Neil Copeland
Ofgem
107 West Regent Street,
3rd Floor, Cornerstone,
Glasgow G2 2BA

27 February 2015

Dear Mr Copeland,

Consultation on the assessment of benefits from the roll-out of proven innovations through the Innovation Roll-out Mechanism

This response was prepared by the energy team within Citizens Advice. It has statutory responsibilities to represent the interests of energy consumers in Great Britain. Our response is not confidential and may be published in full on your website.

We welcome the opportunity to respond to this consultation on the Innovation Roll-out Mechanism. As part of a wider suite of measures introduced under RIIO to stimulate network innovation, the IRM has an important function in enabling the smart grid solutions needed to achieve decarbonisation at an affordable price for consumers. Historically networks have been too reluctant to innovate, so we are supportive of Ofgem's initiative to offer this encouragement.

The risk, however, is that the IRM uses consumers' bills to subsidise networks to take actions that are in their long term interests in any case. This is addressed by both question 2, on the proof of long term value of the innovation to consumers, and question 4, on the proof that it is not already business as usual. A better way of phrasing this question might be 'how should licensees demonstrate that the proven innovation *will not in any case become* business as usual?', since the IRM should only be applied in cases where without it the innovation would not in future be realised.

One point on which we would welcome further clarity is the level of the adjustment to allowed revenue under the IRM relative to the costs and benefits of the innovation in question. The consultation makes it clear that the IRM will only be applied when a) the costs outweigh the benefits during the current price control, and b) the benefits outweigh the costs thereafter. But given this distinction, we would welcome assurance that the IRM during ED1 will offer an uplift in revenue equal to the costs minus the benefits, rather than simply equal to the costs. Otherwise, the networks will be able to recover benefits from an innovation that they have put no money towards, and consumers will pay twice.

A further risk of overpayment arises from hard-to-quantify benefits from R&D, particularly when funded by the LCNF. Through this, consumers have already provided several hundred million pounds of additional funding for networks' innovation trials. Even apart from the efficiency benefits available by introducing benefits into BAU, networks have already gained significant benefits to their brand and reputation through these projects, as well as valuable intellectual property. It is vital that networks are encouraged to take the last and most important step in introducing LCNF learnings into BAU. The IRM should prove a useful 'carrot' to do this, but Ofgem should consider available 'sticks' as well. This could include, for example, establishing the expectation that future efficiency benchmarks will be based on a 'full innovation' projected scenario, if networks' actual BAU fails to reach this level.

An assumption underpinning the IRM is that networks will not receive benefits from current innovation measures beyond the current price control, because any gains in efficiency will be absorbed into the next control. It should be considered, though, that if the fast-tracking system is rerun for the next price control, there will be a substantial potential benefit to any network that can establish innovative solutions now, even if at a net cost, since this will improve their case for fast-tracking. A measure of this benefit should therefore be taken off the extra revenue allowed by the IRM.

Question 1 relates to the requirement to demonstrate significant carbon and other environmental benefits of each proposed roll-out. While we support these aims, we would encourage Ofgem also to allow any innovation that delivers long term cost savings to the consumer, even if without environmental benefits.

We support the approach outlined in question 2 of requiring networks to demonstrate that projects will deliver long term value for money to consumers. As far as possible, however, the onus should be not only on the network but also on Ofgem to proactively come to a judgement, and encourage the kinds of innovation that it thinks would benefit consumers.

To demonstrate that IRM funding is necessary to fund a roll-out as per question 3, it should be recognised that there will be an incentive of networks to underestimate the potential savings and overestimate the costs of innovation. Though every effort should be made to reveal costs accurately at this stage, it would also be very beneficial to reserve the ability to review outturn costs, and claw back IRM revenue as appropriate. This would involve continued scrutiny of innovation, which would also help ensure in future that the innovation is not already considered business as usual. This should be introduced as part of wider improvements to the framework for network reporting, which Citizens Advice has advocated in our recent response to the consultation on environment reporting and elsewhere.

Please do not hesitate to contact me if you would like to discuss this submission further.

Yours sincerely,

Conrad Steel
Policy Manager – Energy Regulation

conrad.steel@citizensadvice.org.uk
03000 231447