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Dear Graeme,

Consultation on SIF Governance Document

This response is made on behalf of National Grid Gas plc (NGG). We welcome the opportunity to respond to this consultation on the Strategic Innovation Fund (SIF) Governance Document.

Our response to the specific consulation questions is included as an annex to this letter, and we have also provided feedback on the drafting of the Governance Document itself on the issues log provided by Ofgem.

The SIF is a vital mechanism in RIIO-2 that will support the network innovation required to contribute to the achievement of Net Zero targets.

The proposed three phase approach is logical and broadly supports an agile and strategically responsive mechanism. We foresee that early engagement with partners and suppliers will support more robust development of projects.

Flexibility in challenge setting could provide more opportunity to participate in strategically important projects, although we recognise that there is a balance to be had between agility of the process inside one set of challenges, and having the opportunity to participate in multiple competitions during a year. We think more clarity on the challenge setting process and our ability to input would be beneficial.

The tools described for the application, assessment, and management of the project seem well considered, and this is reinforced by Ofgem's selection of UKRI as delivery partner, who have well developed application systems and many years of experience managing innovation funding.

We consider that where a project is vital to the progression of a network's energy transition activities, this should be taken into account, and consideration given to the risk of delayed progress arising from limitations in the number of SIF projects funded within each challenge round. Related to this point is a concern that if funding is capped in the early years of RIIO-2 (as a means of allocating funding across the price control period) this would be limiting to the progression of the pipeline of projects across networks where early progression of well-developed projects across the networks is crucial to the energy transition.

We have a concern regarding the agility and flexibility of the three phase approach given the impact this might have to timelines and the ability to consistently resource across project phases. The potential need to demobilise and remobilise between phases could have adverse consequences for robust project development and cost efficiency. Identifying ways to optimise the timelines between project phases would help to mitigate this – in our response we propose some ways that this could be achieved.

Dedicating resource to a large number of discovery phase projects could dilute focus on the projects of most strategic focus, which are likely to be those of large scale, and requiring robust and detailed proposals and teams. Therefore, an understanding of the time that will be afforded to develop the discovery applications is needed as a short turn around would require engagement with project partners before innovation challenges are set.

We wish to seek further clarity on Ofgem's proposals to vary contributions to the default 10% in certain circumstances. We understand Ofgem's position that this is more likely to be the exception than the rule, however this has potential to affect appetite for participation. Specifically for this proposal:

- We would welcome the opportunity to explore the different ways that Ofgem percieves that financial benefits might accrue to network licensees from SIF projects, as this may be helpful to ensure that variations to contribution are not duplicative to other benefit sharing mechanisms (for instance royalty sharing, the totex incentive mechanism, and the 0.2% compound annual efficiency requirement relating to innovation that was included as part of the RIIO-2 Final Determinations).

- Where a project is considered to provide "non-network" benefits, whilst this might warrant an increased contribution from project partners of external funders, an increase to the level of network licensee funding does not seem appropriate given the activities that permitted by licence. The extent to which a project delivers non-network benefits might bring the suitability of the SIF as an appropriate funding mechanism into question.

- Ofgem seeks to fund projects on matched basis with other sources of public innovation funding which do not fund 90%. Further clarity on why Ofgem considers this to be appropriate in the context of the SIF would be helpful, as this could be seen to shift risk to network licensees for an external influence outside the scope of the RIIO-2 regulatory framework.

Finally, Ofgem has put in place a number of important mechanisms to fund energy transition projects (the Network Innovation Allowance, SIF, Use it or Lose it development pots, and Net Zero specific re-openers). The flexibility that these mechanisms afford is a benefit, however is likely to cause differences in the approach across networks. Further guidance from Ofgem, coupled with a holistic approach to engagement on Net Zero development could help to ensure that funding is utilised in the most effective manner, and promote the smoothest possible pathway.

We hope that the information provided is useful for you. Please do not hesitate to contact us to discuss any elements of this response.

Yours sincerely,

Craig Neilson
Future Regulatory Frameworks Manager

Annex 1: Consulation Question Responses

Question 1: Do you agree that our proposals to appoint and remunerate UKRI as our delivery partner provide value for money to energy consumers? If not, please explain why.

Support.

UKRI have several years of experience managing funding calls and have robust systems to run the application and project management through. Using UKRI may also improve the visibility of the calls to external parties that want to be involved.

Question 2: Do you have views on the means by which we can gather stakeholders' insight into strategic innovation priorities before developing a challenge?

Partly Support.

The proposed activities seem sensible and should provide more flexibility. However, alongside this flexibility, sufficient time and structure needs to be afforded to project teams in order to develop robust bids with the right partners.

