



Making a positive difference
for energy consumers

Interested parties

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Update on the RIIO-2 Strategic Innovation Fund (SIF), and consultation on an updated SIF Governance Document

RIIO-2 is supporting regulated network companies to deliver net zero greenhouse gas emissions at lowest cost to consumers, while maintaining world-class levels of system reliability and customer service, and ensuring no consumer is left behind.¹

The Strategic Innovation Fund (SIF) was launched in July 2021 by Ofgem as a RIIO-2 innovation funding mechanism for the Electricity System Operator, Electricity Transmission, Gas Transmission and Gas Distribution sectors. It focuses on finding and funding ambitious, innovative Projects with the potential to accelerate the transition to Net Zero while delivering net benefits to energy consumers.

Ofgem is the sole decision-maker in relation to the SIF. To support the SIF's operation, Ofgem partnered with Innovate UK, as part of UK Research and Innovation (UKRI). As per the SIF Governance Document, Innovate UK's role is to deliver the SIF in line with the SIF Governance Document, including making recommendations to Ofgem on operational matters.

¹ RIIO is our approach to ensuring the monopoly companies who own and operate our gas and electricity networks have enough revenue to run an efficient network that delivers what customers need. RIIO stands for Revenues = Incentives + Innovation + Outputs. RIIO-2 is the price control period which runs between 2021-2026 for Electricity System Operator, Electricity Transmission, Gas Transmission and Gas Distribution sectors, and 2023-2028 for the Electricity Distribution sector.

Update

In March 2022², we³ launched the round 1 Discovery Phase. Following the completion of these Projects on 30 April 2022, we are proposing changes to the SIF Governance Document to reflect:

- a) Ofgem's experience in implementing the SIF
- b) those of Innovate UK's recommendations relating to administration of the SIF, which Ofgem has approved
- c) feedback from stakeholders and participants in the round 1 Discovery Phase.

Ofgem's decision on these proposals will be informed by the responses to the consultation.

Recent workshops on proposed changes

Three separate workshops for licensees were held in April and May 2022 to discuss draft proposed changes to the SIF Governance Document. The first two workshops focused on examining and providing the rationale for the proposed changes up to chapter 9 in the SIF Governance Document. The third workshop focused exclusively on proposed changes to chapter 9 (Intellectual Property Rights and royalties) in the SIF Governance Document. (Please see the 'Proposed changes to chapter 9' heading below for an update on the proposed changes to chapter 9.)

Each workshop, to which all licensees were invited, provided an opportunity to discuss, refine and explore the changes proposed to the SIF Governance Document. Feedback received in these workshops helped inform and further develop the changes being proposed.

The workshops focused on the following key areas. Cross-references are to chapters of the draft SIF Governance Document which accompanies this consultation.

- The differences between SIF Funding and NIA funding (chapter 1)
- The compatibility and clarity of combined or merged Project Phases (chapter 1)
- DNO participation as a Funding Party in Round 2 and beyond (chapter 1)
- Updating yearly knowledge dissemination requirements (chapter 3)

² <https://www.ofgem.gov.uk/publications/energy-networks-launch-40-new-innovation-projects-help-great-britain-accelerate-transition-net-zero>

³ The terms the "Authority", "Ofgem", "we", "our" and "us" are used interchangeably in this document. The Authority refers to the Gas and Electricity Markets Authority. Ofgem is the Office of the Gas and Electricity Markets Authority.

- Updating the Application and end of Phase requirements for the Discovery Phase, Alpha Phase, and Beta Phase (chapter 4, chapter 6)
- Introducing flexible opportunities for a more streamlined Application and end of Phase report processes (chapter 4, chapter 6)
- Developing bank account requirements for Projects awarded SIF Funding (Chapter 8)
- Introducing a framework for Project Logs and Communications (chapter 8)
- Updating the Intellectual Property Rights (IPR) and royalties (chapter 9)
- Updating definitions (Appendix 1).

Please note that no changes have been proposed to the Eligibility Criteria in chapter 2 of the SIF Governance Document. The existing Eligibility Criteria will continue to be used to assess Applications to determine whether we award SIF Funding.

Proposed changes to enable more flexible, agile and responsive governance

Our proposed changes focus on introducing a more flexible, agile and responsive governance and Project environment in the SIF, whilst maintaining regulatory certainty and adherence to the established SIF funding principles.⁴ We consider that the proposed changes will benefit energy consumers by creating a regulatory environment which can respond to the learnings and feedback from round 1.

