



Northern Powergrid's response to Ofgem's network innovation review - the consultation proposals and the proposed legal drafting

Key Points

The network innovation review: consultation proposals

- **We support the broad direction that Ofgem is taking with the changes to the Network Innovation Allowance (NIA) and Network Innovation Competition (NIC) governance.**
- **Some of the detailed changes may work counter to some of Ofgem's stated intentions in the smart, flexible energy system call for evidence. Ofgem needs to ensure better that they are complementary.**
- We support the actions and intentions to create **a more joined-up approach to innovation** that would improve efficiency by facilitating joint initiation and oversight of innovation of common interest.
- We understand and **support the potential reduction of the NIC funding.** This is reasonable provided there is more sharing and common work, but Ofgem should keep it under review and not rule out increasing the NIC funding again if the evidence justifies doing so.
- We **welcome the continued involvement of third parties in innovation** and support the proposal for them to bring forward more proposals both as collaborations with DNOs and via 'calls for projects'.
- **Direct third party access might be considered for projects which only indirectly affect the distribution network,** but is impracticable where projects directly interact with the distribution network as access must be under the control of the asset owner in line with legal obligations and the duty of care. As such, Ofgem is correct to draw the line where it has.
- We believe NIA project visibility is already well catered for and access to data is available for interested parties. **The new proposals will however bring clarity to the matter of accessing NIA data and we therefore support them.**
- **Removal of the successful delivery reward and the bid preparation costs will disincentivise companies from bringing forward longer-term projects** that could deliver significant future value but where the business case is more speculative reducing the likely number of potential projects.
 - **Ofgem should maintain the successful delivery reward mechanism.**
 - The unfunded detailed bid requirement is a barrier to bringing forward projects. This barrier is not as high with other funders and **Ofgem should either reduce the burden of the bidding process or continue to funding it.**

The network innovation review: proposed legal drafting

- In considering the statements within the legal drafting we have assumed that they will be altered in line with the outcome of the policy proposals consultation. However with that proviso the legal drafting on NIC generally and NIA in totality appears to reflect the policy proposals.
- Within the NIC drafting there are two specific areas where we believe the drafting should be improved but we are aligned with Ofgem's intent.

Detailed response to 'The network innovation review: our consultation proposals'

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?
1. We agree that there are significant overlaps between the innovation strategies of the DNOs and indeed the GDNs and that an energy system wide strategy could be developed. Work towards this is already starting through the ENA and should improve knowledge sharing between companies, maximise efficiency of innovation expenditure and thereby deliver better value for customers. The strategy needs to be kept suitably fresh – we anticipate in practice this would mean update every three to four years.
 2. Despite the potential similarities there are also differences between DNOs' strategies driven by local priorities, individual organisations' core skills and the demands of regional stakeholders. These differences would generate a requirement that there is both a common industry strategy and also complementary individual strategies to support the needs of local stakeholders. As an example, Northern Powergrid operates a network with a high degree of high embedded generation but that generation is less biased towards solar than WPD's network; particularly WPD's South West network. This means that the generation presents different challenges and opportunities and requires different approaches in innovation.
 3. Additionally the separate innovation strategies of the DNOs give rise to a diversity of thinking and approaches and it would be detrimental if that was lost. For example, in a 'joint-innovation-only' world projects such as Northern Powergrid's (NPG's) Customer-Led Network Revolution (CLNR) and ENW's Customer Load Active System Services (CLASS) would have been unlikely to proceed. If a single common strategy is developed then there is the risk that innovation in any technology is slowed to the pace of the slowest. Therefore it is important to maintain this diversity from individual companies while building around it a further means to draw together the knowledge and harvest maximum value for all customers from the learning generated.
 4. A common strategy should take a complete view of the energy system and will require key enabling cross-vector innovations to facilitate it. It will allow the type of cross-vector (energy that is converted from electricity to gas or vice versa to allow storage or transportation) thinking espoused in the smart, flexible energy system call for evidence. We, along with Northern Gas Networks, are currently supporting the Energy Systems Catapult on such thinking as Newcastle Energypath which considers smart systems in heat. This will take time and should perhaps be a target for post-2018. In the meantime common industry strategies should be developed built on a bottom-up combination of the common needs for the electricity and for the gas industries.
 5. The common industry strategy, as opposed to tactical innovation implementation plans, should be maintained to remain relevant and applicable. In practice, this suggests it would likely require refresh every three to four years.