There is little information provided in the Governance Document around the challenge setting methodology, and further clarity on this would be beneficial. The following are some further suggestions to support challenge identification:

- Workshops and engagement with the ENA GIGG and EIM groups
- Engagement with the GGG and Hydrogen Grid R&D groups and review of the already defined NSIB and Systems Transformation activities
- Net Zero Advisory group - this was mentioned in a previous workshop as the group for challenge setting but does not appear in the Governance Document
- Annual questionnaire
- Open webinars and network events with third parties that would like to access the funding (Horizon 2020 had some of these events which allowed people with proposals to present out and then interested parties to engage through face to face sessions)

Further information on the frequency and timing of challenge setting, and the time available between challenge setting and application in order to build project teams would help ensure that networks and partners are fully prepared for the application, resulting in better defined projects that are more likely to progress through the three phases.

A useful point of clarification would be whether a project could be resubmitted in later challenge rounds or funded through a different mechanism (such as "Use it or Lose it", or a re-opener) if it has been unsuccessful in progression from discovery to the alpha stage, or alpha to beta stage, due to another project scoring higher. Understanding scoring thresholds would also be useful in this regard. We consider that where a project is vital to the progression of a network's energy transition activities, this should be taken into account, and consideration given to the risk of delayed progress arising from limitations in the number of SIF projects funded within each challenge round.

Question 3: Do you consider our proposed three-phase approach suitable to support large-scale strategic network innovation projects, while encouraging learning and mitigating risk? If not, please set out your reasons why.

Partly Support.

The three-phase approach enables assessment of the feasibility of the activity without the need for NIA and should prevent delays in the Beta programme. However, these phases do extend the timeline of projects due to the gaps between each phase (approx. 5- 6 months). A degree of gap is inevitable, as time will be required for the governance teams to decide on whether to continue to the

next phase, but the length of these will cause issues around funding, contracting and resourcing the project. The length of gaps between the phases could prevent smaller organisations (whom are unable to fund resources during these intervals) from being involved in SIF projects. This would be unfortunate as the development of SMEs and smaller organisations will be key for the energy transition.

The focus on an agile approach is highly beneficial, however, we are concerned that the interval between each phase does not match the speed of progression and momentum we wish to achieve via the SIF projects. We propose the following options to reduce the time between the discovery to alpha and alpha to beta phases:

- Improving assessor engagement through the phases and undertaking some of the assessment tasks through the discovery and alpha phases

- Provide a monitoring officer to each project that has regular review sessions with the team and probes into the detail of the activity. These would need to be experienced leads who could fully understand the topics in development.

- Extending the discovery and alpha phases so that funding is available to undertake some of the activities in the assessment periods

- Restricting partner funding to alpha and beta phases only, which would enable networks to lead the discovery phase and pull the required information together, including developing the partner engagement for the following phases.

- Allowing some or additional project partners to join later phases of the project as needed

In terms overall agility of the mechanism, there may be circumstances where a solution to a challenge has been sufficiently developed outside of the SIF, and this would provide an opportunity to commence projects at the Alpha or even Beta stage, enabling progression of important projects on the quickest possible timeframe.

Question 4: Do you consider that the indicative value and length of the different Project Phases will accommodate a wide range of network innovation projects to support net zero?

Partly Support.

The phased approach is logical and the proposed project values are in an appropriate range. However, there is a concern around the ability to bring the right suppliers and teams together and maintaining those teams throughout all three phases. It is beneficial to have the suppliers in the discovery and alpha phase as they will have important inputs into each stage. However, contracting this work and maintaining the team with a 5-month gap between discovery and alpha and a 6-month gap between alpha and beta will be challenging. We would welcome UKRI's insight into how this could be managed based on its prior experience.

Question 5: Do you agree with our proposed Eligibility Criteria? If not, please explain why.

Partly support.

The eligibility criteria are appropriate. However, the innovation challenges and timeline for these is still unclear, and the alignment of these against some of the key activities that need to be completed as a network are yet to be concluded. In order to ensure our project applications are well developed we anticipate needing at least 2-3 months between challenge notification and application submission to enable engagement of the right partners and team members. This could be shortened if partners join in on later phases and do not need to be party to the early phases.

We observe that the reference to customer vulnerability as a design requirement in Criterion 3 does not seem aligned to the stated objectives of the SIF at the beginning of the document (i.e. with NIA focussing on energy transition and customer vulnerability, but SIF focussing solely on energy transition). However, we support the inclusion of customer vulnerability as an area of potential benefit, as covered in Criterion 2.

Question 6: Do you have views on which parameters Ofgem should consider defining when setting Innovation Challenges? In particular, the types of organisation that need to participate in a consortium as project partners?

