



Together we innovate

From: [REDACTED]

To: Ofwat, 21 Bloomsbury Street, London

PRIVATE & CONFIDENTIAL

Dear Sir / Madam,

Re: Innovation Funding & Competition: Further consultation on design & Implementation

Thank you for the opportunity to share our thoughts and insights regarding Ofwat's proposal for the Innovation funding and competition.

The EIC is a not-for-profit business which, for more than 11 years has been bridging the gap between large utilities and small-scale SMEs in the Energy Industry and more recently in the Water Industry. We have created an environment that facilitates the open rapid discovery and adoption of innovation across the utilities sector, enabling all players to maximise their contribution.

Our aim is to harness innovation to support social progress, improve the quality of people's lives and secure a safe, sustainable and, affordable, water resilient net zero future.

Please see below our response to selected questions.

IPR/Royalties

Q1: Do you agree with our proposed default arrangements for managing IPR and royalties? Do you think these arrangements work for different types of projects and activities (e.g. new technology vs. process innovation, roll-out activities etc.)?

From our experience of engaging with innovators (particularly SMEs) under Ofgem's Network Innovation Allowance, the subject of royalties can often cause innovators concern, due to their continuing nature and the obligations to record and account for those royalties.

There is also the question of the breadth of scope of those royalties. For example, will a percentage royalty be due on sales to the water companies only, or will that percentage apply to sales outside of the water companies and into other industries. In addition, the subject of territorial application of royalties can also be a point of contention.

As a final consideration, adopting royalties as the default arrangement could prevent an element of flexibility for water companies (see alternative arrangement proposed in Q2).

Q2: What alternative arrangements should we be considering for IPR/ royalties?

The treatment of IPR by way of categorising Background IPR and Foreground IPR is entirely prudent and would work if an overall, fully encompassing default royalties' position is adopted.

As an alternative, in order to provide an element of flexibility for the water companies and to ensure that they are therefore fully motivated to implement a particular innovation, a 'discount' on commercial product price may be considered in the alternative.

This would require consideration of a regime similar to that adopted in Ofgem's Network Innovation Allowance governance, whereby each energy company that supports a particular innovation project (i.e. because it fully aligns with the issues and challenges they face) utilises an allocated amount of its share of the innovation funding available. For those companies that commit such an allocation, they receive the benefit of a discount on the final 'commercial product' sale price; determined with reference to a defined direct cost of the production of the commercial product with either a margin cap placed on top of the direct cost, or a discount provided for a determined period of time.

The savings achieved by the contributing water companies from the capped or discounted commercial product cost could then be recorded and passed back to the customer. This places the obligation on recording such savings on the water companies, making them accountable, as opposed to placing an obligation on the innovator to have to report on sales for the purposes of calculating royalties due. It also then avoids complex and potentially time-consuming sales audit mechanisms.

Implementation of a licence of 'Relevant Foreground IPR' (namely such IPR that the 'non-contributing' companies would have the benefit of with respect to the development and demonstration of the innovation, but not the provision of any IPR that would comprise the final commercial product) would be required in this respect. There would then remain an option to seek a royalty from the innovator for any sales to non-contributing water companies, but providing the freedom for innovators to exploit the commercial product in other markets without restriction, which would encourage more innovators to submit innovation solutions because of

the potential commercial reward for them at the end – striking a fair balance for the water companies and innovators.

IPR/Royalties

Q3: Do you agree with the principal that data generated through the innovation competition should be open by default?

The EIC fully endorses the proposed approach to open data.

Q4: Do you agree with our proposed approach that we should consider alternative arrangements beyond company contributions?

Should Ofwat determine that water companies can propose alternative well justified funding arrangements in terms of risk sharing, there will need to be clear time frames and a defined process for agreement between Ofwat and the companies to avoid unnecessary time delays which can be extremely costly and prohibitive to third parties and increase the risk to any collaboration or innovation.

Q5: Do you agree that the guideline minimum company contribution of 10% is appropriate in this context?

The EIC supports this view which has worked extremely well in the energy sector, ensuring full focus and commitment from the water companies in the development and deployment of innovation projects.

Q6: Do you agree with the overarching approach we set out here?

We agree that it is important to retain the ability to flex the funding approach in the first 2 years which will enable the new system to adapt and settle in the most efficient and responsive way. Again, clear review mechanisms need to be put in place to ensure the fund itself doesn't add to any inertia within the system.

Q7: What are your views on introducing separate, proportionate, arrangements for small-scale projects? How might we define small-scale projects for the purposes of the innovation competition?

Following on from our previous consultation response (September 2019, Driving transformational innovation in the sector), we fully support the introduction of an arrangement for smaller scale projects. From our experience in the Energy industry, it will encourage SME engagement, collaboration and contribute to de-risking larger scale strategic projects.

Smaller scale projects will also have a positive impact on culture of innovation in the water sector, as benefits can potentially be achieved faster. With support from adequate governance in the fund, it will generate a culture of learning and maturity.

Smaller scale projects can also be ideal opportunities to create a level playing field for SMEs and new market entrants as they can be considered lower risk by all parties.

Having two separate types of competition with different sets of rules will provide the right context for different size projects and organisations without dictating exactly who should apply to each. This would probably be fairer and easier to administer than having hard rules around project size.