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

6. We support the methods proposed to facilitate increased involvement of third parties through network companies issuing calls for NIC bid ideas.
7. We always welcome the involvement of third parties in innovation. Alongside other network companies we have founded and supported the Energy Innovation Centre, designed specifically to encourage and support the participation of small and medium enterprises in industry innovation activities. Generally the industry has been successful in supporting third party collaboration and anticipation. The Poyry report accompanying this consultation notes that such collaboration is at an all-time high.
8. The need to conduct third party calls for innovation alongside all NIC proposals increases the burden on bidding at a time when it is proposed to reduce funding for bidding activity. That said, we think the proposal to market test ideas is positive and note that it appears to be working satisfactorily for those companies that have already followed this route. On balance we therefore are supportive of the proposal.

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

9. Projects which third parties might undertake which do not impinge on safety or customer service could be considered for direct access to funding for those third parties.
10. More direct access for third parties comes at a high 'cost' in terms of conflicting regulatory or statutory obligations and requiring a high burden of regulatory change. These high costs are not justified. As such, Ofgem is correct to draw the line where it has.
11. As in a previous consultation response, we believe that the statutory ESQCR requirements placed upon licenced operators alongside the need to maintain reliability makes third party access, unless closely-controlled by DNOs, very difficult to facilitate. Put simply, it presents issues that conflict with statutory obligations and corporate control that appear to us to be insurmountable.
12. In addition to these legal obstacles, third parties would also have to abide by the same rules that licensees do with respect to intellectual property and ensure that they are not permitted to use customers' money to de-risk potential lucrative future profit-making activities. There would be a large regulatory burden to establish a new system of licensing for innovation and we do not believe that the evidence from the Poyry report justifies this additional step.

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

13. We are supportive of reducing innovation costs which are passed through to customers. Accordingly, not all innovative work is undertaken through innovation allowances (for example, we deploy innovative new solutions where we can be relatively certain of a payback and this is funded via our business revenues).
14. We do not believe that sufficient evidence exists to support a decision by Ofgem to reduce the direct funding of individual innovation projects with more uncertain outcomes as funded via the NIC. Accordingly, we consider that removal of the successful delivery reward and the bid preparation costs may disincentivise companies from bringing forward longer-term projects that could deliver significant future value for customers but where the business case is more speculative.
15. In the case of the successful delivery reward criteria, many of the current projects do not provide a return in the ED1 period or necessarily a tangible business case for ED2 plans. We believe that the

removal of the Successful Delivery Reward would, on balance, encourage shorter term, lower risk, and lower technology readiness level, projects for companies seek to recover their project costs and proceed to deliver a return in excess. This would be to the overall detriment of customers if this happened.

16. We therefore consider that Ofgem should retain the Successful Delivery Reward mechanism.
17. Bid preparation costs are more complex. They can be expensive and are often used to support smaller third party partners who cannot afford to fund the considerable resources required. Costs are also incurred in the provision of specialist technical support, ensuring that bids are of high quality. The inability to allocate bid costs would impact both of these.
18. However bid preparation costs might be considerably lower, addressing some of the above concerns, if the Ofgem bidding process were modified. The current process requires a very detailed project justification and plan, much of which is never used if the project is not funded. Other funding streams mentioned in the consultation (e.g. Innovate UK, Horizon 2020, Research Council funding) do not have such in-depth requirements and the detailed planning phase is often part of a funded initial project activity, once agreement to fund has been reached. 'Expenses follow success' is indeed common in the schemes mentioned but 'success' there is determined at a much earlier degree of planning when the preparatory expenditure is at a much lower level.
19. We are concerned that these changes as proposed at present may discourage the production of project bids into the NIC which is already unsubscribed. This would be contrary to Ofgem's aim, stated elsewhere, to increase the competition for funding.
20. Accordingly, we are seeking for Ofgem to either reduce the burden of the bidding process by aligning with the reference cases quoted or continue to fund it.

Proposal for future funding level of the electricity NIC

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

Question 2: What are your views on the proposed funding level of the electricity NIC?

21. The rationale for reducing the level of the electricity NIC funding pot and the new level proposed are sensible based on the intent to drive more collaboration which should bring greater efficiency as well as greater value. Also, the recent history of the NIC and its predecessor the Low Carbon Networks Fund support reducing funding.
22. However, this assumes that the future requirements will continue to reflect the recent past. The general take-up level of the NIC may increase towards the end of the price control periods for both electricity transmission and distribution as uncertainty on innovation funding subsequent to the current price control periods may lead to licensees increasing the volume and value of proposals. Similarly the current level of bids may be reflective of the large amount of work that has already been undertaken and that licensed entities are currently looking to integrate into their businesses. As this consolidation of learning matures an increase in project proposals may be seen. However this is not supported by hard evidence at present.
23. Given this uncertainty, Ofgem should keep it under review and not rule out increasing the NIC funding again if the evidence justifies doing so.

