

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

Centrica Plc
Millstream
Maidenhead Rd
Windsor
Berkshire SL4 5GD
www.centrica.com

By email to networks.innovation@ofgem.gov.uk

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Dear Neil,

Reviewing the benefits of the Low Carbon Networks Fund and the governance of the Network Innovation Competition and the Network Innovation Allowance

Thank you for the opportunity to provide comments on the review of the benefits of the LCNF and the governance of the NIC and NIA. We support Ofgem in reviewing these funding channels.

Overall, we suggest that there appears to be a gap between the trials/projects and real world application. This may be improved if a summary of the trials could be produced with their key messages and learnings and when the innovation is expected to be commercially viable. This in turn would make it easier to undertake a post-trial review of the projects at a later date, to determine which of the trials had resulted in innovation being adopted and how widespread this had been. It may also assist in determining the types of projects that should be funded in the future.

It is important to keep NIA projects efficient (as they have less governance than NIC), but still ensuring that learnings are shared and the potential for similar NIA projects being instructed elsewhere is minimised. We suggest that if an area or concept has been trialled in one area there should either be a challenge or a marked differentiation if an application is made in a similar or related concept before funding is allocated. Areas of innovation should be encouraged and adopted as widely as possible across all DNOs once it has been proven in a trial in one DNO area.

We suggest that the main issues impacting NIC and NIA are Intellectual Property (IP) concerns, namely IP generation, IP sharing and commercial exploitation of IP once the demonstration/innovation projects have completed. There needs to be better support to third parties who play a vital role in innovation projects in building new IP, but who are then unable

to commercialise the IP once the project has completed. Perhaps there needs to be an investment pay-back period, following which the IP can be further commercialised, i.e. if a £2m project generates £5m profit, then a £2m cap should be agreed to ensure the initial investment is paid back ahead of the private sector partners being able to exploit the IP they have developed.

Notwithstanding the above comments on IP issues, where possible there should be more encouragement to share information learned from the projects between licensees, especially between DNOs, but also to enable the UK to develop as a leader in innovation ensuring that technology development can also be exploited overseas.

The answers to the questions contained within the open letter are in the attached annex.

If you have any questions relating to this response, please contact me for clarification.

Yours sincerely,

Sarah Owen

Sarah Owen – Regulatory Manager – Centrica

Landline **01753 431052**
Mobile **07979 566011**
Email **sarah.owen@centrica.com**

Annex 1 – Answers to specific questions raised

Question 1: Should we change the NIC and NIA criteria? If so how and why?

The energy industry is experiencing a period of steep change, it is vital that funds for innovation are able to keep up with this changing industry. We believe that wherever possible, all appropriate associations, groups, etc. should be involved and encouraged to play an active role in determining where funding for appropriate innovation development should be taking place. For example, this should include (but not limited to) Innovate UK, Energy Systems Catapult and the Institute of Engineering and Technology.

The awarding of funds should be on an inclusive basis with at least a TSO, DNO and a supplier participating together in as many projects as possible. Without this inclusion across all industry parties, there is a danger that the full potential of the project will not be maximised. With full inclusion the projects are likely to be developed to benefit the interests of the consumer or the market as a whole rather than being limited to the benefit of one element of the market.

We are concerned that the NIA has been used for projects that are either ineligible or unable to secure funding under the NIC. We suggest that additional scrutiny should be placed on the NIA to ensure funding is only made to appropriate projects.

Question 2: Should we give more of an indication of where we consider innovation is required or is that inappropriate?

The network environment (transmission and distribution) is changing and needs to reflect the evolution of system, markets and policy, as well as the way in which consumers will evolve, in the short and longer term, in their use of energy and their generation and storage capabilities, and potential market involvement.

There are many different players involved in this process including TSO, DNOs, Suppliers, technology innovators etc., all of whom should be involved with developing, testing and implementing innovation. IP is the single largest concern in these projects, and Ofgem should consider how IP restrictions can be resolved to ensure innovation can be implemented more widely both across the UK and overseas. There needs to be better support to third parties who play a vital role in innovation projects in building new IP, but who are then unable to commercialise the IP once the project has completed. Perhaps there needs to be an investment pay-back period, following which the IP can be further commercialised, i.e. if a £2m project generates £5m profit, then a £2m cap should be agreed to ensure the initial investment is paid back ahead of the private sector partners being able to exploit the IP they have developed.

