

Mr John Russell
Ofwat
By email

Direct line: [REDACTED]
Email: [REDACTED]

Date: 20 September 2019

Dear John

Driving transformational innovation in the sector

Thank you for the opportunity to respond to your consultation on driving transformational innovation in the water sector. It was also good to speak to you and your team on your recent visit to us.

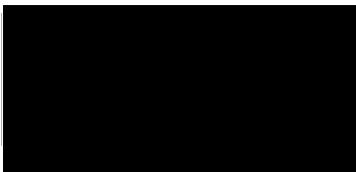
We hope therefore that our record on developing and delivering innovative approaches is well understood and I will not repeat it here. I think that we all agree though that the industry faces great challenges and that we need to redouble our efforts so that we continue to deliver against our customers' expectations.

Innovation is a risky business. Traditionally, regulated companies have borne all this risk with uncertain and limited rewards.

While this has not prevented us from pursuing innovative approaches, addressing the risk/reward balance should encourage more innovation across the sector. We therefore support the broad thrust of the proposals in your consultation as a potentially useful contribution to this.

As a member of UKWIR we have also contributed to the development of its separate response. I hope that you find this helpful and, should you require any further information, please do not hesitate to contact me.

Yours sincerely



Phil Wickens
Director of Regulation and Reform

Wessex Water responses to consultation questions

Q:1 What are the main barriers to innovation in the sector and why?

The multiple barriers to innovation in the water sector are well rehearsed. Fundamentally though the key barrier to innovation in the water sector is the lack of clear commercial benefit to water companies themselves that can be seen to outweigh the risk of trialling new approaches.

Innovative solutions are, by their nature, more uncertain in their outcome. Penalties for failure are usually pretty clear. The 5-year regulatory periods tend to mean that the rewards for success are much less clear and less certain as any cost benefits from innovation may be 'baked in' to future price controls that seem to expand in their complexity each time. Wider environmental and quality regulation and related legal duties have also contributed culturally to a low risk appetite to innovation in certain areas of the sector. This means that although innovations do occur it is often a prolonged process that is hard for innovators and technology developers to navigate.

Much tougher performance improvement and financial targets, as seen in the recent draft determinations, might be considered to be a necessary stimulus for innovation, on the basis that "necessity is the motherhood of invention". We would caution against that view. We fear that this will result in the opposite effect as water companies seek to limit their downside risk by focusing on doing more of what they know works, rather than on things that might deliver a big leap forward, but which may prove unsuccessful.

Q:2 Do you think that the financial support cited in section three is required to stimulate innovation in the sector? If so, what do you believe is the appropriate amount of funding and why?

Given our response to question 1 above we think this intervention would be helpful. There is no doubt that focused funding, which clearly rebalances the risk/reward position would stimulate further innovation.

The design of the fund will be important in rebalancing the risk/reward position. And it is not clear that a fund like this, in and of itself, will be enough to stimulate more innovation than currently exists if there is uncertainty about whether or not that innovation will receive any funding. The lack of clarity and the subjectivity around the decisions to award funding may even deter companies from trying to find the sort of collaborative solutions that Ofwat is trying to foster.

We would therefore propose that:

- the fund is as transparent as possible about the criteria for upfront funding, and that these criteria are broad enough to allow for potential wider societal benefits to be considered,
- that any "clawback" risk is also clearly defined, and relatedly
- that the fund is sufficiently flexible to allow for changes in scope as a project progresses and new opportunities emerge

Q:3 Do you agree that our proposed draft principles for additional financial support will effectively safeguard the interests of customers?

We broadly support the draft principles, save a few important points.

- The requirement that the innovation fund should not just focus on areas that companies would not otherwise have focused on will be very difficult to adjudicate against in an objective manner. This may act as a barrier in and of itself. It is not clear what these areas might even be, as all our customer research has pointed to the outcomes our customers and stakeholders expect us to focus on, all of which are supported by PCs and ODIs. For example, EnTrade has been focused on outcomes that are important to customers and stakeholders, and covers topics that we and others were investing in. However it is a transformational innovation – in terms of the approaches it promotes – and one we consider would have been suitable for a support such as this. We cannot see why companies would focus on areas that are not covered by the regulatory regime already. The examples given include climate change, population growth and changing customer expectations but these are broadly covered (in our case, at least) by PCs on greenhouse gases, STW compliance and C-MeX, to name but a few.
- Whilst we support the idea that innovation may come from collaborative working, we do not believe that this should be a pre-requisite for receiving funding. There are clearly examples, such as those quoted in the consultation, that have delivered innovation through collaboration. However, there are many more that have come from individual company work. In practice of course it would be unusual for any innovative approach not to involve collaboration with third parties of some sort through suppliers, NGOs, tech developers, researchers, etc. but it would not be appropriate if the fund meant that a successfully bidding company would become tied to the use of specific third parties for the duration of any trial. We do support the concept of sharing best practice across the industry. We are also very supportive of avoiding duplication through disparate trials of the same approaches within the industry and this could be enhanced by sharing failures as well as successes.
- Value for money for water customers is clearly important, however many of the best examples of innovation in the sector are ones that have led to companies working outside of the traditional water/sewerage sector boundaries to deliver better outcomes for society as a whole, for instance through collaboration with the debt advice sector and farming communities. Broadening the criteria to one that is delivering public value as opposed to simply value for water customers would be beneficial in this context.
- We feel that the fund should probably steer clear of research as there is too much overlap with UKWIR and EPSRC, NERC, etc.
- Finally, we believe it is important that the fund works for projects crossing into 2025-30. Given that the regulatory periods are a key blocker to innovation at the moment, it seems important that the fund helps bridge this gap.

Q:4 What are your views on the collectively funded innovation competition model which we describe in section three? What other key considerations not highlighted should we take into account in designing/ implementing the competition?

A collectively funded model seems a broadly sensible approach to innovation funding. Our key concern is around the lack of certainty, whereby companies may find themselves innovating, the innovation failing and not securing money from the fund. We expect this will limit the number of submissions to the fund.

We also have concerns around the phasing of the money available and the risk of limiting innovation by requiring companies to commit to project costs. Neither of these points are sufficiently developed yet to comment further.

A key consideration in the design of such a competition is whether or not there should be a limit on the funding given to an individual innovative idea. Is it possible, for example, for a single idea to receive the entire £200m?

Q:5 What are your views on the end-of-period innovation roll-out reward we describe in section three? What other key considerations not highlighted (e.g. whether it should be collectively funded or individually funded) should we take into account in designing/ implementing the reward?

We do not support the end-of-period approach. We feel this would disincentivise companies to promote innovative solutions for fear of not receiving funding. There is a clear risk that this would become more of a PR exercise in telling the best innovation story, rather than delivering truly beneficial projects or approaches.

Q:6 What other potential alternative mechanisms for funding/ rewarding innovation not discussed do you think we should be considering? Which financial support mechanism or combination of mechanisms should we introduce and why? What would be an appropriate split of available funding/ reward?

We have a clear preference for the collectively funded competition proposal.

Q:7 Do you think the potential industry activities discussed in section four could help drive innovation? Are there other activities not identified which you think the industry should be considering?

It is clearly important that the sector works together and shares best practice.

We do also think there may be benefit in setting-out a cross sector innovation strategy. This should be underpinned by a joint statement of the long-term expectations for the sector and its contribution to wider society from policy makers and regulators that will give focus to that strategy. The recent formulation of "RAPID" might be a useful starting point to deliver that. We would expect that this national strategy would allow room for individual companies to adopt their own strategies that will vary in their emphasis depending on the scope and scale of their own local priorities.

The industry already has a number of bodies that work for and on behalf of the companies (WRC, UKWIR, etc.) and we cannot see value in creating another body. A physical incubation / test centre is unlikely to offer good value. Several companies already have facilities to test innovative ideas and, whilst we would be supportive of using these to trial new ideas, we do not support the development of new facilities. We think it may be more beneficial to foster a virtual network of these existing facilities to improve knowledge sharing and collaboration.

We strongly agree with the concept of open data and open systems, as demonstrated by our new Wessex Water Marketplace. The opportunity to open challenges to third parties by sharing data and problems is one that we see huge value in.

Q:8 Do you think the proposals in section five will help drive innovation? Are

there other activities not identified which you think Ofwat should be considering?

The main benefit of cross-regulator work would be in all regulators reaching a collective agreement on long-term priorities and requirements for the sector, as well as simplifying the regulatory mechanisms that drive the incentives for innovation making them easy to understand for all parties.