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The network innovation review: our policy decision

Final decision

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Overview:

The Network Innovation Allowance (NIA) and Network Innovation Competition (NIC) operate in the gas and electricity network price controls to fund research and trial projects for transitioning to a low carbon economy which benefits consumers. Based on an independent evaluation of the Low Carbon Network Fund, and also a post implementation review, we consulted in December 2016 on some proposed changes to the schemes to make these even more effective and increase the benefits for consumers.

Having considered stakeholders' responses, we've now reached a decision. We've decided to adopt most of the changes proposed in our December 2016 consultation. We will: reduce the level of funding for the electricity NIC from £90 million to £70 million; put new obligations on the networks companies subject to the RIIO (Revenue = Incentives + Innovation + Outputs) framework to issue an annual call for ideas from third parties and to jointly develop innovation strategies for the gas and electricity sectors; remove provisions to claim rewards for successful delivery and bid preparation costs; as well as some other changes to reduce the administrative burden of the innovation schemes.

To implement our policy decisions, we will shortly issue a consultation on proposed changes to the RIIO network companies' licences and to the NIA and NIC scheme governance documents.

Context

Ofgem[1] is the Office of Gas and Electricity Markets which regulates the electricity and gas industries in Great Britain. Our principal duty is to protect the interests of existing and future gas and electricity consumers.

One way in which we protect the interests of consumers is by regulating the network companies through price controls. We set price controls to specify the services and level of performance the network companies must provide, and to restrict the amount of money the network companies can recover from consumers through network charges.

The energy system is undergoing rapid and significant change. As a consequence, network-related costs could increase significantly from connecting large volumes of generation, as well as managing the impacts of new sources of gas. We think it is in consumers' interests that the network companies respond creatively to the challenges posed by these changes. New approaches could deliver more efficient and timely services needed by network customers and lessen the cost impact on consumers. This might be achieved, for example, by developing and adopting new technology, different operational practices and novel commercial arrangements.

Historically, monopoly network companies haven't faced strong incentives to focus on innovation. To help encourage the companies to play a full role in exploring opportunities we put innovation at the forefront of the price control RIIO (Revenue = Incentives + Innovation + Outputs) framework. This framework was introduced for gas distribution companies (RIIO-GD1) and electricity and transmission companies (RIIO-T1) in 2013 and for electricity distribution companies (RIIO-ED1) in 2015.

In RIIO there is a time-limited innovation stimulus package to encourage the network companies to adopt a more innovative culture. Two key mechanisms of the package are the Network Innovation Allowance (NIA) and the Network Innovation Competition (NIC). Together the schemes fund the companies to conduct research and run network-related trial projects for transitioning to a low carbon economy, where these offer cost savings and/or wider environmental benefits for customers. The funding provided to companies under the schemes is paid for by consumers through their bills.

We committed to reviewing the governance arrangements of these schemes after they had been in place for two years. Separately as part of our decision on strategy for the RIIO-ED1 price control we set the level of funding under the electricity NIC for the first two years of the RIIO-ED1 period. We said we would decide the level of funding we would make available for the remainder of RIIO-ED1 after reviewing the benefits of the Low Carbon Networks (LCN) Fund.

[1] The terms 'Ofgem', 'the Authority', 'we', 'us' and 'our' are used interchangeably in this document.

Associated documents

Handbook for implementing the RIIO Model:
https://www.ofgem.gov.uk/publications-and-updates/handbook-implementing-riio-model

Decision on strategy for the RIIO-ED1 price control:
https://www.ofgem.gov.uk/publications-and-updates/strategy-decision-riio-ed1-overview

Reviewing the benefits of the Low Carbon Networks Fund and the governance of the Network Innovation Competition and the Network Innovation Allowance, December 2015 consultation:
https://www.ofgem.gov.uk/sites/default/files/docs/151217_-_two_year_review_open_letter_au.pdf

Network Innovation Competition Governance Documents:
https://www.ofgem.gov.uk/publications-and-updates/version-2-1-network-innovation-competition-governance-documents

Network Innovation Allowance Governance Documents:
https://www.ofgem.gov.uk/publications-and-updates/version-two-network-innovation-allowance-nia-governance-documents

EA Summary of Learning: https://www.ofgem.gov.uk/publications-and-updates/ea-technology-s-summary-low-carbon-network-fund-learning

Poyry and Ricardo Energy evaluation report:
https://www.ofgem.gov.uk/system/files/docs/2016/11/evaluation_of_the_lcnf_0.pdf

The network innovation review: our consultation proposals:
https://www.ofgem.gov.uk/publications-and-updates/network-innovation-review-our-consultation-proposals

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Executive Summary

At a time when there is significant change in the energy system, the companies need to be innovative to adapt networks to meet future challenges. They also need to get the most out of their existing capacity. Innovation is critical for transitioning to a low carbon economy at lowest cost to consumers.

We think there is reasonable evidence that network innovation incentives are providing value for money and helping to create a more innovative culture in network companies. In 2016 we commissioned an independent evaluation of the Low Carbon Network Fund (LCNF). It estimates net benefits of between £800 million and £1.2 billion from the scheme when projects are rolled out by the trialling companies. It also estimates the potential net benefits could be up to a six-fold increase when a GB-wide rollout is factored in.

Nonetheless, we think there are opportunities to further increase the value for money for consumers from the RIIO network innovation schemes – the Network Innovation Competition (NIC) and the Network Innovation Allowance (NIA). In December 2016 we consulted on our proposals.[2] This decision document explains how we have considered and taken account of consultation responses, the basis for our decision, and how stakeholders' responses have helped refine the detail of our proposals set out in the December consultation.

We have decided to adopt most of the proposals which were set out in our December consultation and summarised as follows:

- The RIIO regulated network companies will be required to jointly develop an innovation strategy, working with other relevant parties. We are introducing this requirement so that there is a clear overview of why companies are undertaking innovation projects and so that interested parties can understand how the projects relate to one another. In response to stakeholders' views, the relevant companies will develop separate strategies for the electricity and gas sectors.

- The RIIO network companies will be required to issue a call for ideas from third parties each year. The RIIO network companies can do this unilaterally or collectively. Guided by stakeholder responses, we will not require the companies to respond publicly on third parties' ideas but instead require them to do so on a bilateral basis. We will also increase the number of bids each company can submit from two to four to accommodate bids that are based on a partnership with a third party.

- The level of funding available in the electricity NIC will be £70m per annum, reduced from £90m. We consider that this will increase levels of competition amongst participants as well as improving the standard of submissions.

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2 https://www.ofgem.gov.uk/publications-and-updates/network-innovation-review-our-consultation-proposals

- We are removing the successful delivery reward from the NIC. This means that companies will make a compulsory 10% contribution to the cost of projects. According to the independent evaluation, network companies receive 40% of the benefits of innovation projects, therefore, we believe they should contribute to the final cost of projects. In addition, licensees are required to manage projects effectively and efficiently, they should not need incentives to do so.

- Network companies will no longer be able to recover NIC bid preparation costs. As above, network companies stand to benefit from the learning derived from innovation projects. Therefore, we believe it is fair that they bear the costs of preparing submissions.

- Several other administrative changes to improve the efficient operation of the NIC and NIA schemes.

NIC and NIA funded projects should be network focussed

We have recently become aware of a number of NIA projects which either: do not focus on the network (instead they focus on gas production or electricity generation); or, we believe should be undertaken as business as usual because of licence obligations, eg keeping industry codes/standards up to date. We will contact the companies that have registered the NIA projects we have concerns with.

We think it is important that for projects to be eligible they must be networks focussed and have learning for network companies at their core, and/or that they also must not cover licence obligations which should be discharged effectively without the need for innovation funding.