For this reason, we have proposed changes which would enable us to use Innovation Challenges to confirm departure from the default approach outlined in the SIF Governance Document, for example with regard to the three-phased approach to progressing Projects. This means, for example, we could issue an Innovation Challenge which seeks to combine Project Phases. If and when an Innovation Challenge seeks to depart from the default approach outlined in the SIF Governance Document, we propose that we will issue a written consultation on the focus areas and specific parameters within that Innovation Challenge.

We have also proposed changes which enable Innovate UK to determine procedural and Application requirements within the Innovation Challenge Documentation. Such changes would, for example, enable Innovate UK to determine word limits for Applications, length of Project Phases, and any Innovation Challenge-specific or Project Phase-specific reporting

⁴ Projects should be in line with Innovation Challenges set by Ofgem, have potential to deliver a net benefit to the relevant sector's consumers and should focus primarily on the network. Projects can only qualify for SIF Funding if access to the assets of a network company is essential, or in the case of third-party innovators, the innovation would not happen without provision of SIF Funding.

requirements. This builds upon the lessons from round 1 of the SIF because confirming Application details in the Innovation Challenge Documentation will enable Innovate UK to operate the SIF process more flexibly and adapt to the needs of applicants. Such Innovation Challenge Documentation would be issued by Innovate UK, but we would expect Innovate UK to engage widely with applicants to determine the appropriate procedural and application requirements set in the Innovation Challenge Documentation.

Proposed changes to chapter 9 – Intellectual Property Rights and royalties

Prior to this consultation, as part of its role running the SIF process, Innovate UK received feedback from third-party innovators participating and seeking to participate in the SIF that chapter 9 of the SIF Governance Document (Intellectual Property Rights and royalties) was complex and not easily understood. Based on our review of such feedback and our policy objective to increase third party involvement in the SIF, we consider that there is a case for making Chapter 9 more accessible to third parties.

Our proposed changes to chapter 9 aim to make the default IPR rules more easily accessible to third parties. Our proposal is to implement those changes only if we are satisfied that they are not susceptible to misinterpretation and have no unintended legal effects.

Additionally, we propose that, consistent with Innovate UK's support function in relation to IPR, network companies must work with Innovate UK to develop illustrative guidance which helps third party innovators understand the default IPR which underpin the operation of the SIF. Such guidance will be illustrative only and non-enforceable, but we believe additional guidance produced by network companies and Innovate UK could help third party innovators understand the default rules and encourage their increased involvement in the SIF. We have included a consultation question below on this proposal.

Electricity distribution network operator participation in round 2

The RIIO-ED1 (ED1) price control is still running and RIIO-ED2 (ED2) will commence in April 2023. We believe that allowing DNOs to participate in round 2 of the Discovery Phase will enable DNO innovation projects to be taken forward as soon as possible upon the commencement of ED2, ultimately benefiting consumers by supporting and facilitating innovation by DNOs at an earlier stage than previously planned.

There is no condition in the DNOs' ED1 licences in relation to the SIF. However, the new ED2 licences (which will include a SIF licence condition) will come into force on 1 April 2023, prior to any formal decisions being made on the funding of round 2 Discovery Phase Projects. Therefore, should any DNOs wish to submit an Application for funding in the round 2 Discovery Phase, that submission would not be underpinned by related provision in their ED1 licence. However, a licence condition under ED2 will be in place prior to a funding decision by Ofgem on the Applications submitted to the round 2 Discovery Phase and will therefore be in place once the round 2 Discovery Phase Projects commence. DNO round 2 Applications will be assessed by Ofgem in line with the requirements of the SIF Governance Document.

We have also considered whether allowing DNOs to participate in round 2 of the SIF may cause any issues around cross-subsidisation given the quoted £450m value of the SIF for electricity transmission (ET), gas transmission (GT), and gas distribution (GD) sectors' Final Determinations did not include provision to fund DNOs during RIIO-ED1. However, no decision on SIF Funding for round 2 Discovery Phase will be made until RIIO-ED2 has commenced, and any allowance for the DNOs will come from the total RIIO-ED2 SIF pot that we determine appropriate for DNOs.

