Dear Sir / Madam,

**Re: Response to RIIO-ED2 Draft Determinations Consultation**

1. **Introduction**

Thank you for the opportunity to share our thoughts and insights regarding the development of the RIIO2 determinations and core methodology for ED2, and contributing to the body of knowledge which will help shape the future of the energy networks within the UK.

As you know the Energy Innovation Centre (EIC), is a not-for-profit business which, for 13 years has been bridging the gap between large utilities and small-scale SMEs. It consistently provides established routes to market for innovative ideas and technologies. The EIC has a vision which reaches far beyond the creation of improved utilities systems; our not-for-profit organisation is passionate about driving social progress, improving the quality of people’s lives, and securing a safe and affordable sustainable future for our children.

The EIC itself exists as a direct result of the innovation funding incentive. All our outputs over the last thirteen years have been achieved through collaboration and partnership, primarily under the umbrella of the innovation incentives. Part of our success is the establishment of a global innovation community which now has 8,000 individual third party innovators (75% SMEs and 15% international). This is a direct result of NIA funding and all the third-party innovators have a single direct access into the energy networks who are partners to the EIC.

The added value to the industry and ultimately to energy customers is evidenced by the innovation sourced and collaborative projects that have been developed in partnership with the innovation community. The energy companies that work with the EIC, will on average collaborate nearly twice as much as those who are not partners with the EIC and have together raised the bar in creating transparency in innovation by developing the Innovation Measurement Framework that will enable stakeholders to have visibility of innovation across the sector, which in turn will help in facilitating a whole systems approach to the energy transition.

Our partners are collaboratively working with innovators on a co-created programme, which will reduce barriers to the deployment of innovation into BAU. This level of partnership, co-ordination and transparency is industry leading.

The responses to the questions below incorporate comments and contributions from our innovator community. The EIC has included several general observations in relation to the consultation and then goes on to address specific questions detailed within the consultation.

1. **Overview**

Ofgem’s approach to innovation incentives is recognised as best practise and as being a global first, where an entire sector is incentivised to innovate where the outcomes of that activity can then be measured. However, innovation is a journey and the different price controls enable the regulator to iterate and further develop this approach, **building on the strong foundations** created by NIA which is hugely successful from an SME perspective.

SMEs tell us that they have seen and experienced a change in both culture and behaviours across the EIC’s Industry Partners in relation to innovation and collaboration throughout RIIO1.

Since the EIC’s inception the number of projects with SMEs has grown significantly, however, SMEs believe that the maturation of network business is not yet sufficiently developed to provide the motivation to innovate without an incentive. SMEs are unanimous in their positive feedback towards NIA, but believe that if the NIA didn’t exist, and all innovation is directed through SIF, then both innovation and third-party engagement would reduce dramatically.

For innovation to flourish, particularly with SMEs, there is a need to maintain **continuity, consistency** **and flexibility**. Given that innovation takes time to mature to deliver benefits (in the private sector, typically the payback period for innovation is 20 years), the sector requires such **continuity,** **consistency and flexibility** to build upon a strong foundation developed through world leading regulation.

**3.** **Consultation Questions on Core Methodology**

**Core Question 7 – Do you agree with our proposed approach to the value of SIF?**

The EIC and its Innovator Impact Panel agree with Ofgem’s approach in maintaining the existing value of the Strategic Innovation Fund at £450M. The Partnership also agrees with the criteria upon which Ofgem will review whether the fund should be increased in ED2.

The overwhelming view of the Innovator Impact Panel was that “the SIF structure doesn’t really work for small businesses”. It was felt that the nature of the process doesn’t align with the operation and reality of smaller businesses. SMEs specifically highlighted the multi-phased stop start approach to developing projects and the short duration and value of the Alpha phase does not align with the resource levels of many SMEs.

The EIC will share these views directly with colleagues at UKRI for consideration to inform the SIF process as it matures and develops.

The Innovator Community, particularly smaller Innovators are concerned that SIF may become the main innovation funding mechanism for the energy sector. The Innovator Impact Panel are firmly of the view that this will be prohibitive to smaller businesses innovating within the sector.