We will also work with the Expert Panel to ensure that the projects that are funded through the NIC should have a networks focus.

Next steps

We will implement our proposals this year. We will shortly circulate to the network companies for comment draft changes to the NIC and NIA governance documents and relevant licence conditions. After considering responses, we will publish a consultation on proposed changes to the relevant licences, and governance documents so that these are in place in time for the Full Submission stage of this year's NIC process.

We will work with network companies to plan for developing the first set of industry innovation strategies. Separately, we will establish a working group in the summer to develop reporting requirements on the rollout of innovation into business as usual.

1. Introduction

Chapter Summary

This chapter provides some background information on the specific innovation funding mechanisms within the RIIO model, and the December consultation on our proposed changes.

Introduction

1.1. The energy system is undergoing rapid and significant change. Electricity is increasingly generated by small intermittent generators connected to the distribution network and 'intermittent' generators are also connecting to the transmission network. 'Renewable' sources of gas are being injected into the gas network. To adapt the network for these changes, network-related costs could increase significantly from the current level.

1.2. We think it is in consumers' interests that the network companies respond creatively to the challenges posed by these changes. New approaches could deliver more efficient and timely services needed by network customers and lessen the cost impact on consumers. This might be achieved, for example, by developing and adopting new technology, different operational practices and novel commercial arrangements.

1.3. Monopoly network companies generally undertake less innovation than is optimal. There are a number of reasons for this lack of innovation, most notably because savings resulting from innovations are shared with consumers and lead to lower cost allowances, for network companies, in future price controls.

1.4. Encouraging the network companies to innovate in providing network services and outputs is a key element of the RIIO model. Several features of the price control framework are intended to bring about more innovation by network companies. These include:

- The 'totex' approach which equalises the incentives between capital and operational expenditure meaning that there are not undue incentives towards investing in capital expenditure.
- An output-based approach which gives the network companies greater flexibility during the price control to identify suitable and cost effective solutions.

1.5. In addition to the generic features of the price control framework we also introduced specific innovation funding mechanisms. These are intended to act as an initial catalyst to bring about culture change within the businesses that run the gas and electricity networks in Great Britain (GB). Eventually we expected the features in the price control framework to incentivise innovation by the licensees. The table below summarises the Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) schemes.

	NIC	**NIA**
Purpose of scheme	To fund large flagship development and demonstration projects	To fund smaller research, development and demonstration projects.
How funding is awarded	Companies submit bids and compete for project funding.	Allowance set at the start of the price control based on the quality of the company's own innovation strategy
Funding available each year	£90 million for electricity networks (2015 to 2016) £20 million for gas networks	£61 million

Scope of the December consultation

1.6. In 2016 we commissioned an independent evaluation of the Low Carbon Network Fund (LCNF) – a predecessor to the RIIO innovation schemes that operated in the previous electricity distribution price control – to review the benefits to consumers from the scheme. We also undertook a post implementation review of the NIC and NIA to consider if there was scope for improving their operation.

1.7. In December 2016 we consulted stakeholders on some proposed changes to the NIA and NIC in order to make these even more effective and increase the benefits for consumers. A summary of the consultation responses is given in Appendix 1.

1.8. The scope of the December consultation included:

- a summary of the findings from the independent evaluation of the LCNF on whether consumers are getting value for money from the LCNF
- a proposal on the funding level of the electricity NIC for the remainder of the RIIO ED1 price control (2017 to 2023)
- new requirements on the RIIO network companies to jointly develop an industry innovation strategy and to issue an annual call for ideas from third parties

- proposals to remove the Successful Delivery Reward and also remove the provision for companies to recover bid preparation costs from consumers, and
- proposed changes to the governance of the NIC and NIA across all of the RIIO price controls to operate the schemes more effectively.

1.9. The rest of this document summarises stakeholders' responses to the December consultation, how we have taken theseinto account and refined the detail of the December consultation proposals, and sets out our final decision.

Types of project undertaken through the NIC and NIA

1.10. We have concerns regarding some of the projects that have been undertaken through the NIC and proposed for the NIC. While we have proposed changes to address these conditions we wanted to clearly set out our expectations for future NIC and NIA projects within this document.

1.11. Projects that have a wider focus than networks must still have direct benefits and learning for the network aspects of the energy system. For example, a project that facilitates generation of electricity or production of gas could be justified through learning related to its connection and the impact of the new supply source being added to the network. However, any consequential learning from the project around the production of a new supply source, while beneficial, should be regarded as of secondary importance when justifying the project for the purpose of NIC funding. Companies proposing such projects would need to justify why the portion of the project on the generation/production side should be funded by consumers through network charges as the learnings from these elements would not directly flow to network companies.

1.12. We would also caution network licensees against solely justifying the financial benefits of a project on the grounds that it helps to preserve the long term use of the network. Our innovation mechanisms are intended to deliver network benefits, including lower network costs or environmental benefits. We don't view preserving the use of the network as a network benefit in itself. Moreover, preserving the use of the network is something that we would expect companies to have a strong incentive to pursue without the need for innovation funding from consumers.

1.13. We also have concerns regarding the use of innovation funding to update and review codes and standards. While ensuring that codes and standard are kept up to date is essential to help facilitate change across the energy system, in general we see this as a business as usual activity. We would expect companies to propose appropriate changes to codes and standards taking into account the latest technical, commercial and operational developments and the needs of network users to employ new techniques where it is economic and efficient to do so. We see this as one of the core functions of the network companies. In general, we wouldn't expect projects examining these matters to use innovation funding unless there is a strong reason to do so that goes beyond what is expected by their regulatory wider obligations.

1.14. We will assess future NIC projects with this in mind, but do not intend to re-examine any NIC projects that have already been approved. Where we have specific concerns on NIA projects we will be getting in touch with the relevant network companies.

2. Delivering greater value for money

Chapter Summary

This chapter explains our policy decisions on proposals to deliver greater value for money to customers for the innovation projects that are funded under the NIC and NIA. These include: requiring companies to develop an industry innovation strategy; increasing third party involvement in the NIC; and removing the successful delivery reward and provision to recover the cost of preparing NIC submissions.

Industry to develop an industry innovation strategy

Introduction

2.1. The independent evaluation of the LCNF noted that "*there does not appear to be any overarching plan to ensure the direction of future innovation funding aligns with, and supports, the overall GB energy strategy*."

2.2. To increase the strategic alignment of innovation projects, as well as promote transparency, collaboration, dissemination of learning, and stakeholder engagement, we proposed in the December consultation that the RIIO network companies should jointly develop an industry innovation strategy. We also proposed that this should be updated every two years.

2.3. As part of the December consultation we also asked for stakeholders' views on:

- whether there should be a single strategy for the energy system or separate strategies for gas and electricity, and
- whether network companies should continue to maintain their own innovation strategies.

Consultation responses

2.4. The majority of respondents were in favour of an industry wide innovation strategy. A solutions provider thought that a high level strategy would give a long-term view and allow stakeholders to plan ahead. Another stakeholder suggested that it would help highlight key uncertainties for both sectors and develop a framework for collaborative R&D to respond to these. Others thought that the development of a strategy would ensure that due consideration is given to international experience, foster greater collaboration, and encourage engagement with others, eg academics and other innovation bodies, which would help achieve better value for money from network innovation in the UK.

2.5. While most stakeholders agreed upon the merit of an industry-wide innovation strategy, particularly for the strategic alignment of projects and promoting engagement with a wide range of stakeholders, several stakeholders highlighted an important caveat. A supplier, a solutions provider and trade body all said that an industry wide strategy shouldn't override individual network strategies, which are needed to respond to local issues.