We have discussed the potential participation of DNOs in round 2 of the SIF with DNOs prior to this consultation. The issue was also discussed during the workshops on the proposed changes to the SIF Governance Document held prior to this consultation. As part of this consultation, we have included questions below specifically on the proposal to allow DNOs to participate in round 2 Discovery Phase of the SIF and any considerations which need to be taken into account. We are also consulting on the appropriate size of the SIF pot as part of our RIIO-ED2 Draft Determinations consultation and that consultation will close on 25/08/2022, with ED2 Final Determinations due to be published in December 2022.⁵

Timing of an updated SIF Governance Document

As noted in the table below, we aim for the updated SIF Governance Document to come into force in August 2022, ahead of round 2 Discovery Phase opening for Applications. We propose that the updated SIF Governance Document will apply to both Projects already in-

⁵ The ED2 Draft Determinations are separately consulting the value of the SIF for the ED2 period. We will confirm the decision on the value of the SIF in the ED2 Final Determinations, which is planned for December 2022. See page 49 within the RIIO-ED2 Draft Determinations Core Methodology Document; <https://www.ofgem.gov.uk/publications/riio-ed2-draft-determinations>

flight (including round 1 Alpha Projects which are due to start on 1 August 2022) and any future Projects that have yet to be funded.

We recognise that this means proposed changes to governance arrangements will apply to projects already underway as part of round 1 Alpha Phase. We have assessed the fair operation of these arrangements and discussed this during the workshops previously mentioned. We have not identified any issues and do not anticipate any impacts or knock-on effects on these Projects which will be in the Alpha Phase from an updated SIF Governance Document coming into effect in August 2022. However, we have included a question below on this issue and welcome feedback in response to this consultation.

Items published alongside this letter

Alongside this consultation, we have published:

1. A draft SIF Governance Document with all proposed changes incorporated in track changes
2. A spreadsheet with a list of all the proposed changes and the reasoning behind them, which supplements the policy rationale set out in this letter
3. The consultation questions listed below.

Responses in the spreadsheet format are optional. However, space has been included for responses to specific proposed changes.

Consultation questions

1. Do you agree with the proposed amendments to the SIF Governance Document?
(We are happy for respondents to comment on individual changes within the spreadsheet published alongside this consultation if they wish to)
2. Do you agree or disagree with proposed requirement for applicants to outline what other UK government funding (aside from the SIF) a proposed Project, or aspects of Project, has received in the last 36 months when submitting an Application? Do you also agree or disagree with the period of 36 months for this proposed requirement?
3. Do you agree that the amended SIF Governance Document should come into force in August 2022, and should apply to all in-flight and future SIF Projects?
4. Do you agree or disagree (giving reasons) with DNO participation in round 2 of the SIF?

5. Are there any specific considerations relating to the proposed participation of DNOs in round 2 of the SIF which need to be taken into account in the SIF Governance Document?
6. Do you agree that the proposed drafting amendments on IPR within the SIF Governance Document make it easier to understand the default IPR rules?
7. Do you agree there is a need for an illustrative guidance document which seeks to help third party innovators understand the default SIF IPR?

Next steps

Stakeholders are invited to respond to this consultation no later than 3 August 2022.

All responses to this consultation should be sent to both networks.innovation@ofgem.gov.uk and SIF_ofgem@iuk.ukri.org.

We also ask that any network licensee without views or comments on the proposed changes in the SIF Governance Document provide confirmation of receipt and their nil response to the email addresses above by the consultation close.

The annex to this letter details our approach to handling consultation responses and explains that respondents can request their response, or part of their response, be kept confidential.

As noted above and below in the table, and subject to our consideration of stakeholder responses to the consultation questions, we aim to publish a decision on this consultation and the updated SIF Governance Document in August 2022 (alongside any non-confidential responses to this consultation). The table below provides an indicative timeline for the introduction of an updated SIF Governance Document, dates for the round 1 Alpha Phase and dates for the round 2 Discovery Phase.

Milestone	Date
Consultation on updated SIF Governance Document	6 July 2022
SIF round 1 – Alpha Phase begins	1 August 2022
Consultation on updated SIF Governance Document closes	3 August 2022
Decision published on the updated SIF Governance Document and updated SIF Governance Document comes into effect	August 2022
SIF round 2 – Discovery Applications open	September 2022
SIF round 2 – Discovery Applications close	November 2022
SIF round 1 – Alpha Phase concludes	31 January 2023

RIIO ED-2 begins for DNOs	1 April 2023
Decision on SIF round 2 Discovery Phase Projects	April 2023

Yours sincerely,

Graeme Barton

Head of Price Control Operations – Small & Medium Sized Projects

For and on behalf of the Authority

Annex: Your response, data and confidentiality

We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you do wish to be kept confidential and those that you do not wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't

link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk