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Dear Neil,

National Grid Gas Distribution Ltd response to the Ofgem network innovation review and associated legal drafting

National Grid Gas Distribution Ltd (NGGDL) owns and operates four of the UK's gas distribution networks, transporting gas safely and reliably to eleven million businesses, schools and homes. We welcome the opportunity to respond to your consultation dated 1 December 2016 on the changes Ofgem are proposing to the Network Innovation Allowance (NIA) and Network Innovation Competition (NIC). In addition, this letter also responds to your consultation dated 21 December 2016 on the proposed legal drafting associated with the review.

The proposals set out in the consultation are primarily based upon the experiences of electricity distribution and transmission, along with the findings of the independent review of the Low Carbon Networks Fund (LCNF). NGGDL believes that the proposals and recommendations would be stronger if they were derived from a balanced view of gas and electricity innovation, taking into account the effectiveness of the innovation schemes for both to date.

We would also recommend that Ofgem review the overall proposals in the round as it is our conclusion that overall the changes, if implemented as proposed, are arguably contrary to Better Regulation Principles of Accountability, Proportionality and Targeting and will put additional overhead and cost into the process rather than delivering the stated aim of removing it.

NGGDL are in support of high level separate gas and electricity industry strategies with a view to moving to a combined industry strategy when there is clearer Government direction and policy on the future of energy. Furthermore, NGGDL believes that consideration should be given to increasing the amount of funding available for gas innovation. It has been demonstrated that gas has the potential to form a central role in the decarbonisation of both heat and transport, and the level of innovation funding available to gas projects is not equitable when compared with electricity, and must be proportionate to the scale of the challenge.

NGGDL also recommend that a mechanism is made available through the innovation process that allows projects to come back for further sanction where external factors have had a significant impact on the project outside of the networks control.

NGGDL believes that existing arrangements are working well to support collaboration between Distribution Networks, third parties and subject matter experts (SMEs) and support ways to improve this further, including an annual call for innovation from third parties. This would need to be in alignment with the respective industry strategies. However, at this stage we do not believe that providing direct access for third parties to the NIC would provide additional value to customers. Third parties would need to accept a form of regulatory governance and would need to be administered by an independent body creating further overheads. Further work is required to determine whether this is feasible.

Removing the successful delivery reward and making the 10% contribution to the project non-refundable would not lead to an increase in value for money for customers. Companies may potentially focus on innovation that benefits their direct business, drives direct cost efficiencies and there is a risk that third parties would not be in a position to fund the required NIC project costs.

Having considered the associated legal drafting, the documents on which comments are invited are electricity governance documents. Although they are similar to the gas governance documents they are not identical and certain electricity governance provisions and definitions are irrelevant. In addition, the proposed changes may not be implemented, depending on the outcome of the consultation. On this basis, although we appreciate the early opportunity to provide input on the consultation dated 21 December 2016, we do not consider it appropriate to provide comments at this stage. However, we would welcome the opportunity to comment on revised, gas network documents, following the consultation.

Further to the general comments above, NGGDL has provided detailed responses to the specific consultation questions in the annex attached to this letter.

NGGDL look forward to the opportunity for further involvement in developing network innovation. In the meantime, we would welcome the opportunity to discuss and expand on any of the points made within this response in more detail. If you require any further information please do not hesitate to contact me.

Yours sincerely,

By Email,

Huw Sullivan
Innovation Delivery Manager

Annex to National Grid Gas Distribution Ltd response to the Ofgem network innovation review and associated legal drafting

Proposals for delivering greater value for money

Question 1: What are your views on our proposals to introduce a requirement for the network companies to jointly develop an industry-wide innovation strategy?

- **If you agree, should companies retain their own strategies, and in addition should there be a single system strategy, or one for gas and another for electricity?**
- **How often should the strategy be updated?**

NGGDL agree in principle to the aim, however would not support the development of a combined industry-wide innovation strategy at this stage. At present there is no clear agreed future energy policy (rather a mix of potential scenarios) and the development of an overall strategy poses the risk of being so high level that it has little value or creates divergence between industry sectors. NGGDL would support high level separate strategies for electricity and gas, focusing on the common problem areas and challenges for the future, for example including but not limited to the role the gas network will play in providing a solution to decarbonise heat and transport out to 2050 and beyond.

The larger scale problem statements typically align well to NIC projects. Once these mature we could see a combined industry strategy developing, when there is more certainty and direction from the Government regarding the future of energy, with funding for gas in line with the scope and opportunity of benefits which is, as a minimum, the same as electricity. If this approach is not taken, innovation may be incentivised towards electricity which could drive a more expensive outcome for the customer. In the short term we need to ensure that the industry takes a “no regrets / keep all options open” approach, which we believe is best served through independent gas and electric strategies.

