lowest intervention cost and best performance, which will presumably include the benefits of the approved roll out of Proven Innovation, DNOs should only need to take account of benefits accrued by the DNO in the current price control period. The target setting process naturally sets allowances around the most efficient solution. Hence DNOs would not normally retain any long term innovation benefits beyond the period. If benefits did accrue to DNOs in subsequent periods, the calculation of IRM funding would need to account for these otherwise this would result in DNO benefits being potentially double counted.

We believe that a two stage process is therefore required:

1. Demonstrate the long term benefits to customers of a proposed roll-out using a cost benefit analysis that compares roll out costs against long term benefits (cost savings, carbon reduction, etc) as funded by and accruing to customers.

2. Identify the benefits of the roll out that will accrue to the DNO in the remainder of current price control period, for example based on improved incentive performance or improved performance under the Totex Incentive Mechanism.

Step 1 is used to justify the long term benefits of the roll out of the Proven Innovation. The net of Step 1 and Step 2 is used to (a) demonstrate that IRM funding for the roll out is required and (b) to set the quantum of the funding provided to the DNO.

Further consideration should be given to the parameters used to ascribe benefits for customers, drivers and NPV calculation timeframes specific to individual operators' business models and the value of financing the rollout to their investors against other investment opportunities.

Question 4: How should licensees demonstrate that the proven innovation is not already considered business as usual?

When assessing if a Proven Innovation is considered business as usual we would expect this will include confirmation of the absence of the technique/s from the investment strategy and business plan of the DNO applying for the IRM funding.

Factors such as the barrier cost influencing adoption of a Proven Innovation as business as usual in one licence area will not necessarily be replicated in another. Therefore, evidence of business as usual uptake by one DNO operator should not necessarily preclude IRM funding allocation for another where there are clear value for money, environmental and carbon benefits to be gained for consumers.

It follows therefore that any IRM application should clearly demonstrate the absence or insufficiency of alternative sources of funding, from for example incentives, to enable the roll-out.

An example of this would be C₂C which, through LCN Funding has become a Proven Innovation and one which we have incorporated into our business plan with updated policies and standards to support roll-out. The timing of the dissemination means that other licensees may not have had the opportunity to allow for the overcoming of any technology hurdle in their own business plans and may wish to seek IRM funding to enable them to develop the capability to offer C₂C contracts to their customers.