**Core Question 8 – Do you agree with our proposed approach to weighing SSMD criteria and benchmarking RIIO – ED2 – NIA requests against RIIO – ED1?**

The EIC and Innovators believe that NIA is an absolute necessity to ensure the continuation of innovation and engagement of small businesses within the energy sector. NIA has enabled third-party involvement in network innovation, allowing bespoke innovation solutions to be developed which will deliver benefits to UK energy consumers.

As previously shared, SMEs believe that the NIA is one of the most effective innovation funding mechanisms available within the UK and some have said Europe. This funding mechanism is invaluable as it brings project developers closer to customers, thereby increasing the pace of innovation and reducing the level of investment that is needed. It also increases the potential for success. Additionally, NIA is one of the few funding mechanisms that will invest in lower TRL innovations that may ultimately provide higher benefits to consumers in the longer term. This is demonstrated by several key projects due to deliver large returns to network operators and energy consumers that have been developed through the EIC.

Innovators are concerned that Ofgem appears to have reduced the level of NIA funding requested by network businesses and thereby reducing their ambition and potential innovation. Innovators stated that “we are entering a period of rapid change, where so much innovation is required” and suggested that the regulator consider increasing NIA funding and not reducing it. Innovators believe that the rreduction in NIA funding will consequently reduce the level of innovation undertaken by the industry at a time when we need to see it increasing.

However, innovators shared Ofgem’s concern regarding the challenge to deliver innovation into BAU. Innovators fully support Ofgem’s drive to ensure that network businesses become more effective in this area, which will create positive results for energy consumers and UK plc.

**Core Question 9 – Do you agree with our proposed approach to setting NIA allowances?**

The EIC and its Innovator Community welcome that NIA funding will remain available for the first 3 years of ED2 and that projects may continue for the full 5 years of the price control. However, whilst the community understands Ofgem’s desire to review the allowances at 3 years to align with GD3 and T3 developments, the review highlights a number of concerns.

Innovators are concerned that the review may be an opportunity to remove NIA and focus on SIF, which as stated earlier is seen as prohibitive to smaller innovative companies being able to contribute to the energy systems transition.

Innovators also highlighted that the capacity within the network businesses to undertake a full review of the Network Innovation Allowance after 3 years, would impact on the innovation pipeline. By way of illustration, the RIIO2 business planning process within network businesses diverted resources away from developing and transferring innovation into BAU, creating delays and challenges to SMEs working in the sector.

The Innovator Panel were unanimous in their agreement that the regulator should not reduce NIA allowances as this would impact the ambition of networks, and that energies should be focussed on supporting the industry in developing effective benefits monitoring and BAU roll-out processes.

The overall uncertainly created by a mid-term review will impact the confidence of SMEs to work with the industry and likewise will create uncertainty within the network businesses. Experience has shown that this may have a detrimental impact on the volume and ambition of innovation. At such a critical time, the Innovator Impact Panel are asking Ofgem for certainty that the NIA funding will be available for the 5 years of price control (i.e. NIA funding also available for regulatory years 4 and 5), as this will in turn deliver greater security for network businesses and increase innovation from the Innovator Community. Clarity as this stage is key.

**Core Question 10 – Do you agree with our proposal to allow DNOs to carry over any unspent NIA funds from the final year of RIIO - EDI into the first year of RIIO – ED2?**

The Innovator Impact Panel and the wider Innovator Community fully support, endorse and welcome the approach being proposed by Ofgem in allowing projects to run for a further year to enable a completion. This will ensure that in this final year of ED1 innovation will not be artificially curtailed and projects will be able to roll forward into RIIO2.

Thank you once again for inviting the EIC and its Innovator Community to contribute to the consultation. Should you require any further information or insight from our Innovator Community please do let me know and we would be happy to facilitate more detailed conversations and insights as required.

Yours sincerely

Denise Massey

Managing Director Energy Innovation Centre Ltd

25 August 2022