Such a model provides flexibility should we see a major change to strategy, through the implementation of Government Policy by BEIS or the DfT for example. Consideration also needs to be given to strategies or changes to strategies coming from other bodies, such as the Committee on Climate Change, Policy Exchange, Carbon Connect, the Energy Research Partnership etc.

At a more granular level it is unlikely that all company innovation strategies will be in complete alignment due to different business priorities, geographical or regional challenges and requirements, and therefore we recommend that detailed separate company strategies are retained. NGGDL believes that this should be the major focus for most NIA projects. However it should be noted that we are already sharing our strategies and problem statements at this more granular level through the Gas Industry Governance Group (GIGG).

NGGDL believes that any gas industry-wide innovation strategy should be reviewed on a regular basis and propose a review every four years as a minimum.

Question 2: What are your views on our proposals to help facilitate increased involvement of third parties in the NIC via the network companies?

Since the beginning of the RIIO-GD1 price control, gas distribution network companies (GDNs) have been successful in developing innovative projects under both the NIC and NIA involving third parties. NGGDL has secured funding for four NIC projects. The most recent of these, HyDeploy, was a collaborative bid with NGN and four third parties acting as project partners and both our BioSNG projects are collaborative projects involving specialist SMEs. NGGDL therefore believes that in principle the existing arrangements work for the gas industry with regards to involvement of third parties. However, we acknowledge that there is room for continual improvement.

NGGDL would welcome a call for innovation support from third parties on an annual basis with regards to NIC projects only. This could be collaborative dependent on project types and would need to be in alignment with the gas industry strategy. Setting the right criteria for any third party involvement is essential and it is imperative that third parties do not see this primarily as a profit opportunity and hence drive unnecessary costs for the GDNs in responding. Undertaking a NIC project for both a Distribution Network and a third party is a significant commitment and a relationship will need to be built between them beforehand to undertake the project. Project calls through this route must therefore align with the overall gas innovation strategy, targeting business, industry and customer needs rather than be an entirely 'open call' for support.

For more detailed projects, processes and calls relating to NIA projects already exist through partner organisations, including the Energy Innovation Centre (EIC). Therefore, any new process should look to enhance not duplicate existing arrangements. For example NGGDL has previously issued a voluntary call for innovation through the EIC to third parties. We also publish an annual NIA Summary Report to raise awareness and understanding of our network challenges to third parties and SMEs. We have good engagement from partners and are open to proposals from third parties for innovation projects that are relevant to the challenges we face.

NGGDL supports the principle of raising the number of NIC bids to four; however consideration needs to be given to the discussion that took place at your innovation workshop on 11 January regarding two of these being from third parties. Given the related proposal to reduce the bid preparation costs and remove the 10% recovery criteria, it was highlighted that third parties may not see themselves picking up these costs. We would encourage Ofgem to consider the associated responses from third parties on this matter to see whether the hypothesis posed in the 11 January meeting is valid.

It should also be noted that for those third parties who are not normally subject to a regulatory regime, there is a risk that they may not want their approaches and responses to any bids to be made public for commercial reasons. Clearly this would need to be addressed in any governance documents.

Question 3: What are your views on providing direct access for third parties to the NIC?

NGGDL is of the opinion that providing direct access for third parties to the NIC would not improve the overall level of customer benefit delivered by the NIC. NGGDL believes that the compulsory contribution of 10% of the total project cost from the Funding Licensee (lead network) is an effective way to ensure that projects are aligned to relevant industry areas of innovation.

Any such scheme would need to be administered by an independent body to avoid any conflict of interest. As stated in the consultation, third parties would need to be willing to accept a form of innovation licence and the innovation would need to be embedded into the network companies' practices in order for the innovation to deliver actual benefits. Further work is needed to determine whether this is possible and practical.

An alternative approach may be to use the Ofgem Innovation Link website as a further mechanism for third parties to engage with networks on relevant innovation projects alongside the new proposed annual call aligned to strategic needs.

Question 4: What are your views on our proposals to remove the Successful Delivery Reward and the provision to recover Bid Preparation Costs?

NGGDL believes that removing the successful delivery reward (SDR) and making the 10% contribution to project costs non-refundable would not lead to an increase in the value for money that consumers get from the NIC. This may result in Network companies pursuing innovation projects that provide benefits back to their direct business rather than the development of the wider related network industry; or innovation projects that provide certainty, thus defeating the point of innovation.

For example, NGGDL's Future Billing Methodology project seeks to address commercial billing issues which currently restrict access to the gas grid for alternative gases, including lower-carbon gases, such as biomethane, BioSNG and hydrogen blend, the use of which could provide an economical pathway to de-carbonising heat. As a GDN, we are neutral to any direct short-term benefits, but we do see significant wider economic value in a sustained role for gas grids into a low-carbon energy future. Without the incentive of recoverable costs, revenue-restricted entities such as GDNs would be less likely to undertake such projects that could bring wider industry benefits, but instead focus only on narrower innovation that would drive direct cost efficiencies.