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.

24. We welcome the clarification and support the proposals on change management. This will make the effective and timely management and administration of projects easier and allow a necessary degree of flexibility of action. The nature of innovative projects requires constant change and accommodation, even when the final outcomes remain unchanged. Regulatory recognition and support for this is appreciated.
25. For running projects, the proposed drafting on what constitutes a material change is clear but may prove difficult to use. Licensees are asked to pre-suppose the conclusions that the expert panel would draw when presented with particular changes. They risk claw-back of funding if they get this assessment wrong. We suspect that this may encourage licensees to refer back to Ofgem more often than they otherwise might expect in order to reduce this risk.
26. For new projects the proposed requirement to appoint project auditors to assess the production of deliverables needs further clarification. We would like to see Ofgem supporting an approach where an auditor or project officer is associated with the project through its full lifecycle, continuously monitoring progress and making decisions on changes at key moments from an informed perspective. This has worked well in the case of our Activating Community Energy project that is jointly funded by Innovate UK and has such an officer assigned who attends project meetings and tracks progress.

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

27. We welcome this proposal. Generally we have found the NIA and NIC 'open innovation' approach to intellectual property to be helpful and delivering value for customers. We have also been able to find sensible ways to resolve any issue provided we are able to clearly communicate the requirements of the governance document. A standard guide to the IP requirements, with the preferred default arrangements plainly stated, would be useful in this respect.
28. It has been our approach to use these default requirements as a clear starting point for discussion and our ability to state that this is the preferred way of working has been useful in aligning the expectations of contractors, partners and suppliers. We would like to maintain this position and would hope that any guide emphasises default over alternative arrangements which should be seen very much as an exception.
29. The use of the default arrangements has given us considerable freedom of action with project outputs and, for example, has allowed us to share project data with interested parties allowing projects to continue to deliver additional value after they are formally concluded.
30. We also expect that the industry now has case studies that may be useful in illustrating particular approaches in a plain English guide.

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?

31. The proposals to increase the level of visibility of the NIA projects also look sensible. In most cases we are already operating to these standards. For example we already make data from projects available to interested parties.
32. We also monitor other DNOs' project outcomes and use these to inform our own business-as-usual activities.
33. Generally, observing both our own projects and those of our peers, we believe that NIA is being used in line with the requirements and spirit of the governance requirements. All details of projects are publicly posted at commencement and any that appear to be inappropriate, either in terms of size, scope, or technical maturity may be challenged at that time by Ofgem. Any company should be in a position to explain their motivation, detail their project design and show how it provides value for money in line with their innovation strategy. We have examples where Ofgem has made enquiries in exactly this manner and we consider this an appropriate method for checking compliance with the governance requirements.
34. We suspect that the number of projects challenged is and would be small. Informal consultation with Ofgem at the project design phase is the best way for licensees to avoid such challenge. Ofgem should provide formal advice as to the types of project they would like to be consulted on (for example, higher financial value or projects with forecast payback of less than five years).

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

35. There is nothing in the changes proposed that will assist to deliver better the ambition in the smart energy call for evidence for more energy system projects. The continued focus on 'networks benefits only' governance forecloses a number of projects for which other funding sources may not fill the gap. This is an important topic that needs Ofgem to take a view on the extent to which the governance of the NIC may be changed in order to fill a funding gap for whole energy system projects.

Detailed points in response to ‘The network innovation review: proposed legal drafting’

36. In considering the statements within the legal drafting we have assumed that they will be altered in line with the outcome of the policy proposals consultation. However with that proviso the legal drafting generally appears to reflect accurately the policy proposals.
37. Within the NIC drafting there are two areas where we believe the drafting could be improved:
- Although paragraph 2.2 states that the chapter 2 requirements associated with collaboration and learning portals apply only to “a Network Licensee who has the NIC Licence Condition in its licence and who has applied to the NIC for funding” this is contained within a larger statement and should be made more prominent. We support the intent and seek for the drafting to make it clearer.
 - It is not clear how the ‘Funding Return Mechanism’ would apply to third-party-led projects.
 - Paragraph 5.28 is clear that “if something is not delivered and the Network Licensee is deemed to be at fault funding will be returned.”
 - On a third-party-led project the Network Licensee presumably cannot be at fault and therefore the Funding Return Mechanism would not apply.
 - We ask Ofgem to be explicit on the intention and drafting in this area, and if the Funding Return Mechanism is expected to apply, state how it would apply and to whom, with particular consideration of how it might apply to non-licensed third parties.