

Consultation

Consultation on RIIO-ED2 Network Innovation Allowance (NIA) funding for years 2026/27 and 2027/28

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We are consulting on a proposal to provide an additional £45.6m of innovation funding to Distribution Network Operators (DNOs) for the last two years of the RIIO-ED2 price control. We particularly welcome responses from people and organisations with an interest in electricity distribution networks and innovation. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Consultation – Consultation on RIIO-ED2 Network Innovation Allowance (NIA) funding for years 2026/27 and 2027/28

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1. Introduction

Section summary

This section provides a background and introduction to what the NIA is and how it fits into RIIO.

It also sets out our reasons for this consultation and any next steps that need to be taken.

What are we consulting on?

- 1.1 We are consulting on a proposal to provide an additional £45.6m innovation funding to DNOs over the last two years of the RIIO-ED2 price control. We are inviting views from DNOs and all interested stakeholders on our proposed way forward which is set in this consultation document.

Background

- 1.2 Network companies are natural monopolies. Effective regulation of privatised for-profit monopolies is essential to ensure they cannot unfairly exercise their monopoly power to the detriment of their customers. This is particularly important in the case of essential utilities, such as energy. It is therefore crucial that an effective regulator protects energy consumers by controlling how much network companies can charge their customers.
- 1.3 We regulate the monopoly companies in the four energy network sectors: Electricity Transmission (ET), Gas Transmission (GT), Electricity Distribution (ED), and Gas Distribution (GD). Ofgem does this through periodic price controls that are designed to ensure network companies are properly incentivised to deliver the best possible outcomes for current and future energy consumers. This includes ensuring that consumers only pay for investments that are needed and do not overpay for those investments.
- 1.4 The current price control model is known as RIIO (Revenue = Incentives + Innovation + Outputs). RIIO-2 is the second electricity and gas price control under the RIIO model. The price control period runs from 1 April 2021 until 31 March 2026 for ET, GT and GD. The price control period for ED sector runs from 1 April 2023 to 31 March 2028.
- 1.5 As part of our RIIO-2 innovation stimulus funding we decided to maintain the Network Innovation Allowance (NIA) to fund innovation relating to support for consumers in vulnerable situations and/or the energy system transition. The NIA enables companies to take forward innovation projects that have the potential to

address consumer vulnerability and/or deliver longer-term financial and environmental benefits for consumers, which they would not otherwise undertake within the price control.

- 1.6 Any DNO expenditure under the NIA is reported to Ofgem as part of the network companies' Regulatory Reporting Packs. This provides Ofgem with oversight of how much has been spent and therefore how much funding remains available. We are continuing to look at options to better track the benefits of innovation.
- 1.7 When setting the RIIO-ED2 price control starting 1 April 2023, we decided DNOs would have a 'use it or lose it' allowance (UIOLI), with flexibility to allocate funds across RIIO-ED2, as long as projects are registered within the first three regulatory years, ie before 1 April 2026 (more information is available at paragraphs 3.94 to 3.118 of [RIIO-ED2 Final Determinations Core Methodology Document](#)).
- 1.8 We said we would review by the end of 2025 whether more NIA funding should be allowed for the final two regulatory years of RIIO-ED2, which is the subject of this consultation.

Next steps

- 1.9 Subject to the responses to this consultation, we will make a decision on whether to provide additional innovation funding through the NIA in the final two years of RIIO-ED2.
- 1.10 If we decide to provide additional funding, we will consult on changes to the Special Conditions of the Electricity Distribution Licence to implement our decision.

How to respond

- 1.11 The consultation will be open until the 18th of April 2025. Responses will be reviewed, and a decision will be published following consideration of the responses received.
- 1.12 We want to hear from anyone interested in this consultation. We are particularly interested in the views of DNOs and those stakeholders with an interest in innovation. We would also welcome responses from other stakeholders and the public. Please send your response to networks.innovation@ofgem.gov.uk.
- 1.13 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, your data and confidentiality

- 1.14 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.
- 1.15 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.
- 1.16 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 1.
- 1.17 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

- 1.18 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

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Choose the notify me button and enter your email address into the pop-up window and submit.

ofgem.gov.uk/consultations

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Would you like to be kept up to date with *Consultation*
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Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

2. Options and proposed way forward

Section summary

This chapter sets out the potential options for NIA funding in final two years of RIIO-ED2 and our proposed way forward.

