



Making a positive difference
for energy consumers

All Electricity Distribution
Network Operators (DNOs)

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Dear all,

Letter to Distribution Network Operators (DNOs) regarding participation in round 2 of the Strategic Innovation Fund

The Strategic Innovation Fund ("SIF") is a funding mechanism that is currently available to the Electricity System Operator, Electricity Transmission and Gas Distribution sectors, that aims to fund ambitious, innovative projects with the potential to accelerate the transition to net zero.

The SIF Governance Document sets out the regulation, governance and administration of the SIF.¹

Ofgem is the decision-maker in relation to the SIF. However, to support the SIF's operation, Ofgem is partnering with Innovate UK, part of UK Research & Innovation. Innovate UK's role is to operate the SIF in line with this SIF Governance Document - administering the funding programme, monitoring the delivery of Projects, making recommendations to Ofgem on operational matters, supporting third-party innovators and, where possible, supporting successful Projects to become business as usual activities.

The SIF and the electricity distribution sector

The Electricity Distribution sector is still running the RIIO-ED1 price control ("ED1"), and will commence RIIO-ED2 ("ED2") in April 2023. The original position was that the DNOs would become eligible to access the SIF upon commencement of ED2, with the first

¹ Version 2 of the SIF Governance Document is published alongside this letter, and available here: <https://www.ofgem.gov.uk/publications/updated-sif-governance-document>

opportunity to bid for funding to any round 3 of the SIF. However, following engagement with industry and discussions with Innovate UK, we have confirmed in the decision letter that DNOs can submit Applications to round 2 of the SIF in late 2022, ahead of the start of ED2.² This means that DNOs' SIF projects can start on or soon after the 1 April 2023.

We want to enable DNO innovation projects to be taken forward as soon as possible, and as the DNOs are already familiar with the SIF from their engagement in round 1 as project partners, we consider it in consumers' interests to allow the DNO's to bid into the SIF in round 2 without a delay until ED2 commences.

The SIF in the DNO licences

There is currently no condition in the DNOs' licences in relation to the SIF. The new RIIO-ED2 licences will have a SIF condition that we expect to be consistent with what operates in other sectors³, however this will not come into force until 1 April 2023. Therefore, should any DNO wish to bid into round 2 of the SIF, that bid would not be underpinned by anything currently in their licence.

Ofgem has considered whether it is necessary to modify the current ED1 licence to incorporate a new condition in relation to the SIF or whether the DNOs can bid into round 2 of the SIF without any licence modification. On 22 April 2022, Ofgem emailed the DNOs seeking views on our minded-to position not to modify the ED1 licence.

Ofgem's view

We have considered the risk of DNOs proceeding with SIF round 2 bids in the absence of an ED1 SIF licence modification to be very low, given it has no impact on the DNOs' outputs or allowances in ED1. The SIF licence condition in other sectors makes provision for three actions: Providing an allowance for SIF outputs (Part A); adjusting that allowance to reflect output delivery (Part B); and adherence to the SIF Governance Document (Part C).

Decisions on outputs and funding following round 2 of the SIF will not be made until on or after 1 April 2023, when the ED2 SIF licence condition will be in force, therefore the only part of the condition that is relevant to the DNOs in ED1 is adherence to the SIF Governance Document.

As previously indicated to the DNOs, we do not foresee any realistic circumstance where we would seek to rely on the current ED1 licence, were it to only contain reference to adherence to the SIF Governance Document, in terms of any enforcement action for the

² The decision letter to update SIF governance confirmed our decision that DNOs can submit Applications to round 2 of the SIF. This decision letter is available here: <https://www.ofgem.gov.uk/publications/updated-sif-governance-document>

³ Special Conditions 5.7 (Gas Transmission), 9.13 (Gas Distribution Networks), 9.19 (Electricity Transmission), and 3.4 (Electricity System Operator).

SIF. We are satisfied that an agreement between Ofgem and the DNOs to adhere to the SIF Governance Document when submitting an Application into round 2, with no modification to the current licence, provides sufficient assurance for all parties and strikes an appropriate balance between risk and the resource requirement for a statutory licence consultation.

Submission of Applications by DNOs into round 2 of the SIF

Applications to round 2 of the SIF can be submitted by DNOs via UKRI's secure online portal until 23 November 2022.

We expect all bids and any subsequent activities in relation to the SIF in ED1, and beyond, to be consistent with the criteria and requirements set out within the SIF Governance Document.

Expert Assessors, with the support of Innovate UK, will assess applications from all sectors consistently and follow the assessment criteria detailed in the SIF Governance Document. Decisions on all Applications are expected to be published in or after April 2023. The funding decisions and any distribution of SIF funds will then be made as per the provisions contained in the ED2 SIF licence condition.⁴

Ofgem is satisfied that the draft of the ED2 SIF licence condition⁵ will not require any substantial modification in respect of SIF funding Applications made during ED1, and that the DNOs can fully participate in round 2 of the SIF with adherence to the SIF Governance Document.

If anyone has any further queries around DNOs participating in the SIF please contact graeme.barton@ofgem.gov.uk.

Kind regards,

Graeme Barton

Head of Price Control Operations – Small and Medium Sized Projects

For and on behalf of the Authority

⁴ SIF funding is recovered through network charges and distributed to licensees by the Electricity System Operator (ESO) and NTS Owner.

⁵ The draft ED2 SIF licence condition was discussed with DNOs at ED2 licence drafting working groups on 27 October 2021 and 26 January 2022.