2.6. Some stakeholders also suggested ideas for developing an industry wide strategy. Most thought that the industry strategy should build on companies' individual strategies, draw on international experience, and integrate other mechanisms such as those operated by Innovate UK. A trade body said it was important an industry wide strategy balances responsiveness to change against the need for stability to encourage investment. It thought this could be achieved by a two yearly review of a roadmap with different time horizons. For example, the short term would only be subject to minor adjustments, the medium term would have mid-course changes and only the longer term could have strategic shifts. Another stakeholder suggested we extend the period for developing the first strategy to the end 2017. It said it would be time consuming to agree and implement an approach for developing the strategy and also to engage stakeholders on it.

2.7. Some solution providers did not support the introduction of an industry wide innovation strategy. Some considered that its development could be a barrier to truly innovative projects. For example, a solutions provider said that it may result in innovative ideas being overlooked for accepted ideas. Similarly, another respondent thought a strategy may be overly prescriptive and limit the scope of projects, or perhaps lead to a hiatus of innovation before the strategy is published.

2.8. Some Gas Transporters (GTs) said that an innovation strategy is unnecessary for the gas sector. They noted that duplication hasn't been an issue in gas innovation, and that there are good levels of cooperation. Another noted that GTs are collaborating through the Gas Innovation Governance Group (GIGG).

2.9. Some stakeholders highlighted other issues about the introduction of a requirement on the RIIO network companies to jointly develop an innovation strategy. These included how the companies are funded for its development, the difficulty of reaching agreement between large groups which can be time-consuming, and that it could be cumbersome to change.

2.10. In response to the specific consultation questions:

- The majority of respondents think there should be separate gas and electricity strategies because the systems are complex and face different issues.

- Stakeholders said that companies should retain their own strategies to respond to specific regional challenges and priorities.

- There were a range of stakeholder views on how often an industry wide strategy is updated ie annually to every four years. The majority favoured an update every two years.

Our consideration of responses

2.11. We note that most stakeholders agree with the findings from the independent evaluation that there is a need for a more strategic overview to network innovation. We also welcome the suggestions stakeholders have made about the scope of an industry-wide innovation strategy and how this might be developed, including engagement with a wide range of stakeholders.

2.12. We agree with stakeholders that an industry-wide innovation strategy should not constrain innovation. In our view, it should map out key challenges, the high level options for managing uncertainties and the fit with other initiatives in the UK and international innovation landscape. We also agree that the network companies should continue to develop individual strategies, particularly to cover regional differences, which would also usefully inform an industry-wide strategy. We think this approach should alleviate the risk that an industry-wide strategy is too prescriptive or that it prevents projects being implemented that are outside the priorities for industry as a whole.

2.13. We recognise that the gas network companies have taken forward the GIGG on a voluntary basis to foster greater collaboration in innovation. However, as noted above we think an industry-wide strategy is needed to foster more than just improved collaboration. It is needed to ensure the industry is giving due consideration to the longer term strategic issues, and aligning and coordinating efforts across industry to determine whether or not these are being sufficiently addressed, eg the future role and use of gas networks in a decarbonised UK energy system.

2.14. We agree with stakeholders that a strategy, by its nature, should not need to be updated every year. Nonetheless, we think that a strategy should be reviewed regularly and updated when needed.

2.15. We are of a similar view to most stakeholders that it would be more expedient for the RIIO network companies to develop, at least initially, an innovation strategy for each sector because there are different challenges and priorities. These could be combined into a single strategy in future, if it becomes clearer that there are common issues, and innovation in each sector is complementary or interrelated.

2.16. We think it isn’t necessary to provide additional funding to the RIIO network companies for developing an industry-wide strategy. While we recognise it will involve a time commitment, we think there is a synergy with RIIO network companies’ business as usual activities under the NIA, ie the development of the strategy will both complement and inform the companies’ individual innovation programmes and planning activities.

Our decision

2.17. We have decided to propose a new standard licence condition for the RIIO network companies to work together and to engage relevant stakeholders to develop separate strategies for gas and electricity. Stakeholders will include but are not limited to: Offshore Transmission Owners, the Engineering and Physical Sciences Research Council, the Department of Business Energy and Industrial Strategy, Innovate UK, generators, energy suppliers and consumer representatives.

2.18. The policy decision (subject to consultation on the licence) is that companies would also be required to review the strategy every two years and update it if necessary. We would require the companies to prepare a plan by 31 July 2017 for the development of the first sector innovation strategies to be published before the end of 31 March 2018.

2.19. We will work with the network companies to prepare a plan for the first innovation strategies. Our current thinking (subject to consultation on the licence) on the form the strategies would take is that they will:

1. Specify the key challenges and uncertainties for each sector over different time horizons
2. Identify the areas where innovative solutions could be developed and align these within a framework covering the dimensions above. This would include current and future activities under the NIC and NIA, as well as others being taken forward under other UK or international initiatives
3. Conduct an initial gap analysis of the projects being undertaken by licensees relative to the challenges they are facing
4. Identify areas of work being undertaken using other funding schemes, eg Innovate UK or Horizon 2020 and minimise duplication
5. Identify if there are areas which would benefit from greater coordination and collaboration between parties, and
6. Consider the suitability of network companies and/or third parties taking the lead on filling any of the gaps and/or opportunities to collaborate with others to do so.

2.20. We welcome stakeholders' views on the form the sector strategies should take.

2.21. We are retaining the requirement in the electricity distribution licence requiring the network companies to maintain company specific strategies.

Increasing third party involvement

Introduction

2.22. In our December consultation, we outlined a potential concern that some ideas for network innovation from third parties may not be put forward into the NIC because these aren't a good fit with the network's business model rather than because the idea doesn't have merit from the perspective of consumers.

2.23. To help increase the involvement of third parties in the NIC and deepen the pool of potential projects, we sought views on proposals building on the approach already taken by some companies. These were:

- A requirement on the RIIO network companies to issue an annual call for ideas from third parties
- A requirement on the RIIO network companies to respond to proposals publicly, and
- To increase the number of projects a network company can put forward as full submissions from two to four where additional projects involve the network company partnering with third parties on the latter's idea.

Consultation responses

2.24. The majority of respondents supported the proposal for an annual call for ideas in order to bring fresh thinking and deepen the pool of ideas, skills and experience. A few stakeholders expressed doubts as to whether a mandatory annual call would result in an increase in third party proposals in the NIC, noting that the network companies are still the gatekeeper.

2.25. A couple of respondents questioned the need for the annual call to be mandatory on the basis that several network companies already issue regular calls. A trade body had concerns that mandating an annual call would add complexity for little benefit.

2.26. Several solutions providers preferred a single industry-wide call in order to facilitate coordination of effort and reduce the administrative burden on third parties. An electricity transmission owner said that companies should be able to operate their own competitions as this allows more flexibility to issue calls that target specific network challenges. It noted this doesn't preclude networks from collaborating at the time of the call.

2.27. The majority of respondents did not support the proposal for the RIIO network companies to give public feedback to third parties, mainly due to commercial sensitivities. There was also some concern that this might dissuade some third parties from putting forward ideas. A distribution network operator (DNO) suggested it would be more constructive to provide feedback in a manner which was subject to the normal commercial confidentiality rules.

2.28. There was broad support for the proposal to increase the number of projects that a RIIO network company can put forward as full submissions into the NIC from two to four, if the additional bids involve a partnership with a third party on its idea.

2.29. One DNO asked for clarity on what a 'third-party led bid' means. It noted that the licensee bears the obligations associated with complying with the NIC guidance document and the network licence, so developing a third-party idea is non-trivial. It also said that a mandatory annual call shouldn't preclude third parties from coming forward with ideas at any time, or prevent licensees from grouping together to produce a call for ideas if they chose to. It also thinks that the governance in this area should not restrict the RIIO network company such that it can only use ideas from a specific call or time-period for third party participation in NIC, as this would unduly restrict licensees from using the best ideas available to them.

Our consideration of responses

2.30. We welcome the support from the majority of stakeholders for the proposal to make it mandatory for the RIIO network companies to hold an annual call of ideas from third parties. Although some stakeholders consider it is unnecessary to make it mandatory, due to the fact that some RIIO network companies are already issuing calls, we think a licence obligation would be more beneficial. This would make the practice more widespread across the RIIO network companies, and provide additional certainty for third parties to plan and invest in ideas.

2.31. We note stakeholders have mixed views about whether or not it is preferable that the new proposed licence requirement specifies a single industry-wide call. A single call for ideas could be more practical for the RIIO network companies and third parties if ideas are being sought to address common strategic priorities or complementary approaches to address business/customer needs. Companies may also wish to work with organisations such as the Energy Networks Association or the Energy Innovation Centre in issuing a single call. In other instances, for example, where there are specific regional challenges that need an innovative solution, it may be more efficient for the relevant RIIO network company to separately issue a call for ideas. Overall, we think there are benefits from having some flexibility around how the RIIO network companies issue annual calls for ideas.

2.32. We welcome stakeholders' overwhelming support for increasing the number of full submissions a RIIO network company can make into the NIC from two to four if these additional bids involve a partnership with a third party on its idea. We think increasing the number of bids will benefit consumers as it will encourage greater third party participation, and will potentially increase the diversity of innovation projects across the full range of network activities.

2.33. Some stakeholders have asked for further clarity of the meaning of the term 'third-party led bid', which we used in the December consultation. On reflection, we think that the term lacks precision. We've used the term to refer to a scenario where an idea initiated by a third party is subsequently developed in partnership with the RIIO network company for submission into the NIC.

2.34. In this scenario, the network company, as licensee, would be ultimately be responsible for meeting the obligations associated with the NIC governance document and its licence in relation to a partnership project. However, we expect the network company and third party would agree if one of the parties is better placed to lead on the day to day interaction on the full submission process. In addition, we also anticipate the partnership parties would agree a bilateral agreement to align contractual obligations with the party best placed to manage risks around the delivery of the project.

Our decision

2.35. We've decided to propose a new requirement (subject to consultation on the licence) on RIIO network companies to issue an annual call for ideas from third parties if they intend to submit innovation bids into the NIC. However, we will not propose a requirement for a single industry-wide collective call. Nor would the requirement prevent companies from cooperating on issuing calls.

2.36. In response to stakeholders' views we decided that network companies shouldn't respond publicly to third parties on ideas. However, the companies would be required to give feedback directly to all applicants (and to Ofgem where requested, although we do not expect this to be necessary in most cases), explaining why the idea will not be taken forward.

2.37. We have decided to increase the number of projects that the RIIO network companies can put forward as full submissions from two to four, where the additional projects will be implemented in partnership with the third party who initiated the idea.

2.38. Subject to consultation, we intend to implement the new requirements to increase third party involvement by amending the NIC guidance document.

Potential direct access for third parties to the NIC

Introduction

2.39. Currently third parties are prohibited from participating in the NIC without a RIIO network company partner. Facilitating direct access for third parties would require changes to primary legislation. When we previously consulted[3] on this issue in 2011, there was limited appetite amongst stakeholders for allowing third parties direct access to the NIC.

2.40. In the December Consultation we sought stakeholders' views on whether there is more support for seeking legislative change to allow third parties direct access to the NIC. We were also interested to hear stakeholder views on whether other bodies

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[3] https://www.ofgem.gov.uk/ofgem-publications/56942/open-letter-consultation-non-network-company-access-innovation-stimulus.pdf

(eg Innovate UK or the Government) were more suited to providing and administering innovation funding rather than Ofgem.

Consultation responses

2.41. Three solution providers were in favour of facilitating direct access for third parties. One suggested a 'sponsor of last resort' as a medium-term measure for third parties to take forward good ideas. Another noted that direct access would need to be accompanied by incentives on a host DNO to provide some assurance to the third party of the future potential for deployment into business as usual if the innovation project is successful. Another stakeholder suggested that legislative change is unnecessary if the RIIO network companies are asked to voluntarily allocate 50% of innovation funding to a third party eg Innovate UK.

2.42. Eleven stakeholders had neutral views on allowing direct access for third parties. These stakeholders noted that the involvement of network companies is critical for realising the benefits for consumers eg to provide access to a network and test ideas at scale, to move successful innovation into business as usual, to embed learning and to pass on benefits to consumers through cost savings.

2.43. The remaining 14 stakeholders opposed seeking legislative change at this time. These stakeholders thought it would significantly undermine the potential benefit to consumers from the RIIO innovation funding. Most cited a similar argument to that described above about a network company partner being critical to realising benefits for consumers. In addition, some also said that projects taken on by third parties without support from a network company would have higher risks of failure and face higher barriers, eg safety, financial etc. Lastly, some stakeholders considered it was inappropriate to allow direct access to third parties because the policy intent of the RIIO innovation stimulus is specifically targeted to address disincentives on network companies to innovate.

Our consideration of responses

2.44. Responses to the December consultation suggest that stakeholder support for allowing third party direct access to the NIC is at a low level - similar to what it was previously.

2.45. We acknowledge that realising consumer benefits from innovation projects significantly relies on buy in from the RIIO network companies to adopt successful innovations. Therefore, direct access without a network partner could potentially undermine the value for money of projects funded under NIC.

2.46. We think that the absence of a network company partner to test the potential of a project and hypothesise on its potential benefit at scale could also weaken the competitiveness of a bid against the NIC project criteria. The project potential is a factor we consider in the bid competition for funding under the NIC.[4]

2.47. We think that the suggestion of a 'sponsor of last resort' is not compatible with the principles of the NIC. To deliver the best value for money for consumers it is intended that project bids compete for funding and only proposals with the most merit are funded under the NIC. It isn't intended that all project bids that are submitted are funded. However, we think the new requirement on the RIIO network companies to call for ideas every year will go some way to increase the involvement of third parties in the NIC and deepen the pool of good ideas that are funded under the NIC.

2.48. Similarly, we disagree with the suggestion that the RIIO network companies voluntarily contribute a proportion of innovation funding to an external agency for allocation to third party projects. The RIIO stimulus funding under the NIC and NIA is part of the price control that we use to regulate the RIIO network companies and make them accountable for delivering the network outputs that consumers fund. The amount of consumer funding each network company receives for innovation is contingent on it meeting the obligations associated with the schemes' governance arrangements and the network licence. It is therefore not possible for the network companies to make a voluntary contribution of consumers' money to an external agency for subsequent allocation to third parties. This would not be compliant with the scheme governance arrangements.

Our decision

2.49. We have decided not to pursue legislative change at this time. We consider that the current access to funding by licensees in conjunction with encouragement for third-party partnering is appropriate. We have not identified a strong rationale for energy network consumers to directly fund innovation by non-network companies.[5]

Removal of successful delivery reward

Introduction

2.50. The Successful Delivery Reward (SDR) is a provision in the current NIC arrangements to incentivise efficient delivery and good project management by network companies. The companies can apply to have the 10% contribution they

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[4] In particular, the absence of a network partner could weaken bids in regards to demonstrating how they meet eligibility criterion B – value for money, and C – creating knowledge that can be rolled out across the GB energy network.
[5] We fund innovation by network licensees as there are disincentives inherent in the price control framework to carry out innovation in certain instances – this rationale does not apply to third parties.

initially make to project costs returned through the SDR when a project is successfully completed.