Question 3: Should the focus of the NIC and NIA be broader and cover the broader energy system?

Question 4: Can we improve the process for deciding on which projects to approve and if so how?

Question 5: How can we improve participation in the NIC?

Participating in the NIC could be increased by opening the fund to a broader spectrum of players, particularly suppliers or flexibility operators who could take the lead in the project but also include interested DNOs and TSOs.

As stated above the issue of IP constraining participation should be investigated by Ofgem and changes made to the IP restrictions to improve participation and ensure innovation can be implemented more widely.

The appropriate processes need to be put in place to prevent the NIA being overused as it is seemingly easier to gain funding for projects via the NIA than the NIC (NIA is used as a backstop). Any projects that could apply for NIC funding should be encouraged in that direction. Additionally, the NIC process should be reviewed to ensure there is a balance between bureaucracy and the number of successful project funding applications.

Question 6: Please comment on your experiences if you have worked with licensees when implementing NIC and NIA projects or when transferring innovation into business as usual.

We suggest that more work is required on ensuring that the results from these projects can be shared across the industry. To-date, insufficient information on the results of these projects, has been shared to enable the innovations to be adopted as business as usual. Projects should be fully inclusive with representation from TSOs, DNOs, and customer facing third parties, all information should be shared across the entire market to allow the adaption and adoption of innovation to the broader market.

Care should be taken to ensure that projects are set up with the relevant market players undertaking the usual market activities. There have been some projects where DNOs have adopted a customer facing role (I&C DSR) or as an owner/operator of storage that is in conflict with both current policy and future policy direction. In order for the correct innovation to occur with the correct parties, and for this to be developed and adopted on a larger scale, all relevant industry parties with the appropriate roles should be included in the project from the beginning.

Question 7: Are there any other issues we and the independent evaluator should consider as part of the review?

Question 8: To what extent do you consider that the LCN Fund has succeeded?

From the experience gained by Centrica worked on LCNF projects with DNOs, we make the following observations:

- The LCNF has allowed the DNOs to set up large dedicated innovation teams which we believe have led to a positive change in culture. The flip side of this is that because the projects and FTE are funded by a subsidised 'safety net', the DNOs innovative culture has evolved without commercial focus and unfortunately very little of what has been trialled in the projects has been commercially replicated.
- There are numerous examples of DNOs engaging directly with customers to trial new services such as DSR, flexible generation or storage, we firmly believe that DNOs are best placed to focus on their industry role and should include customer facing businesses to interact with customers. The most efficient use of LCNF funding, is to

involve more innovative customer facing businesses in the private sector that are able to move at a far quicker pace and commercialise the technology/propositions developed by the projects.

Question 9: To what extent do we need to continue incentivising innovation by DNOs?

Rather than DNOs we believe the market as a whole should be incentivised to bring forward project application that they would then have the ability to lead and included interested licensees. The LCNF trials have shown that the technology and expertise exists in the private sector to deliver whatever the DNOs want to trial, what is missing is a long term commercial incentive/indicator to invest.

Ofgem should consider whether funding would be better spent subsidising new technology and propositions to be delivered by innovative third parties and procured by DNOs on a commercial basis.

Question 10: Are there any other issues we need to consider as part of the LCN Fund benefits review?

Centrica's experience of bidding for and delivering on LCNF was that far too much emphasis was placed on academic rigour, governance, rigid deliverables and timescales. This unfortunately led to over bloated project management and projects that were designed to produce presentable results rather than reflect commercial or practical reality and provide real world replicable learning.

We suggest that projects would benefit from being funded and delivered in a leaner and agile way and Ofgem/DNOs should take lessons from how products and projects are developed by the fast moving tech-start-up world. Innovation projects by their nature are inherently unpredictable and need a more flexible framework in order to maximise the learnings and develop innovative solutions.

As stated above, the IP rules are complex to interpret by DNOs and 3rd party partners, this lack of understanding often make contracting with 3rd parties extremely challenging and bureaucratic. As a result, new IP generation could be severely limited on some projects.