- | |
|--|
| <p>Q1. Do you agree with our proposed approach?</p> <p>Q2. Are you aware of, or do you have evidence of innovation that would not proceed in the absence of our proposed approach being implemented?</p> |
|--|

Context

- 2.1 Innovation is an essential part of how we expect energy networks to operate and a key feature of the RIIO price control framework. To deliver a low-carbon energy system that is reliable, safe and efficient at a pace in line with our net zero targets, companies have to find new ways of developing and operating their networks.
- 2.2 The NIA provides limited funding to RIIO network licensees to enable them to take forward innovation projects that have the potential to address consumer vulnerability and/or deliver longer-term financial and environmental benefits for consumers, which they would not otherwise undertake within the price control. Further details and eligibility criteria are set out in the RIIO-2 NIA Governance Document ([RIIO-2 NIA Governance Document \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/rrio2-nia-governance-document)).
- 2.3 We only provided NIA for the first three years of RIIO-ED2. This was to allow us to consider alignment of the RIIO-ED2 innovation stimulus with potential future reforms in other sectors as a result of the development of RIIO-3. We considered that alignment allows electricity distribution consumers to benefit from the learnings and experiences of operating the Strategic Innovation Fund (SIF) and NIA alongside one another and support the aims of the SIF to promote collaboration between energy network companies across sectors. We said we would review by the end of 2025 whether more NIA is required for the final two regulatory years of RIIO-ED2.
- 2.4 We have now published our Sector Specific Methodology Decision (SSMD) for the RIIO-3 price controls covering electricity and gas transmission, as well as gas distribution ([RIIO-3 Sector Specific Methodology Decision for the Gas Distribution, Gas Transmission and Electricity Transmission Sectors | Ofgem](https://www.ofgem.gov.uk/riio3-sector-specific-methodology-decision-for-the-gas-distribution-gas-transmission-and-electricity-transmission-sectors)).

- 2.5 While we identified a number of areas for improvement, the RIIO-3 SSMD confirmed our decision to retain the NIA. We believe that the flexibility and pace of the NIA play a key role in driving innovative projects taking a whole systems approach to solving challenges of meeting net zero.
- 2.6 Our consultation on the framework for the next electricity distribution price control ([Framework consultation: electricity distribution price control \(ED3\) | Ofgem](#)) also confirmed our belief that both the NIA and SIF are appropriate mechanisms in supporting the development of disruptive technologies and innovative business models that may not be explored within ED3 in the more efficiency focused innovation delivered with BAU or other funding.
- 2.7 We believe it is therefore now an appropriate time to revisit the NIA awarded as part of the RIIO-ED2 settlement. The alternative approach would be to wait until later in 2025 when we would have more data on the actual roll-out of innovation in RIIO-ED2. This may provide a clearer indication of the need for additional funding. However, we think an earlier decision will provide DNOs and stakeholders with more certainty over future funding arrangements and reduce the risk of missing opportunities that may otherwise be the case.

Current NIA allocations

- 2.8 The NIA has provided £87.2m of funding towards innovation projects since the start of RIIO-ED1 in 2015, with £68.4m of this funding being allocated for the first three years of RIIO-ED2¹.
- 2.9 As part of our RIIO-ED2 setting process we required DNOs to provide evidence that the areas they would target for NIA funding were high-risk and in need of ring-fenced stimulus, undertake other innovation projects as business as usual and have in place processes to report on and track innovation projects. Proposals were scored on these criteria and others, as well as the strength of evidence provided, and we decided to provide the following funding for the first three years of RIO-ED2:

¹ All figures regarding funding over the course of RIIO-ED2 are expressed in terms of 2020/21 prices.

DNO	ED2 NIA funding allocated (£m)
ENWL	8.4
NPg	7.5
NGED	18
UKPN	15
SPEN	11.1
SSEN	8.4
Total	£68.4

- 2.10 There has been a total of 363 NIA projects proposed by DNOs under the RIIO-ED2 NIA funding mechanism so far.² Through regulatory reporting by the DNOs, and the ENA Smarter Networks portal, we have seen examples where the NIA has been an effective means of testing innovation at a smaller scale that can then transform into a scaled project. While the SIF also provides funding for innovation, there has been an eagerness from DNOs to still adopt the NIA for smaller scale projects without the pressure of the different timescales in the SIF. Smaller scale projects that successfully save consumer bills can be scaled as a larger project to save more consumers even further funds. Without the NIA and the budget being granted this may not be possible as DNOs would potentially be hesitant to commit to a large-scale project from the beginning without pre-existing data such as that from a past NIA project.
- 2.11 Our RIIO-ED2 Final Determinations said that the NIA can be spent flexibly by DNOs throughout the price control, as long as projects are registered by 31 March 2026. DNOs could plan to spread NIA spend across the entire RIIO-ED2 period, should they wish to avoid a complete stop to NIA funding, in the event that we decide not to award additional NIA for the final two years of RIIO-ED2. Some projects could start in the final two years of RIIO-ED2 and run until the end of RIIO-ED2 if necessary. However, we have received evidence from network companies through their annual reporting packs that suggests that without further funding, if DNOs continue to spend at the same pace as seen in 2023/24, half of DNOs would use their full allowance prior to the end of the ED2

² [Search Results | ENA Innovation Portal](#)

period. Extending the funding available to DNOs could therefore maximise the potential benefits of innovation that would not otherwise take place.

Options

- 2.12 We have considered three options on the provision of additional funding through the NIA in the last two years of RIIO-ED2.