In most cases we would want to include the technical experts either OEMs or SMEs, at least one academic partner and potentially other research groups. As with NIA the consumer benefits and how the project supports the energy transition must be parameters on which to set the innovation challenges.

Question 7: Do you have views on the circumstances in which Ofgem may require a higher level of compulsory contribution towards projects?

Do Not Support.

We seek further clarity on Ofgem's proposals in this regard. We understand Ofgem's position that this is more likely to be the exception than the rule, however this has potential to affect appetite for participation. Specifically for this proposal:

- We would welcome the opportunity to explore the different ways that Ofgem percieves that financial benefits might accrue to network licensees from SIF projects, as this may be helpful to ensure that variations to contribution are not duplicative to other benefit sharing mechanisms (for instance royalty sharing, the totex incentive mechanism, and the 0.2% compound annual efficiency requirement relating to innovation that was included as part of the RIIO-2 Final Determinations).

- Where a project is considered to provide "non-network" benefits, whilst this might warrant an increased contribution from project partners of external funders, an increase to the level of network licensee funding does not seem appropriate given the activities that permitted by licence. The extent to which a project delivers non-network benefits might bring the suitability of the SIF as an appropriate funding mechanism into question.

- Ofgem seeks to fund projects on matched basis with other sources of public innovation funding which do not fund 90%. Further clarity on why Ofgem considers this to be appropriate in the context of the SIF would be helpful, as this could be seen to shift risk to network licensees for an external influence outside the scope of the RIIO-2 regulatory framework.

- Fundamentally, if a project does not have direct benefits to network customers, this would be a concern as there are other BEIS funding routes for other energy transition projects that networks unable to access. It would be expected that anything funded through SIF has a direct impact to the energy networks in the UK.

Question 8: Do you agree with our proposed requirements to encourage collaboration and share learning? If not, please explain why.

Partly Support

Some ability to redact sensitive data as with the NIA projects is required. Projects such as cyber security and GSO projects can host information should not be in the public domain, although overview information could be shared.

Question 9: Do you have views on whether and, if so, how the ENA Smarter Networks Portal and annual innovation conference could be improved better to achieve its aims of effectively disseminating learning and enabling partnerships between licensees and third parties?

Several improvements have been undertaken in the last year both to the ENA Smarter Networks Portal and to the ENIC conference. These have proved successful, and it is the networks plan to take lessons learnt from past engagement activities to further improve the events and systems moving forward.

We observe that funding for the development of the ENA Smarter Networks Portal currently sits within the NIA. There may be instances where SIF specific enhancements or changes are required.

Question 10: Do you agree with our proposals on requirements for project applications? If not, please explain why.

Support.

The proposed question areas are reasonable although the number of words may be limiting in the early application phase. We propose running the process as defined but monitoring whether this might need subsequent amendment.

Question 11: Do you agree with our proposals for the assessment process? If not, please explain why.

Partly Support.

Please could Ofgem provide clarification as to whether the expert assessors are involved in the discovery and alpha phase to improve their understanding of the project, or whether this is expected to be limited to the 10-week window? As noted in our responses to questions 2 and 3, we think increased assessor involvement in the discovery and alpha phases could help to reduce the timeframe between phases.

Ofgem has put in place a number of important mechanisms to fund energy transition projects (the Network Innovation Allowance, SIF, Use it or Lose it development pots, and Net Zero specific re-openers). The flexibility that these mechanisms afford is a benefit, however is likely to cause differences in the approach across networks. Further guidance from Ofgem could help to ensure that funding is utilised in the most effective manner and promote the smoothest possible pathway.

As already noted in our response to 2, a useful point of clarification would be whether a project could be resubmitted in later challenge rounds or funded through a different mechanism (such as "Use it or Lose it", or a re-opener) if it has been unsuccessful in progression from discover to the alpha stage, or alpha to beta stage, due to another project scoring higher. Understanding scoring thresholds would also be useful in this regard. We consider that where a project is vital to the progression of a network's energy transition activities, this should be taken into account, and consideration given to the risk of delayed progress arising from limitations in the number of SIF projects funded within each challenge round.

Please could Ofgem provide clarification on circumstances where a SIF project is directed to be funded through a reopener, what will the impact be on the timeline and whether UIOLI funds be utilised to progress that activity prior to the reopener?

We observe the potential for variation in cost and benefit analysis across different parts of the framework (totex, re-openers, NIA, SIF), and we also aware that BEIS is aiming to develop a CBA modelling approach for the future Hydrogen network. Whilst this should not prevent the progression of the SIF, we think there is merit cross industry collaboration to align thinking across these different mechanisms with the aspiration of ensuring that projects and programmes are assessed on a consistent and congruent basis. Within the SIF itself, having a standardised approach would help support consistency and objectivity of assessment.