2.51. The independent evaluation of the LCNF found that on average 40% of the benefits arising from innovation projects flow directly to network companies. Given the significant benefit the RIIO network companies are getting from implementing innovation projects we think it is appropriate that the companies make a non-refundable contribution to project costs. Accordingly, in the December consultation, we proposed removing the SDR for all future NIC projects ie for all projects awarded funding from 2017 onwards.

Consultation responses

2.52. There were a handful of stakeholders (consumer group, supplier, trade body and a solution provider) that supported the proposal to remove the SDR. These stakeholders cited various reasons including that the RIIO network companies shouldn't get an additional reward for good project management as this should be the norm. Others noted that the companies already benefit from executing projects efficiently through the RIIO efficiency sharing mechanism, so the SDR potentially represents a double incentive.

2.53. However, the majority of stakeholders (network companies, solution providers, and trade bodies) opposed the removal of the SDR. These stakeholders have concerns that removing the SDR could affect the number and types of projects submitted to the NIC. For example, some respondents thought that projects that provide customer benefits, eg cheaper connections to the distribution network, rather than network benefits may not be implemented. It was also highlighted that riskier projects would also be less attractive for the RIIO network companies to implement.

2.54. Several respondents also raised concerns that removing the SDR will remove the incentive for the company to ensure there is effective project delivery and that learning is properly disseminated.

2.55. Some respondents also argued that removing the SDR would introduce a barrier to entry for smaller third parties due to increased financial pressure.

Our consideration of responses

2.56. We acknowledge the point stakeholders have raised that the SDR has helped the business case for implementing some projects that would otherwise have been marginal for RIIO network companies. However, we note that this is an inadvertent feature of the SDR. The SDR was not intended to incentivise particular types of projects, eg projects where the benefits flow to generators or consumers rather than the network companies. It was intended to incentivise good project management alone.

2.57. The NIC itself is intended to stimulate innovation. Therefore, we think the removal of the SDR is appropriate if it is doubling up incentives for the companies to innovate. The removal of the SDR is also consistent with RIIO network companies developing a stronger innovation culture and moving along the spectrum from a moderate level towards a high level of innovation.[6]

2.58. We have identified several ongoing, large-scale NIA projects which aim to provide customer benefits.[7] We note also that NIA projects require the networks companies or project partners to input a 10% compulsory contribution which is non-returnable – this is comparable to our proposal of a NIC with no SDR. We think there are also other significant incentives (both financial and reputational) for the RIIO network companies to fund trials that benefit consumers, such as the RIIO ED1 Incentive on Connections Engagement (ICE)[8] and the need for Gas Transporters to facilitate the transition to a low carbon economy. For these reasons, we expect the proposed removal of the SDR would not have a significant negative impact on the types of projects submitted under the NIC.

2.59. We also think it's unnecessary to provide additional financial reward to the network companies for good project management of innovation trials as there are licence requirements on the network companies relating to the Project Deliverables, and the dissemination of learning generated from a project.

2.60. We expect that the issue of a financial barrier posed by the removal of the SDR is mainly relevant for small and medium-sized enterprises working on projects with lower technical readiness levels (TRL). Given the TRL is lower it is also likely that these are better suited to research and/or development projects through the NIA rather than development and demonstration through the NIC. In addition, the RIIO network companies may be willing to provide some or all of the compulsory contribution if they stand to benefit when the project is successful.

2.61. Overall we think the network companies should be making a contribution to the costs of implementing the projects. We think the SDR is unnecessary and represents poor value for money for consumers. The licence obligations, alongside reputational incentives and the efficiency sharing mechanism, are sufficient to ensure the network companies disseminate learning from the projects and follow good project management practices.

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[6] *Moderate level*: where companies have some interest in innovation but no overall programme. *High level*: innovation is a vital ingredient to the success of the business and risks are identified and managed rather than avoided. See Annex F of the independent evaluation of the LCNF for more information on these definitions.
[7] These include a £5.8 million project focused on facilitating the connection of electric vehicles to the electricity distribution network and a £5.2 million project on understanding the potential of hybrid heating systems.
[8] In RIIO-ED1, we have introduced an incentive to encourage DNOs to provide good service to customers that are seeking to connect. DNOs must provide evidence that they have engaged with their larger connection stakeholders and responded to their needs. If they fail to do this, they could incur a penalty. Further detail on the ICE can be found here.

Our decision

2.62. Subject to consultation on the licence, we have decided to remove the SDR for future NIC projects, ie the network companies will not be able to apply for the SDR on projects that are funded through the NIC in 2017 and thereafter.

2.63. We will consult on proposed modifications to the NIC Governance Document to implement this decision.

Removal of provision to recover bid preparation costs

Introduction

2.64. All network companies participating in the NIC can recover the cost of developing bid submissions from customers regardless of whether these are funded at the full submission stage -so long as projects have passed the initial screening process. The amount is capped at either £175k or 5% of the funding requested that year, whichever is smaller.

2.65. In the December consultation we proposed removing the ability of network companies to recover the bid preparations costs (BPC) from consumers. The independent evaluation has shown that a significant proportion of the benefits of innovation projects flows to network operators – therefore we think it is appropriate that they fund the development of submissions to the NIC. The NIC would not be unusual in not providing these funds.

Consultation responses

2.66. The majority of respondents opposed this proposal. Stakeholders said that the removal of this provision would adversely affect the quality and quantity of the future bids as the financial risk to network companies would increase if they couldn’t recover BPCs from consumers.

2.67. Respondents also said it would negatively affect smaller third party project partners which have fewer resources to fund the preliminary stages of bid preparation.

2.68. Respondents also said the NIC assessment process is more onerous compared to other research and development funding mechanisms, such as Horizon 2020. Accordingly, the RIIO network companies have to put more resources into NIC bid preparation in order to meet the requirements of the scheme.

Our consideration of responses

2.69. We believe removing BPCs will result in companies bringing forward stronger proposals as they are putting their own money at risk.

2.70. We have a similar view about the potential impact of removing BPCs on SMEs as we do about the impact of removing the SDR. This is likely to apply to smaller companies involved in developing lower TRL technologies which are probably better suited to using the NIA.

2.71. We acknowledge that the requirements for NIC bids are relatively rigorous. However, the NIC funds a minimum of 90% (and currently up to 100% if a company receives a full SDR) of the total project budget, therefore, we think it is appropriate that the assessment and decision making process is robust.

Our decision

2.72. Subject to consultation on the governance document, we have decided to remove the specific provision in the NIC arrangements for all network companies to recover BPCs from customers from 2018/19. We believe that requiring companies to fund the development of submissions will deliver greater value for money for customers as companies will have a greater investment in their success.

2.73. We will consult on proposed modifications to the NIA licence condition to implement this decision.

Timing of changes

2.74. Subject to consultation responses on proposed licence and governance documents amendments, the table below summarises the timeframes in which we intend implement the changes outlined in this chapter.

Decision	When it would come into effect	Extra notes
Industry innovation strategy	New Standard Licence Condition in 2017.	The current proposal is that licence condition would include a deadline of 01/04/2018 for the completion of the initial strategies.
Call for third party led projects	This would have effect when the new version of the governance document is introduced in 2017.	The current proposal is that network companies are to hold a call for ideas in 2017. Any successful third party led projects would be submitted to the NIC in 2018.

Decision	When it would come into effect	Extra notes
Removing the successful delivery reward	Projects awarded funding from 2017 would not be eligible to seek a successful delivery reward.	
Removing the provision to recover bid preparation costs (BPC)	Network companies would be able to recover bid costs in 2017/18 but they wouldn't recover these from 2018/19.	

3. Funding of the electricity NIC

Chapter Summary

This chapter sets out our decision on the level of funding to be available in the electricity NIC for 2017 to 2023.

Introduction

3.1. The independent evaluation of the LCNF and our sensitivity analysis suggested that innovations by network companies are making their way into day-to-day use and are delivering financial and carbon benefits. The future consumer benefit, which is expected to comfortably exceed the scheme costs, provides a strong case for continuing innovation funding to drive beneficial innovations by the network companies that would not happen in its absence.

3.2. As a result, we considered two options for setting the future funding level of the electricity NIC. We considered both:

- maintaining the current level of funding, ie £90 million per annum, or
- reducing the level of funding to £70 million per annum.

3.3. In the December consultation we proposed reducing the level of annual funding to £70 million because the level of funding available in the NIC and the LCNF, have historically been underutilised. We think it is unlikely that reducing the annual funding available will negatively impact consumers.

3.4. Under our proposal, the level of funding committed to through RIIO ED1 would reduce from £60 million to £40 million for the period 2017-2023.

Consultation responses

3.5. Most respondents were supportive of the proposal to reduce the amount of funding available. This is on the basis that the historical underutilisation of the innovation funding in the LCNF and NIC suggests a lower headline figure isn't likely to constrain the implementation of good ideas ie it wouldn't be detrimental to consumers.

3.6. Some respondents felt that Ofgem should retain some flexibility to increase the pot if uptake increases and/or challenges faced by the system change dramatically.

3.7. One respondent felt that the gas and electricity funding should be combined. Other respondents also noted that the level of funding available under the gas NIC should be increased given the new challenges posed by new sources of gas.

Our consideration of responses

3.8. We welcome the general support for reducing the level of funding in the electricity NIC, which will be in place at least until 2021.

3.9. It is not possible to combine the gas and electricity NIC funding. This is because of the legislative structure we work within. When we take a decision on the use of funds recovered from gas consumers we must do so in the interest gas consumers. Similarly, we must do the same when we make a decision about funds recovered from electricity consumers. As not all gas customers are electricity customers and vice versa, we are prohibited from funding electricity projects if this is raised through gas network charges or the converse.

3.10. We note the point raised about the challenges posed by new sources of gas and the potential need for additional funding. However, the level of funding in the gas NIC was outside the scope of this review.

Decision

3.11. We have decided to propose to reduce electricity NIC funding under the electricity distribution price control from £60 million to £40 million per year over 2017-2023. This means there would be a total of £70 million available in the electricity NIC until at least 2021 to fund flagship innovation projects. Thereafter, future funding of the electricity NIC would depend on the decision taken in the next electricity transmission price control review.

4. Other governance changes

Chapter Summary

This chapter describes other changes we have decided to propose to the governance arrangements of the NIC and NIA so that these operate more effectively. These include: making it easier for companies to amend NIC projects after they have been awarded funding; providing a simple guide to the intellectual property arrangements; removing protections against cost over runs; and requiring further justification for NIA projects.

Processing change requests for NIC projects

4.1. Under the current NIC governance arrangements, network companies must seek Ofgem's permission to make changes to projects in flight.

4.2. In the December consultation we recognised that this is administratively burdensome, particularly for relatively small changes. To address this issue, we proposed:

- For current NIC projects that network companies would only need permission from Ofgem for material changes in a project.
- For future projects that network companies wouldn't need Ofgem's permission to make changes. Instead:
    - Network companies would identify specific project deliverables and link elements of the funding request to those deliverables;
    - At the end of the project, companies would commission an external auditor to review whether the deliverables have been achieved;
    - Where a project deliverable is not achieved due to the hypothesis being tested turning out to be false, Ofgem will not claw back the efficient spend associated with testing the hypothesis. However, where a Project Deliverable is not achieved due to another reason (eg a failure of project management or the project being terminated at an intermediate stage), Ofgem has discretion to claw back the funding associated with the output.

Consultation responses

4.3. Respondents supported the proposal of reducing the burden of processing change requests and welcomed clarification of the circumstances when these would be required. Some respondents felt that the proposed definition was workable. However, others requested or suggested additional examples of what would constitute 'non-material' changes.

4.4. There was a mixed response to the project deliverables proposals for future projects. Two respondents are opposed to this approach. One said this was because it thought it would be difficult to apportion project funding to different project deliverables because project learning and deliverables are typically interrelated. The other respondent argued that the approach for future NIC projects would increase the effort of governance and also increase the costs of governance. It expected the additional costs would be covered by funding awarded to a project under the NIC.

4.5. Other stakeholders that responded to this question were more open to the principle of project deliverables and to providing assurance around project delivery. However, they voiced concerns about the administrative burden and increased costs of commissioning an external audit of the completed project. Several stakeholders commented that an internal audit would be more cost efficient than an external audit.

Our consideration of responses

4.6. We agree with stakeholders' suggestion that additional examples of changes which are not material would be useful. We plan to include examples of both material and non-material changes in our consultation on proposed NIC governance document amendments in relation to dealing with project changes on current NIC projects.

4.7. We have considered stakeholders' suggestions that project assurance could be provided through alternatives to an external audit report. As a result, we are refining our proposal. Instead of specifying an external audit report we plan to require the network company to provide 'independent verification' on project delivery. We think this approach will allow greater flexibility for network companies to select an appropriate and cost efficient independent third party to conduct the verification. We considered the use of internal auditors as suggested by some stakeholders but are of the view that the independence of the verifying party from the network company and project partners is paramount.

4.8. We agree with stakeholders that the additional cost of the independent verification is a recoverable project cost under the NIC.

Our decision

4.9. Subject to consultation on proposed amendments to the governance documents, we intend to implement the proposal with some changes to the examples of 'material' or 'non-material' changes in respect of the project change arrangements for current projects.

4.10. In relation to project assurance on future NIC projects, we have decided that the companies would obtain 'independent verification' that project deliverables have been achieved. Subject to consultation responses on governance document amendments, we propose to define 'independent verification' as:

> "*Verification by a third party that:*
>
> > *(i) has sufficient levels of expertise and knowledge to enable it to verify that Project Deliverables have been met and, if not, the reasons for this.*
> >
> > *(ii) is not affiliated with the Network Licensee or its Project Partners."*

4.11. The current proposal is that cost of obtaining this would be a NIC cost capped at two percent of overall NIC funding and would be included as a specific cost item in future NIC submissions. The proposal is that we would reserve the right to require a network company to commission an alternative verification report if we are not satisfied with the independence and/or quality of an original. If this is the case, this would be carried out at the network company's own cost.

Improving the interpretation of the default intellectual property arrangements

4.12. In the December consultation we proposed a plain English guide to the intellectual property arrangements for the NIC and NIA. We suggested that this is separate to the governance documents – and would not have legal standing.

Our consideration of responses

4.13. We had originally intended that this would be a document separate from the governance document. However, a number of respondents noted that a separate document may not have the same visibility to third parties as the governance document.

4.14. Given these responses we consider it sensible to include the guide within the governance document itself. Some network companies also noted that ultimately they would always argue that their interpretation of the governance document superseded the guide if it did not have legal standing. It therefore makes sense to include a description of the types of arrangements that we think are permissible within the governance documents themselves.

Our decision

4.15. We will consult on proposed amendments to the governance documents to include a plain English guide to the IP arrangements and this would form part of the governance documents. This may not be included in the next iteration but we will work on this text over the course of the summer. The guide will describe the types of arrangements we think would be appropriate under the default IP arrangements. It will also provide a non-exhaustive description of the types of non-default arrangements the Authority may be willing to approve.

Removal of the contingency funding mechanism

4.16. We proposed removing the ability of network companies to seek protection against shortfalls in Direct Benefits[9] or cost over runs. This is called the contingency funding mechanism.

Our consideration of responses

4.17. This mechanism has not ever been used and companies have historically covered costs of these types themselves. Respondents to the consultation did not respond substantively to this proposal.

Our decision

4.18. We have decided to consult on proposed amendments to the governance documents to remove the contingency funding mechanism. Subject to consultation responses, the intention is that protection against cost over runs and shortfalls in Direct Benefits would be removed in the next iteration of the governance documents.

Further assurance on project eligibility under NIA

4.19. In the December consultation we highlighted our concerns regarding the eligibility of a small number of NIA projects. To provide additional assurance on eligibility of projects under the NIA we proposed that when a network company is registering a project it:

- Justifies why each project is eligible and innovative against the NIA eligibility criteria on their Project Eligibility Assessment (PEA), rather than simply stating it is.

[9] As defined in the NIC Governance Documents.

- Gets sign off from a senior member of staff on each PEA before the NIA project is officially registered.

Our consideration of responses

4.20. Most respondents were supportive of the proposal and believed the changes would enable them to provide additional clarity and assurance regarding the eligibility of each of their NIA projects. One respondent was opposed to the proposal to require senior level sign off, and greater justification of projects. He felt we should focus on the outputs of projects rather than inputs. Some network companies also commented that they already have robust internal authorisation processes for innovation projects.

Decision

4.21. We will consult on proposed amendments to the governance documents to implement both proposals outlined above. These will include requiring companies to explain how a project is eligible but also requiring them to explain whether the project would happen in the absence of NIA funding.

Lower level changes to the governance of NIC and NIA

4.22. In the December consultation, we also proposed several lower level changes to the governance of the NIC and the NIA. Broadly these proposed changes are intended to: (i) reduce the burden of participation in the NIC and NIA; (ii) ensure that data from projects is accessible to interested parties and that innovation makes its way into business as usual; or (iii) ensure better compliance with the NIA governance document. More detail on the rationale for these proposals is given in the December consultation.

NIC alternative bank accounts

4.23. We proposed removing the requirement for Ofgem to approve the use of alternative bank account arrangements for NIC projects. This proposal is intended to reduce the resource requirements of network companies and Ofgem.

4.24. Stakeholders support this proposal, therefore (subject to consultation on governance document amendments) we've decided to implement this change.

Merging the reports for ongoing NIC and NIA projects

4.25. We proposed merging the reports for ongoing NIC projects into a single annual report covering all of a network company's NIC projects. We also proposed that this could be within the same document as the company's annual summary of NIA activity.

4.26. Some stakeholders have concerns that merging these reports could reduce their usability for customers or risk Ofgem not having possession of information in a timely manner. These stakeholders said that NIC project progress reports should remain separate from the NIA progress reports and the annual summary reports. The remaining stakeholders supported the merging of project reports on the basis that this would prevent duplication, provide efficiencies and increase visibility of a central document. However, one stakeholder said it will continue to publish six monthly project reports for major NIC projects.

4.27. Subject to consultation on governance document changes, we intend to implement this proposal. Network companies that want to continue publishing six monthly project reports (in addition to the new consolidated annual report) would not be precluded from doing so.

Remove requirements for Customer Engagement and Data Protection Plans

4.28. We proposed removing the requirement for network companies to develop Customer Engagement and Data Protection Plans for NIC and NIA projects. The Data Protection Act places obligations on any organisation gathering and holding data. We do not think we should place additional obligations on companies with regard to data protection. We also proposed removing the need for companies to have customer engagement plans approved by us as we do not believe we are best placed to add value by approving companies' engagement plans. While we proposed removing the requirement for a customer engagement plan, we note there are incentives within the price controls to engage effectively with customers and/or stakeholders.

4.29. There was an even split of views from stakeholders in response to this proposal. Three stakeholders opposed the proposal on the basis that network companies should be required to demonstrate that they have taken customer engagement seriously. These stakeholders also felt that these plans can be key elements in the successful delivery of projects. The remainder of stakeholders supported the proposal.

4.30. Subject to consultation on proposed changes to the governance document, we intend to implement the proposal and would remove the requirements for these plans in the Governance Document. Companies are required to comply with the Data Protection Act. We also expect companies to plan carefully any interaction they have with customers through their internal governance procedures.

Cross sector projects in the NIC

4.31. We proposed that projects requiring funding from both the gas and electricity NICs should make a single submission to both competitions. There would then be a joint meeting of the gas and electricity Expert Panels to consider these cross sector projects.

4.32. None of the consultation responses were opposed to this proposal, although one stakeholder commented that the NIC was not the most appropriate mechanism for cross sector projects due to the legislative restrictions on transfer of cost and benefits. We acknowledge that without legislative change there are limitations on cross sector projects under the NIC. However, this change would make it easier for companies wishing to take forward cross-sector projects to do so.

4.33. We've decided to implement the proposal in order to reduce the resource requirements for network companies and Ofgem.

Sharing of trial data from NIC and NIA projects

4.34. We proposed requiring network companies to have systems in place to be able to share data collected from trials, anonymised where necessary. We consider this will allow data to have value beyond the initial project it was gathered for, giving consumers maximum value for their investment.

4.35. There was a mixed response to this proposal. Some stakeholders were supportive and acknowledged the benefits of learning from the work carried out by other network licensees. None of the consultation responses were strongly opposed to this proposal, however a number of respondents commented on the need to ensure appropriate limitations on the data which must be shared as well as the need to consider the cost and resource associated with data sharing.

4.36. Subject to consultation on proposed changes to the governance document, we intend to implement the proposal. We would require companies to share data that is collected through customer funded projects. Companies would include their data sharing policy within project reports. We would expect network companies to share data with third parties if the party requesting it can demonstrate why it is in consumers' interests (subject to data being suitably anonymised and/or redacted for commercial sensitivity).

Reporting on the rollout of NIC and NIA projects into business as usual

4.37. We proposed using the Regulatory Instructions and Guidance (RIGs) to require network companies to report on the potential for innovative projects to make their way into business as usual, as well as plans for each project undertaken by themselves and other network companies.

4.38. One stakeholder did not consider that the RIGs are an appropriate place to include forecast solution roll-outs, benefits achievement or the reasons for a business as usual roll-out decision. It also commented that the effort associated with doing this for all projects documented in an annual RIG submission would be onerous. The remainder of respondents were not opposed to the proposal but commented that the cost and resource of additional reporting obligations should be considered.

4.39. We recognise that introducing reporting requirements for innovative solutions would increase the resource requirements for companies. However, we intend to implement the proposal (subject to consulting to updates to the RIGs). In providing specific innovation funding we believe companies should be considering proposals they have developed as well as solutions developed by other licensees. This is how innovation projects can deliver value for money to customers. We do not believe formalising this expectation should alter the resource requirements of companies as they should be undertaking this work anyway.

4.40. Subject to consultation, we intend to establish a working group this year to develop new templates, in order to ensure the reporting requirements are proportionate. We expect that there would be two elements to the reporting, one of which would be included in the regulatory reporting packs and would record the actual benefits of rolling out innovative solutions into business as usual relative to the cost of the network company's former methods. We would also introduce a new template in which network companies would give their assessment of innovative solutions and their forecast of the possible benefits they will deliver. This would sit outside the regulatory reporting pack, given the comments of some respondents.

5. Next steps

Chapter Summary

This chapter explains the how we intend to implement our decision.

Proposed changes to legal text

5.1. In April, we will circulate a draft version of the proposed licence and governance document amendments required to implement this decision to network licensees in April for consultation.

5.2. Subject to consultation responses on the proposed licence amendments, in May we will publish a statutory consultation on proposed changes to the licence. At the same time, we will consult on the proposed changes to the NIC and NIA governance documents following the process set out in the NIC and NIA licence conditions.

