

Network licensees

Direct Dial: 0141 354 5416

Email: steven.mcmahon@ofgem.gov.uk

Date: 1 March 2022

Strategic Innovation Fund Round 1 Discovery Phase: clarification of the requirements imposed by chapter 8 of the SIF Governance Document

The Strategic Innovation Fund (SIF) is a funding mechanism for the Electricity System Operator, Electricity Transmission, Gas Transmission and Gas Distribution sectors within the RII0-2 network price control.¹

The SIF aims to find and fund ambitious, innovative Projects with the potential to accelerate the transition to Net Zero, while delivering net benefits to energy consumers. The SIF is delivered in partnership with Innovate UK, part of UK Research and Innovation (UKRI).

This letter seeks to clarify and provide some regulatory flexibility regarding the requirements of chapter 8 of the SIF Governance Document.² The SIF Governance Document sets out the regulation, governance and administration of the SIF. Chapter 8 within it sets out the requirements for the administration of Projects that are awarded SIF Funding.

Ahead of round 1 Discovery Phase Projects beginning on 1 March 2022, our³ engagement with Funding Parties (ie network licensees) has suggested that there are uncertainties on the intent and meaning of the requirements to hold SIF Funding within the Project Bank

¹ Further information regarding the Strategic Innovation Fund can be found here: <https://www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatory-programmes/network-price-controls-2021-2028-riio-2/network-price-controls-2021-2028-riio-2-riio-2-network-innovation-funding/strategic-innovation-fund-sif>

² A copy of the SIF Governance Document is available here: <https://www.ofgem.gov.uk/publications/sif-governance-document>

³ The terms 'we', 'us', 'our' refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

Account. Funding Parties have also flagged practical difficulties complying with requirements in paragraph 8.6 of the SIF Governance Document. We deal with the two specific issues below.

We confirm the overarching intention of Chapter 8 of the SIF Governance Document is to provide commercial flexibility for network licensees to hold SIF Funding, provided that expenditure can be tracked at Project-level.⁴

The Project Bank Account

Our intent is that the Project Bank Account does not need to be Project-specific. Instead, funds for multiple Projects can be pooled into a consolidated Project Bank Account, provided that there is the ability to track funds at a Project-specific level. In other words, if a Funding Party secured SIF Funding for more than one Project, they can put the funds for two distinct Project in the same Project Bank Account. However, the Project Bank Account must be exclusively used for SIF Funding.

The audit of alternative banking arrangements

As an alternative to use of the Project Bank Account, Funding Parties can choose not to keep the SIF Funding in a separate bank account and instead adhere to requirements in paragraphs 8.4-8.8 of the SIF Governance Document.

Based on feedback from some Funding Parties, we note that the implementation of the SIF has moved at pace and Funding Parties may not have had sufficient time for auditors to review any alternative banking arrangements. Therefore, some Funding Parties are unable to comply with the requirement in paragraph 8.6 for *'auditors [to] review the system and processes that the Funding Party is proposing to use... before the Project is initiated and any SIF Funding is spent.'*

In response to this feedback, our view is that where Funding Parties can demonstrate that any failure to comply with paragraph 8.6 of the SIF Governance Document - in relation to these round 1 Discovery Phase Projects being awarded SIF Funding this year - has arisen because of the pace at which the SIF programme has been implemented, we will take full account of this in considering compliance or enforcement actions on such issues. Provided that Funding Parties operate transparently and notify us of any problems complying with this aspect of the SIF Governance Document, we should not need to take any compliance or enforcement action against Funding Parties.⁵

⁴ As per definition of 'Project' within the SIF Governance Document, the innovation being taken forward in each Project Phase is a distinct Project. We need to be able to track expenditure incurred by each licensee on each individual Project.

⁵ For reference, Ofgem's enforcement guidelines can be found here: <https://www.ofgem.gov.uk/publications/enforcement-guidelines>

Not all Funding Parties may need to utilise this regulatory flexibility, but this is open to all Funding Parties should the need arise.

At this time, this regulatory flexibility is limited to round 1 Discovery Phase Projects being awarded SIF funding this year. Funding Parties are expected to comply with all requirements in chapter 8 of the SIF Governance Document for future rounds of the SIF.

Next steps

We will continue to engage and support network licensees on the implementation of SIF Projects. Our approach remains focused on creating an environment that allows innovation to thrive.

We will also look to clarify the definition of Project Bank Account within the SIF Governance Document at the next available opportunity to prevent continued uncertainty on this issue.

If you would like to discuss any of the issues raised in this letter, please contact Graeme Barton (Graeme.Barton@ofgem.gov.uk).

Your sincerely,



Steve McMahon
Deputy Director, Networks