In the Network Innovation Competition (NIC) annual process there was a cap on the funds available per year/challenge. As there is no mention of this in the draft governance document, we would be grateful if Ofgem could confirm its position for the SIF (i.e. is there an approach in mind that allocates the SIF funding pot of £450m across RIIO-2?). We would be concerned that such capping would be limiting to the progression of the pipeline of projects across networks where early progression of well-developed projects across the networks is crucial to the energy transition. This links to our view that a holistic approach to engagement between networks and Ofgem on the overall Net Zero project pipeline would be beneficial and help ensure that the various funding options are used most effectively. If Ofgem decides to apply a cap in any year and there are multiple viable projects, please could Ofgem confirm if unsuccessful projects can proceed in subsequent rounds of challenge, and if there would be a mechanism by which the cap is reviewed?

Question 12: Do you agree with our proposals on requirements for reporting, and our proposals to monitor projects? If not, please explain why.

Support.

However, we would echo our previous points regarding ability to maintain resourcing through the three phased approach.

Question 13: Do you agree with our proposed funding arrangements for SIF projects? If not, please explain why and suggest whether there are alternative funding arrangements that may be preferable.

Partly Support.

The approach seems very similar to how NIC is managed. However, we note some areas of the funding mechanism that need to be addressed.

Para 7.7 in the draft document states that Ofgem will issue the SIF Funding Direction to each licensee once a year, to allow sufficient time for the impact of SIF Funding to be reflected in NTS Charges or Transmission Network Use of System Charges, from 1 April of the following year. Given that allowed revenues will now be published in November via the Annual Iteration Process, in order for SIF funding to be reflected in the following year's charges, it would need to be directed in time to support this process. We understand that Price Control Financial Model variable values to support the AIP need to be finalised by mid-November. If the directions are not issued in time for the AIP, this could lead to a situation where ESO and NGG are distributing money to funding parties, but not able to recover this through charges, creating a cash flow mismatch. This could be partly mitigated by the ability to forecast revenues via the AIP, but on inquiry, the draft PCFM guidance for ESO does not mention SIF, and there does not appear to be explicit guidance in the GT counterpart.

The draft Governance Document states that projects should be funded based on the benefiting consumer group, with either the ESO or NGG distributing funds. In the case of a whole system project, benefits could be shared between customer groups in both the electricity and gas sectors. However, only one funding party can receive funding from the associated distributor of funds, which gives rise to a situation where the allocation of funding does not reflect the sectoral split of beneficiaries. We would be grateful if Ofgem could provide clarity on the arrangements in such circumstances.

Question 14: Do you agree with our proposed requirements regarding project administration for SIF projects? If not, please explain why.

Support.

The approach seems very similar to how the NIC is managed.

Question 15: Do you agree with our proposed default rules for intellectual property rights and royalties for SIF projects? If not, please explain why.

Partly Support.

Given the broad range of projects that may be brought forwards under the SIF mechanism and the potentially greater diversity of funding sources that is foreshadowed by the Governance Document, it is important that network licensees are given flexibility to contract on the basis of IPR arrangements that are best suited to the particular project and which will best secure consumer value, whilst also allowing for the necessary knowledge dissemination to take place. We consider that this is best achieved by adopting a consistent position with the IPR arrangements permitted under NIA, which permits network licensees to select between several default foreground IPR ownership positions, including sole ownership by the creator, joint ownership between network licensee and creator in proportion to funding and effort, and sole ownership by the network licensee. We consider such consistency in approach on IPR is also helpful from the perspective of third parties who work with network licensees on projects funded under a range of different mechanisms, for whom the myriad of different requirements can be off-putting.

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Given Ofgem's policy intent to adopt a consistent approach on IPR across NIA and SIF the key paragraphs within the IPR section of the SIF Governance Document should mirror the wording that is used in the corresponding section of the NIA Governance Document. This will ensure absolute clarity and avoid ambiguity or differences of interpretation for the benefit of all parties. We have provided detailed comments on this in our accompanying issues log.

As regards the proposed rules on royalties, given there has been little practical application of the royalties mechanism to date it is difficult to assess its suitability. One area of concern is that there is no time or value limit on the royalties that are returned to consumers which has the potential to increase administrative burden on network licensees over time. Additionally, given the mechanism as currently drafted would operate in perpetuity it is not clear how it may be applied in a range of scenarios that may subsequently arise, such as where there is further development of the IPR generated under a SIF project, but such development is funded outside of SIF. We would welcome further engagement with Ofgem on this issue.