

Ofwat innovation funding and competition: further consultation on design and implementation

Response

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.)?

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

In principle, we support the proposed distinction between background and foreground IPR but believe it will be key to assess bids on a case by case basis. As the fund is seeking to attract new entrants and smaller-scale innovators (start-ups etc.), there's a risk that complex, prescriptive IPR and royalty arrangements will act as an immediate barrier to entry. As an alternative to a firm set of rules, we would suggest defining a set of Principles, with project bidders required to set out a proposed approach to IPR and Royalties to be assessed and negotiated as part of any bid.

We would suggest that Ofwat's proposed 'One-stop-shop' should be a source of guidance for all potential participants on this issue ahead of any Competition.

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

We recognise the potential benefits to a more consistent and open approach to data across the sector, including increased access and potential collaboration, not to mention providing greater transparency and therefore accountability across the sector. We would suggest that the following considerations need to be made in order for the concept of open data to provide tangible value and insight to those seeking to benefit from it:

- There is a practical need to define common standards, which could be iteratively developed on a project-by-project basis through the Innovation Fund, rather than a blanket 'open' approach which may result in an abundance of data that is difficult for potential users to adopt and utilise
- There needs to be good governance, value-driven use cases and the appropriate infrastructure to ensure security and quality
- There's an opportunity to make a clear distinction between sharing data and the dissemination of project outcomes/results as part of the Innovation Fund:

- An 'open by default' approach to disseminating project outcomes/results across Water Companies and Partners will reduce duplication of effort and provide crucial insight to plan for scaled roll-out of successful approaches and/or technologies across multiples water companies
- Open data will be a key enabler for implementation and may serve as potential insight/key resources for further projects, but this is more likely to appeal to specific users with a utility in mind

Network Rail systematised an approach to open data¹ but this was quite an undertaking at the cost of around £6million over a period of years. Iteratively developing open data feeds on a project-by-project basis would allow for a greater understanding of the benefit a wholesale approach would bring.

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

- In principle, yes, but again will best be assessed on a case by case basis
- We would seek to achieve a wide-ranging engagement in collaborative projects by recognising a range of possible in-kind contributions in the form of people's time, access to and investment in facilities, materials and consumables, travel and expenses and background IPR

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

We agree the 10% contribution seems appropriate as an initial figure but would stress that this contribution may manifest as resource, access to facilities etc. and that the 10% may be split across collaborating parties.

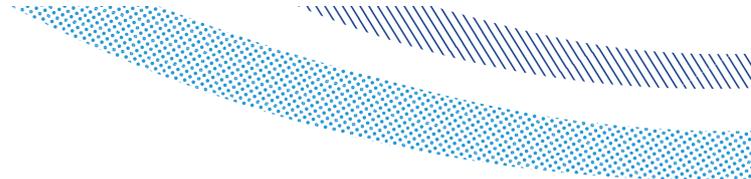
Q6: Do you agree with the overarching approach we set out here?

We agree that it's important to avoid explicit prescription with regards to variables such as TRL, scale and nature of project. It will be important to provide specific challenges in order to focus efforts, but with so many variables across individual water companies – performance, capability and strategy focus – bids that may not appeal to some may be well suited to others.

We note that the Water Innovation Strategy defines specific Themes to help provide briefs/challenges for the Competition, with a focus on desired outcomes across multiple horizons, inviting innovators and potential Partners to leap-frog unnecessary incremental step-changes where possible. Compatible with Ofwat's want to avoid prescriptive project types, the strategic themes seek to channel focus but not define specific outputs in order to encourage interpretation and creative thinking.

We do believe there's a need to further define what constitutes as 'transformative' as this could be relative to company, sector or industry. We believe that the Innovation Fund has the potential to unlock high-potential, high-risk projects that companies are not able to embark on but have the potential to provide a step-change, overcoming the key challenges faced by the sector, its customers and the environment. Looking at problems/opportunities that are more medium-long

¹ <https://www.networkrail.co.uk/who-we-are/transparency-and-ethics/transparency/open-data-feeds/>



term would mean the Fund complements planned or existing Innovation Programmes at a company level.

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?

This ‘seed funding’ approach could be an interesting way to gain initial insight and reduce the risk of exploring specific problems and/or opportunities. Channeling smaller ‘pockets’ of funding towards the ‘Discovery’ and ‘Define’ stages of innovation practice - where you would seek to better understand a problem and baseline current performance - will give greater confidence in funding further stages of development and testing without having committed greater funds in the first instance.

