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Dear Mark,

Re: Ofgem Simplification Plan 2016-17

On behalf of Electricity North West Limited, I would like to thank you for the opportunity to respond to the above open letter. Our comments below focus on your request for thoughts on how Ofgem can support innovation and the safe testing of new products and services in the energy market.

This response should be read in conjunction with our recent response to your colleague, Neil Copeland, with regard to the Low Carbon Networks Fund, Network Innovation Competition and Network Innovation Allowance. A copy of which is included in my covering email for your assistance.

The innovation support mechanisms put in place by Ofgem have delivered and are continuing to deliver significant benefits to our customers. These savings would not be available without innovation support for a couple of reasons:

- DNOs are seen as low risk for investors who have not shown willing to fund speculative innovation especially with the high sharing factor returned to customers. Prior to the NIA and proceeding IFI allowances, any innovation in energy networks was limited to low risk – almost certain reward technologies and hence benefits to customers were small in scale and slow to be developed.
- The challenge of decarbonisation in the energy sector is the largest technology challenge faced by the UK. To meet this at an affordable cost in timescales compatible with government policy objectives requires direct innovation funding such as NIA and NIC. The governance around these modes is in our view fundamentally sound and provides opportunity for researching higher risk but potentially high benefit technologies such as CLASS¹. These projects have the potential to transform the energy sector and deliver multi million pound savings for customers.

However, one of the key challenges with NIC funding is that benefit should flow to electricity customers. This makes research into new techniques to save energy or promote low carbon generation technologies where initially the benefits flow to the supply chain more problematic to pursue. Whilst some work in this area has been done we would consider it appropriate to revisit this particular aspect of funding governance; as all energy sector costs can ultimately flow to customers in a properly structured market. To obtain the full benefits for customers the integration aspects of relative funding should also be considered; for example Energy

¹ www.enwl.co.uk/class.

Systems Catapult funding could be combined with NIC projects to allow larger and more ambitious projects to be considered.

It should also be noted that the IPR rules around innovation funding can and have acted as a barrier to obtaining more independent funding for innovation. Whilst NIC and its predecessors such as Tier 2 LCN Fund have allowed considerable contributions from manufacturers into research projects, these would have been larger and hence benefits to customers larger had there been a more flexible IPR regime. It is important that customers obtain appropriate benefits for their funding contribution and we would see that governance revisions to allow bodies such as the NIC Expert Panel latitude to agree those IPR arrangements most appropriate to specific projects as being of significant benefit.

We also suggest that there may be merit in Ofgem reviewing its enforcement guidelines in relation to the implications for energy companies considering innovative approaches. Innovation is, by its very nature, risky and there needs to be some recognition of this under the enforcement guidelines. We support the Government's proposals that "*regulators should follow the principle that enforcement action is a last resort and regulators should help first*"² and suggest that more could be done to support companies seeking to be more innovative in the discharge of their obligations to the benefit of customers.

Finally, it is essential that companies who successfully implement new technology get the rewards relative to the amount of risk that they bear. We have been discussing this principle with Ian Rowson with particular regard to our CLASS project but believe Ofgem should include this as a general principle of its Innovation Strategy.

I hope this response is of assistance. If you wish to discuss any of the points raised, please feel free to contact me (details provided above).

Yours sincerely

Jen Carter
Regulation Manager

² HM Treasury, 'A better deal: boosting competition to bring down bills for families and firms', November 2015, para 4.3