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Dear Neil,

This response follows the previous Citizens Advice response to Ofgem's provisional proposals. As we indicated in that response, we do not have a firm view on whether the innovation allowance and competition is working adequately. Nevertheless, there are contradictory messages and policies in the proposals, which risk missing an opportunity to improve network's innovation culture.

We agree with the observation that network companies are insufficiently focused on innovation, to the long-term detriment of consumers. Innovative activity which could cut costs in the long-run is avoided, and consumers pick up the tab. It is therefore disappointing that Ofgem has struggled to distribute even the relatively limited pots of money through the LCNF and early stages of the NIC and NIA. It is unclear whether the net effect of the measures proposed here will serve to increase uptake of innovative activity, even as they should cut the immediate consumer costs of supporting the NIC.

Within Ofgem's proposals, it is hard to tell what its guiding view of networks' attitude to innovation is. The evidence from trials so far seems to indicate that networks view innovation - at least of the type sponsored by the LCNF and NIA - as a burden. Even when networks can pass on the majority of the costs of trial activity on to consumers, and can apply to recover their deposit on 10% they put at stake initially, networks have not shown as much appetite to run innovation trials as the various programme budgets allowed for. Yet at the same time, Ofgem notes in its assessment of the programmes' value that public value through innovation and spillover, and value to the networks in terms of their ability to outperform their initial price control settlements, vastly outweigh the cost of the trials. This leads to the seeming paradox at the heart of the innovation incentives - networks appear to face little risk in participating and could reap major rewards but despite this they choose not to bring forward trials.

In our view, this calls into question more fundamental matters of the design of the incentive than these proposals touch on. Lowering the annual funding limit for the NIC seems a sensible response to years of under-subscription. Transferring the burden of risk from consumers to networks by abolishing the successful delivery reward and removing the bid preparation costs allowance will lead to a short-term gain for consumers, but also puts a further hurdle (it is unclear how high) in the way of network participation. If networks have been reluctant to innovate under programme structures which make it essentially risk-free, it is hard to believe that they will be more active when it is no longer risk-free (i.e. when the 10% deposit cannot be recovered).

The proposals simultaneously seem reasonable - but also seem unlikely to work - because they build on a baseline that doesn't seem to be working. It seems more urgent and more consequential for Ofgem to delve further into the question of whether an incentive effect for network innovation really exists at all, before worrying too much about the exact percentage of networks contribution to the trials. As the consultation document identifies, there is in any event little hard evidence to go on to assess the extent of networks' changing behaviour in response to marginal changes in their incentives.

Against this backdrop, the proposals to allow increased involvement of third parties could be a way to deepen the pool of projects. However, given the need for networks to authorise, work in detail on, and shoulder a large share of the cost and regulatory burden of third party projects, it remains to be seen how much wider the net is actually cast. Third party projects will move if networks acquiesce to them, but will not be able to be used as a lever to move networks in a direction they are unwilling to go.

Stemming from Poyry's evaluation of the previous innovation programmes, it is not merely a question of numbers of projects being initiated. The type of project being authorised matters too. Poyry's assessment found 37% of initiatives lead to currently viable applications, with 41% ready should the energy sector move in a particular direction, and 22% where the future applicability is less clear. While that does not indicate a failure - learning that something doesn't work can be as instructive as learning that something else does - it would be good to see some emphasis placed on how soon it can be adopted into standard business practice. There would be less value to the trials were they so futuristic that they end up stuck on the shelf afterwards because no one knows what to do with their findings.

It is also unclear, among that 41%, how mutually compatible or exclusive the conditions are in which the findings might become relevant. As an illustrative example, if you had a trial that gave findings that were applicable to a world with majority vehicle electrification, and another with findings relevant in a world where hydrogen is used for the bulk of transport fuel, those findings would be mutually exclusive. Are the supported trials giving results that are relevant in a small number of common possible futures, or are they spread over a wide range of different things that could happen? Is any work put in at the pre-trial stage, to assess what future conditions are more likely to make a project relevant, and is there any attempt to weigh the likelihood of different scenarios occurring against each other?

Yours sincerely,

Simon Moore

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