Practically, it might be worth thinking about this in the context of broader project Governance, introducing stop/start/pivot points within projects as key milestones that allow invested parties to regroup, change approach, or cease funding at the earliest possible juncture (‘failing fast’). This ‘seed funding’ might be more impactful if bidding were more frequent than on an annual basis too, as smaller cost would imply tighter scope and shorter timelines, meaning that any further funding or increase in scope would want to be secured in a timely manner to maintain momentum.

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 this space?

We agree that the ultimate ambition of any innovation process is to lead to adoption and benefits at scale but being too focused on delivery risks limiting the Fund’s scope to near-term, low-risk projects that may not provide the transformative step-change in performance this Fund is looking to enable. We do appreciate that high likelihood of success/eventual roll-out and transformative change are not mutually exclusive, however.

We would be concerned about the need to articulate sector-wide roll out potential as part of project bids as this is not in the gift of those companies bidding but strategic decisions within water companies based on ability to invest and fast-follow. The onus on the companies leading should be to disseminate learnings and potentially consult on implications/business fit as part of post-project sector engagement. The opportunity for potential Partners is increased market access, which could be enabled through this post-project engagement as part of the Water Innovation Centre, detailed in the ‘Enabling Innovation’ addition to the Water Innovation Strategy.

We believe it’s worth considering the assumed barriers to ‘fast following’ successful innovation in the sector at the moment; assuming lack of awareness, subsequent lack of access to data and information, and risk-aversion. Our suggestion would be to promote those leading and focus on enabling greater dissemination of results and data in the first instance to see if there’s a step-change in adoption across sector – there is inherent value and financial benefit in this approach as all water companies will better understand what’s working without having invested in testing in the first instance.

Q9: What practical arrangements should we introduce to ensure adequate ring-fencing of the innovation funding?

We agree with the Principles but would seek further clarity around approach but would seek further clarity around the following points:

- The ability to charge corporate costs to the project e.g. for personnel, IT access, etc. We would suggest that Ofwat's rules on transfer pricing for services provided to non-regulated businesses (in Ofwat's Regulatory Accounting Guideline 5) provide an obvious model
- We would like to ensure that none of these proposals inadvertently trigger the need for a creditor consent process under our financing documents. We believe this can be avoided whilst staying true to our aims. We would propose to discuss this in more detail directly. An example of this would be the method for ring-fencing any cash awards
- A proposed third-party audit/assurance of the appropriate use of funds (for which clear rules will be essential)

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?

We support this clear intent to increase access for smaller innovators/start-ups and those new to the sector, and believe that there are two key enablers here:

1. Clear articulation of the Fund's value proposition – efficient access to the sector/market – whilst managing expectation of uptake
2. Clear articulation of the need/opportunity/challenge to be addressed for potential Partners to respond to
3. The use of new communications channels and platforms targeting new entrants to the sector

We believe the devil will be in the detail of process and approach as part of this Innovation Challenge – for example, there would be practical benefit in a period of 'definition' after initial bidding to water companies for sponsorship in order to better define scope, necessary involvement and investment. This collaborative approach would allow water companies and new Partners to shape thinking together as it may be difficult for a company to commit to projects at singular events.

Q11: Do you agree with our proposed approach to returning funds to customers? Are there any other circumstances, not considered here, under which we might consider returning funding to customers?

We believe that allowing for failure without the prospect of having to return funds is critical for the Fund to drive a step change in transformation (in a way that is not present in the sector today). We believe it's crucial to consider the potential ROI of the fund as a whole, and have ROI expressed in some form within each bid proposal so that level of certainty (of success) and potential impact (financial and ideally against other forms of value, too) can be assessed, enabling Ofwat to balance near-to-market against 'blue sky'.

We also agree with the proposed reconciliation model which simply divvies up any unused funds between companies.

Q12: Do you agree with our proposed approach for managing interactions with the price review?

We would challenge the blanket approach to never considering adjustments to associated ODIs as, by definition, the innovations that are most central to delivering against customer priorities will have associated ODIs. We would suggest that any bid proposal should consider the immediate impact on company ODIs, and where this is considered material there should be scope for a symmetrical risk sharing – so customers share both in the upside of any successful innovation via not paying ODI rewards, and the downside risk.

Q13: Do you agree with our proposed amendments to the principles? Are any further amendments to the principles required to reflect our approach to outstanding policy issues outlined in this document?

As above, we believe that plans for roll-out should not be a requirement but consideration. Companies should be able to articulate the potential of an approach and/or solution as a tangible benefit (financial but where possible highlights different forms of value too). Feasibility is a fundamental reason to test and trial new technologies and approaches, and without this understanding it's difficult to scope roll-out.

We would suggest a few additional builds to the amended Principles:

- Principle 1: We believe that research and understanding need to be called out explicitly as key steps within the Innovation process and potential project types for the Fund
- Principle 2: as mentioned in our response to Question 6, we believe further definition is needed to articulate 'transformational' innovation in-line with the desired outcome of the Fund
- Principle 6: it would be beneficial to define the success criteria of the Fund ahead of launch so that all involved may contribute to its success. How will this be measured and what will success or failure dictate?
- Principle 8: as mentioned in our response to Question 3, we believe there should be a distinction between data and learnings, with open data iteratively developed on a project-by-project basis
- A topic discussed but not currently within Principles is the necessity of failure. We believe a proportion of projects that are stopped or don't lead to scaled roll-out will be a key indicator that the sector is pushing boundaries

Q14: Do you agree with our proposed focus, major strategic themes and overall approach for the competition?

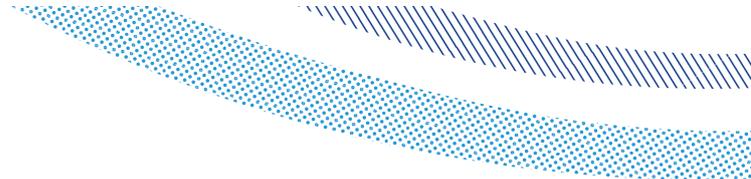
We broadly agree with the proposed focus, noting that the Water Innovation Strategy defines seven specific Themes to inform Fund challenges. We believe it is crucial that the Fund align with these Themes as key challenges and/or opportunity areas across the short, medium and long term to ensure clear direction and enable shared desired outcomes. A key enabling activity, therefore, is co-creation between the appointed organisation selected to manage the competition and those leading on the definition of the Water Innovation Strategy (across the seventeen regulated water and wastewater companies).

We believe it is important for decision-making within the competition activities to be unbiased and as objective as possible. Where there are proposals to innovate directly with regulators around regulation and policy, how will these be fairly assessed based on potential benefits by Ofwat?

Q15: What is the appropriate split of available funding between the Innovation in Water Challenge, the main competition and enabling activities?

We believe that there should be fair assessment across the Water Challenge and Enabling activities in the first year as a separate 'Innovation in Water' challenge from the 'Main Competition' is potentially confusing, especially for new entrants. In the first instance we would recommend briefing specific, targeted challenges for companies to respond to through the Water Challenge, with no bias or restriction around 'size' or 'scale' in this pilot year.

For us, the question is what would drive the most value across the Water Challenge and Enabling activities, and what's the capacity to support these activities within the water and wastewater companies in the first year? In understanding the benefits – through business cases where



possible – it might be that a few Key Enabling Activities (such as the set-up of a Water Innovation Centre as proposed in the Water Innovation Strategy ‘Enabling Innovation’ document) will provide substantial benefits through new ways of working and prove transformative in themselves.

Q16: What are your views on the feasibility of running all three types of activities in the pilot year, and on the proposed timings in Annex 3?

As mentioned in our response to Question 15, we would suggest that the focus for year one be overall Fund process and set up, Enabling activities and the Innovation in Water Challenge – however, we believe there’s potential overlap where the Enabling activities could be part of the Innovation in Water Challenge as there will be need for definition, design and on-going Partnership with initiatives such as the Water Innovation Centre. We believe that this first year of activity is crucial to the Main Competition’s success – a chance to raise awareness with Partners and new entrants, establish new ways of working across the water and wastewater companies, and define first bids for the Main Competition.

We believe that indicative timings in Annex 3 are a fair guideline once the Main Competition is eliminated in this first year, but again want to reiterate potential co-ordination between the Innovation in Water Challenge and Enabling Activities for greater efficiency.

Q17: Do you agree with our proposed approach to key implementation considerations outlined here?

We believe the key implementation considerations are highlighted, but would suggest a few specific considerations:

- **Application process:** Once again, it’s essential that the design of this application process is co-created with the water Companies as the success of any project is going to begin and end with the ability to resource and adopt (should the project be successful) within the seventeen water and wastewater companies
- **Assessment process and decision-making:** We would suggest that an important attribute of the independent expert panel be the ability to stretch and challenge bids, not just evaluate ‘value for money’ to promote a step-change in thinking that is unbiased and open to innovation across people, process, technology and regulation
- **Monitoring:** We believe there’s an opportunity to take a lean, iterative approach to reporting and monitoring over the course of the AMP, evolving in-line with the strategy, fund maturity and capacity at a company level
- **Evaluation:** As mentioned in our response to Question 13 (Principle 6), we believe it is crucial that the Fund success criteria be defined ahead of launch and in-line with the objectives of the fund, for transparency and alignment with all activity over the AMP