Option 1: Pro Rata Increase

- 2.13 The first option is to increase the total amount of NIA funding awarded to DNOs from three to five years on a pro rata basis, allocating additional funding so that DNOs have the same amount to spend per annum in the last two years of the price control. This follows our approach in RIIO-ED2 Final Determinations where we calculated DNOs' proposed NIA as an annual figure initially and then multiplied this by three to arrive at the RIIO-ED2 allowance.
- 2.14 This would allow DNOs to continue to register projects after 1 April 2026 and is consistent with our approach for RIIO-ED3 to maintain the NIA. We consider this would be the simplest and quickest to implement, therefore providing most certainty to DNOs and stakeholders.
- 2.15 This approach would result in £45.6 million of additional funds being distributed across the sector in the final two years of RIIO-ED2. As this is a UIOLI allowance any unspent funding is not charged to customers.

Licensee	ED2 allocation for years 1-3 (£m)	Additional pro rata funding for years 4 and 5 (£m)	Total funding across ED2 (£m)
ENWL	8.4	5.6	14.0
NPgN	3.2	2.1	5.3
NPgY	4.3	2.9	7.2
WMID	5.6	3.7	9.3
EMID	5.6	3.7	9.3
SWALES	2.8	1.9	4.7
SWEST	4	2.7	6.7
LPN	4.7	3.1	7.8
SPN	4	2.7	6.7
EPN	6.3	4.2	10.5
SPD	5.9	3.9	9.8
SPMW	5.2	3.5	8.7
SSEH	3	2.0	5.0

SSEN	5.4	3.6	9.0
Total	68.4	45.6	114

- 2.16 We are aware that major changes to the NIA process could cause confusion to a system that has delivered benefits to consumers over several years. Given our stated intention to continue the NIA in the upcoming RIIO-ED3 price control, we do not think it would be desirable to effectively pause funding for two years before restarting in 2028 and provision of this additional funding helps mitigate that risk.

Option 2: Detailed Assessment

- 2.17 The second option is to conduct a more detailed assessment to determine if further NIA funding is required, and if so, at what level. This could be accomplished through several methods:
- Inviting DNOs to submit requests and then conducting an assessment similar to that done when setting the RIIO-ED2 price control.
 - Conducting a retrospective review of actual spending and evaluating those projects for value for money or other criteria, in order to determine the appropriate level of funding for new awards.
 - Basing the decision on the success of previous innovation rollouts.
- 2.18 This option could have the advantage of revealing a more accurate figure of how much additional funding is required. However, we consider this would be more onerous and take longer to conclude.
- 2.19 We consider that the risk of providing more funding than is necessary that this option seeks to address is already minimised under option 1 as this funding is a UIOLI mechanism, and therefore any unspent funds will not be charged to customers. Conducting an in-depth review could however risk prolonged uncertainty for DNOs and stakeholders.

Option 3: No Additional Funding

- 2.20 The final option we have considered is to award no additional funding until ED3 in 2028. We do not support this option.
- 2.21 The electricity distribution sector has seen substantial innovation with the funding that has been provided to date. Innovation is and has been in the past a very useful way of helping the wider GB market - whether that be through innovation projects that have aimed to reduce consumer bills or bills or other

projects that have tried and have been successful at making operational efficiencies. We are also continuing to support innovation through other programmes such as the SIF.

- 2.22 Were no additional funding to be provided, DNOs would enter the final two years of the price control with no further innovation funding. While we allowed for the funding that was awarded to be used throughout the full five-year price control, this could result in a number of innovation opportunities not being explored and risk pausing the NIA process for the final two years of the price control, only for it to likely be restarted at the beginning of the next RIIO-ED3 price control. We believe this would result in inefficiencies and be confusing for network companies and wider stakeholders. It would also lessen the benefits to consumers that increased innovation can provide.

Our proposed way forward

- 2.23 We are minded to proceed with option 1 and provide DNOs with the same per annum funding for the last two years of the RIIO-ED2 price control as they received for the first three years of the price control period.
- 2.24 In addition to the reasons above, we consider that maintaining the current level of funding will help DNOs better plan their annual funding for the coming years and avoid the need for significant change.
- 2.25 We also understand the desire from DNOs and other stakeholders to maintain the level of innovation funding to avoid any missed opportunities between now and the start of ED3. We would welcome any evidence on our minded-to-position of continued funding as part of the responses to this consultation.

3. Implementation of our proposed way forward

Section summary

This section provides a summary of our way forward with our ideas on potential modifications to the Electricity Distribution Licence.

- 3.1 We aim to publish our decision later in the year once the consultation has closed and we have carefully considered all responses.
- 3.2 If we decide to proceed with our proposed way forward, we will consult on a proposed modification to Special Condition 5.2 of the Electricity Distribution Licence. This statutory consultation will run for at least 28 days and, if we decide to implement these changes, they will take effect 56 days after our final decision.
- 3.3 If we decide to award additional funding following a more detailed assessment, or that no additional funding is necessary, we will set out more detailed next steps in our decision.

Appendices

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Appendix 1 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

We will not share your personal data with any third parties.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the project has closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it

- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information

For more information on how Ofgem processes your data, click on the link to our "[ofgem privacy promise](#)".