NGGDL are of the opinion that the removal of the bid preparation costs to bring network innovation in line with other funding mechanisms is a risky proposal because it is very likely that third parties cannot fund the degree of preparation required associated with an NIC bid. NGGDL might support such an approach if the application process were to be stripped back to mirror the requirements of regimes such as the Transport for London process or the Innovate UK approach.

Proposal for future funding level of the electricity NIC

Question 1: What are your views on the rationale for reducing the level of electricity funding pot?
Question 2: What are your views on the proposed funding level of the electricity NIC?

From the information provided in the consultation it is not clear as to whether, as part of the review and the LCNF evaluation, consideration has been given to the future landscape of the energy industry and the potential scale/number of innovation projects needed for the industry to innovate and meet the 2050 carbon reduction targets and beyond. The present levels of under subscription could fall as further innovation is required and Government Policy develops.

NGGDL are keen to understand how and what this reduction would mean for the gas NIC funding levels. There is a case to consider an overall increase to the Gas element of NIC as we believe that the £18m was set at a period when there was limited evidence that the future of gas was a ‘likely’ scenario. However recent industry reports have highlighted the case for gas in the decarbonisation of heat as the least cost pathway and therefore this needs to be considered as a driver for further and increased innovation in this area, especially relating to, for example, Hydrogen.

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Other proposals for governance arrangements

Question 1: Do you agree with our proposals to clarify the circumstances we do and do not expect change requests are submitted to us?

- **If you agree, do you think our proposed draft explanation of material changes is clear?**
- **If you think alternative drafting would achieve this more effectively please provide this drafting.**

NGGDL have no comment in relation to existing projects.

With regards to future innovation projects, NGGDL make the assumption that further guidance will be provided as part of the amended NIC document.

We recognise and support the requirement to provide assurance around project delivery. It is our belief that this can be delivered through the Ofgem proposal of greater clarity on project outputs along with an audit. However we would suggest that the internal audit function within distribution companies is best placed and is the most cost efficient way for this activity to be delivered. There are already precedents in this area, for example, the Data Assurance Guidelines.

We would recommend that Ofgem consider a mechanism in the overall change control framework for projects to come back for further sanction where significant external factors outside of the control of the project have occurred. NGGDL would highlight the example of the BioSNG project where Brexit and exchange rate factors raised costs significantly and which could not be, nor reasonably have been, forecast within the context of a bid. Hence it would seem appropriate to consider having a mechanism to raise this within the process. However clearly this would be for extenuating circumstances only.

Question 2: Do you have any feedback on our proposal to publish a plain English guide to our default intellectual property (IP) requirements?

We support this approach.

Question 3: Do you have any views on our proposals to improve the visibility of the NIA projects? What are your suggestions for a proportionate way to get assurance that the NIA is being used by network companies in an appropriate way?

NGGDL support the need to share information. It is our view that mechanisms already exist to share the associated outputs from the NIA and NIC projects through the ENA portal and that the gas network companies work well through GIGG. However we recognise there is room to maximize the benefit from existing arrangements. Our recommendation would therefore be to evolve the working practices within this area.

We support the requirement for additional assurance around NIA eligibility on the assumption that it is a simple requirement to elaborate 'why' through a text box description or something similar.

Question 4: Do you have any comments on any of our other proposals?

Although it has not yet been used by network companies, NGGDL does not support the principle of removal of the contingency funding mechanism. With innovation, there is a risk that events can occur that are out of the control of a network company and therefore we deem it appropriate to have such a mechanism in place with appropriate amount of additional funding available. This happened to NGGDL with Brexit impacting the BioSNG plant funding, which could not have been reasonably forecast. Hence it would seem proper to have a mechanism for contingency funding but under strict governance.

NGGDL believes that there would have been value in widening the scope of this review to incorporate the eligibility criteria for the IRM, in particular the thresholds required. The current thresholds are set at a level that the majority of innovation projects cannot access.

NGGDL would ask Ofgem to consider asking third parties and those outside of Distribution Networks the real value the annual LNCI conference provides due to the cost and associated expenditure. Our view is that it is mostly Distribution Networks and suppliers talking to one another which we already do. By moving it to every two years or pairing it with another regular industry event, such as Utility Week Live, it would help reduce costs and may actually create more value in wider collaboration and sharing. However we stress this is a Distribution Network opinion and this event is run for the wider industry and so we would ask Ofgem to consider other's views.

Finally and looking ahead towards the end of the current price control period, it is important to establish guidelines setting out how funding will continue for those projects that span both the current and the future price control. NGGDL believes that without such guidelines in place, innovation projects may decline and stop by 2019/20.