The Innovation Competition, will require a formal bidding process within set timescales at considerable costs to the bidding consortium. Given the nature of this process (similarly with the NIC in the energy sector) this will attract larger organisations and potentially prohibitive to smaller companies.

However, the Innovation in Water Challenge which, as described in 1.6, suggests it will be designed to enable partnerships and collaboration with third parties which will increase the volume of innovation and collaborators into the water sector. This approach arguably delivered the greatest impact in increasing transparency, collaboration and partnership working with third parties in the energy sector.

(Please see further in Q10 response)

Q8: Do you agree with our proposal for ensuring roll-out is at the heart of the innovation competition? How might we reward both leaders and fast followers in?

It is essential that commercialisation, deployment and roll out are at the heart of this fund. We believe that the approach set out is correct and rewarding fast followers will make a positive difference in collaboration and deployment. Every water company is incentivised to collaborate and not duplicate efforts which will also promote and deliver improved standardisation across the sector.

However, there are two caveats:

1. Ofwat would need to ensure that the focus on outcome and commercialisation does not stifle early innovation. The commercial route to market can sometimes be unclear at the early stages of innovation e.g., Electrification of transport is a good example. Innovation is needed to ensure different components of the transportation of flexible energy is available which requires innovation, however the route to commercialisation isn't clear and the demand has not yet arrived. Energy Policy will ultimately provide this clarity and the industry will need to respond immediately to the market changes. Therefore, if this is a prerequisite, it may preclude some innovation being supported.

2. There needs to be a clear balance between rewarding leaders and rewarding collaboration.

Experience in in the energy sector has demonstrated that companies embrace competition which has created additional barriers to collaboration and shared learning which ultimately impacts on innovation rollout across the sector.

The development of an Innovation Measurement Framework (based on the Energy Innovation Measurement Framework) would ensure visibility of each company's culture and activity, which would organically support the development and deployment of innovation. The framework should be used, not only to support the fund, but most importantly to put the spotlight on the company's innovation culture as a whole.

Q10: Do you think the proposed innovation challenge approach will help better enable partnerships and collaboration between companies and third parties, in particular smaller innovators? Are there alternative approaches we should be considering? How can we make sure this approach works in practice?

As per our response to Q7, we welcome the Innovation in Water Challenge approach. If designed in such a way that it is universal and that the cost of participation is low, this is a great opportunity to enable partnerships and collaboration between water companies, SMEs and new market entrants.

To achieve genuinely open innovation, transparency and consistency are essential. In order to achieve consistency, there needs to be a single approach to how proposals are put together taken forward which meets all innovators needs not just those who know the industry well.

The EIC's experience within the energy sector has clearly identified that small businesses and new market entrants to utility sector need a level of education, support and translation to enable the large utilities and smaller businesses to work together effectively through clear facilitation.

This facilitation should be deployed through the Water innovation Centre, whereby each challenge would be defined with a set of criteria and then managed through the platform. This would reduce any management costs as the infrastructure is already available and can be audited.

The platform enables sharing of challenges, submission from innovators through a simple proposal template and dissemination across challenge owners (the water companies) for review.

The proposals with most water company sponsors would then be awarded funding. This would again support the case for collaboration may increase pace and maybe an alternative way to award funding.

Submissions from third parties would take the form of a short/digital pitch which would lower the barrier to entry to SMEs, reduce costs and open the market to new entrants as submissions wouldn't be led by water companies. The arrangements for IPR/royalties are detailed in our response at Question 2.

Q11: Do you agree with our proposed approach to return funds to customers?

Ofwat's approach in returning unused funds to customers is wholly appropriate. However, any proposed adjustments and the recouping of monies from water companies would need greater clarity.

Experience has shown that any ambiguity or risk in monies being recouped after they have been spent by a company, have in the past negatively impacted on potential proposals coming through from third parties. Granular detail would be needed in this area enabling water companies to understand and assess the risk at the outset. This in turn increases the pace and potential adoption and support for innovation projects and reducing the level of risk to third parties.

Q16: What are your views on the feasibility of running all 3 types of activity in the pilot year and on the proposed timings in annex 3?

In the pilot year we believe Ofwat's ambition to launch all 3 activities is absolutely correct. It signals the right aspiration and pace for the sector which is needed given the net zero and water resilience challenges we all face.

The ambition to progress 3 workstreams is extremely positive and must be recognised as a year of learning. However, this will bring with it a level of inconsistencies in approach as the sector learns and adapts to the new ways of working. However, the EIC could help address some of the inconsistencies and the unknowns by bringing existing independent knowledge and expertise to support this process. Our tried and tested processes, legal documentation and knowledge is proven to meet the needs of third parties/SME innovators, the water companies and regulators including a level of validation and filtering of submissions, if required.

We sincerely hope that our response, which represents the experience of innovators within the energy sector, adds value to the thinking of colleagues in Ofwat and ultimately delivers an extremely effective innovation fund which will deliver the innovation required to meet the demand of existing and future water customers and the environmental challenges we all face.

Please do let me know if you have any queries and the EIC Team will be happy to assist.

Yours sincerely

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