5.3. Subject to consultation responses, it is intended that changes would be in place either for this year's NIC competitive process or the competitive process next year as per the detail set out earlier in this document.

Regulatory reporting of innovation benefits

5.4. Subject to consultation responses, we will establish a working group this year to develop the new tables and guidance necessary to implement our decision on gathering data on the rollout of innovative methods in to business as usual.

5.5. We will involve all network companies in these working groups over the course of the remainder of 2017.

5.6. It is our current intent that these new tables will be included in the packs for licensees reporting on 2017/18.

Industry innovation strategies

5.7. We expect network companies to establish the working groups necessary to develop industry innovation strategies in the coming weeks. We will work with the network companies to ensure robust work plans are put in place so that initial strategies are in published by 31 March 2018.

The 2017 Network Innovation Competitions

5.8. The deadline for this year's Initial Screening Process (ISP) for both competitions is 5pm on the 4 April 2017. We will confirm the Full Submission deadline after the ISP stage has been completed. We will issue our final decision on which projects will receive funding by 30 November 2017.

Appendix 1 – Summary of consultation responses

Question: 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?**

1.1. Twenty seven respondents answered this question; fifteen respondents were in favour of the proposal, five were neutral and seven did not support the proposal.

1.2. Most respondents supported the proposal of a high-level industry innovation strategy to highlight areas of commonality, avoid the potential duplication of work and allow for gap analysis. However some respondents were concerned that the strategy would be prescriptive and become a barrier to innovation. Several respondents also noted that the GTs are collaborating through the Gas Innovation Governance Group (GIGG) and therefore did not think an innovation strategy is required for the gas sector.

1.3. Respondents thought that the companies should retain their own innovation strategies to reflect that there are regional issues. The majority of respondents also thought that there should be separate strategies for the gas and electricity sectors, with a couple of respondents suggesting the strategies should be integrated in the future.

1.4. The respondents had varied views on how often the strategy should be updated, with suggestions for the strategy to be updated yearly, biannually and every four years.

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

1.5. Thirty one responses addressed this question. All of these were positive regarding the idea of increasing third party involvement within the NIC. Respondents noted that increasing the involvement of third parties would help promote diversity in the type of projects submitted for the competitions which may lead to more radical solutions being developed which could benefit customers.

1.6. Respondents were more varied in their levels of support for the proposal regarding companies issuing annual calls for ideas. All respondents were of the view that any feedback provided in response to this call for evidence should not be published due to commercial confidentiality. Respondents also had reservations regarding how the call for evidence would be implemented. There was not a consensus regarding whether this call for evidence should be issued on a company by company basis or whether the industry should work together to create a collaborative call. Concerns were also expressed regarding whether it would lead to third parties having to submit the same idea multiple times in order for it to be considered by the different companies.

1.7. A significant majority of respondents were in favour of increasing the number of submissions a company can make from two to four. One proposed that we should only allow two of the submissions if they were from third parties.

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

1.8. Twenty seven respondents replied to this question. Three of these believed this would be a positive move, with the rest expressing reservations about the proposal.

1.9. Favourable respondents to this proposal believed it would encourage more competition for the funding whilst enabling third parties to develop proposals not picked up by network licensees. Another respondent supported the idea if we also put in place incentives to work with a host DNO.

1.10. Negative responses included engagement with network licensees was vital for technology to be taken up as part of business as usual. Respondents also noted that there would be a need for legislative change and that there were other funding streams available for third parties.

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

1.11. Twenty six respondents answered this question. Six responded positively to the suggestion with the others believing we should reconsider the proposal.

1.12. Positive responses believed licensees should fund innovation themselves. This would incentivise them to look outside of the business for solutions and ensure the projects were efficiently run. Other arguments included companies should not be rewarded for simple project management and that participants stood to benefit through TOTEX incentives.

1.13. Negative responses believed removing the SDR/Bid Preparation Costs would act as a barrier to participation and that the current arrangements encouraged companies to run projects well and provide high quality submissions.

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

1.14. Twenty respondents answered this question. Of these, twelve respondents agreed with the proposal and six strongly opposed the proposal.

1.15. Respondents in favour of the proposal agreed that reducing the pot would increase the level of competition and noted that the NIC has recently been undersubscribed. Some respondents thought that Ofgem should retain the flexibility to increase the funding amount again if the NIC becomes oversubscribed or if the challenges facing the system change significantly.

1.16. Some respondents thought that reducing the amount of NIC funding would lead to less NIC submissions and less competitiveness as there would be a reduced chance of success. Some respondents also noted that increased involvement of third parties may mean that the underutilisation of funding may not continue.

1.17. One respondent thought that the gas and electricity funding pots should be combined. Other respondents stated that the gas NIC funding pot should be increased to reflect the challenges posed by the increase in different sources of gas on the network.

Question: What are your views on the proposed funding level of the electricity NIC?

1.18. Twenty respondents addressed this question. Of these ten supported the proposal and ten opposed.

1.19. Those in favour noted that the electricity NIC has recently been undersubscribed and agreed with our statement that reducing the pot would increase competition, potentially increasing the quality of the projects funded.

1.20. Those against believed the current funding levels to be sufficient with the potential to deliver more benefits to customers. Other responses doubted whether decreasing the levels of funding would improve the quality of bids and would likely reduce the number of NIC bids. Respondents also believed the impacts of this change would be increased when combined with the proposals to remove the bid preparation costs/ successful delivery reward.

Question: 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.

1.21. Eighteen respondents addressed this question with all of them being for the proposal.

1.22. Respondents believed this to be a positive step and that it was helpful for us to clarify when a change request was required. They believed this had the potential to reduce the administrative burden on companies. One was pro the sentiment but expressed concerns that a company would have to go through the full internal change request process to ascertain whether the change should be classified as a change request. To mitigate this they proposed including examples of material/ non material changes in the Governance Document.

1.23. Respondents provided a range of feedback on our proposed drafting, highlighting key terms such as 'reasonably' and 'material' which required further clarification.

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

1.24. Eighteen responses focussed on this area. Of these, fourteen were in favour of the proposal with four expressing some doubts.

1.25. Most responses believed the creation of a plain English guide would bring clarity to this area and that this would be beneficial for SMEs when negotiating contractual arrangements with the companies.

1.26. A number of responses believed creating separate guidance on IP requirements would potentially lead to confusion and thus the guide should sit inside the Governance Document.

Question: 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?

1.27. Nineteen responses addressed this issue with sixteen being fully supportive of our proposals and three expressing reservations.

1.28. Most respondents welcomed our proposals of changing the NIA registration process so that companies were required to outline why their projects' met the eligibility criteria rather than simply ticking a box. Several respondents suggested that in addition to this we should also require companies to outline how each of their projects fitted into the overall innovation strategy. One suggested in addition to this we should run a targeted audit on projects to ensure compliance.

1.29. There was also support for our proposal that companies should report the benefits of their innovation projects within their RIGS. However, one respondent stated we should create a separate reporting tool for this purpose; they did not believe the RIGs would be the best place for the information to be recorded as the data listed therein must be accurate and auditable and thus the predicted benefits would not meet these standards.

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

1.30. We had nine responses to this question, all of the respondents used this section to express further concerns regarding our proposed changes to the assessment process for future NIC projects.

1.31. Most respondents were concerned with the requirement for them to hire external auditors at the end of the project. Respondents felt any costs incurred from this should be included in the NIC submission. They also believed this should be changed to an internal audit to lower the potential costs.

1.32. One respondent disagreed with the introduction of Project Deliverables as they believed this could slow the pace of innovation owing to increases in the levels of risk associated with a subjective assessment of their outputs. They also believed that learning outcomes of projects were inter-related and that it was therefore not possible to ascribe values to each deliverable in the manner proposed.