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23rd June 2020

Dear Sir/Madam,

Innovation funding and competition: further consultation on design and implementation

Thank you for consulting on the design and implementation of the new £200m water sector innovation fund.

We welcome this consultation, in particular the further guidance the consultation provides to assist in the development of the new sector innovation strategy, and the recognition that more effective joint working across the whole sector is required to encourage and enable innovation. This is particularly apt in the context of the clear public health and environmental obligations with which water companies must comply.

In Wales, under the Wellbeing of Future Generations Act, we are tasked with working proactively with our regulators to co-produce and co-deliver sustainable change. We see the new sector innovation strategy as being one of the linchpins that will enable and support this change for the whole sector – industry, regulators, and stakeholders alike.

Dŵr Cymru published its refreshed Innovation Strategy in 2019 in preparation for our work in AMP7 and our 2050 Innovation Journey Plans ([see www.dwrcymru.com/en/Innovation.aspx](http://www.dwrcymru.com/en/Innovation.aspx)). These set out in some detail the research and innovation we feel are needed to deliver the ambitious outcomes we have agreed as priorities with our customers for AMP7 and beyond.

Many of these are common to the sector and we have been working with UKWIR and their consultants Arups to ensure they are appropriately reflected in the draft sector Innovation strategy to be published in early June.



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We welcome correspondence in Welsh and English

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We also welcome the trialling of a 'One-Stop-Shop' to provide regulatory advice and support to innovators. To that end we would welcome clarification that both environmental regulators and government policy makers will be involved in offering such advice. Many of the blockers to adopting more sustainable innovative nature based/catchment solutions are to do with the way environmental regulation enforcement works and national policy is set – not the availability of new technology or ideas.

Turning to the specific proposals in the consultation, we welcome the openness with which the outstanding policy issues are set out, your views on how funding can be used, and your proposals for the design and implementation of the competition. We also welcome and support the view that stronger collaboration and partnership across the whole sector and beyond is needed and that the innovation funding and competition will help accelerate change, for the benefit of our customers and the environment alike.

Our detailed answers to the consultation questions are annexed to this letter. We hope you find them useful. Please do not hesitate to contact me if you require any further information.

A copy of this response is being sent to colleagues in the Welsh Government's Water Team for their information.

Yours sincerely



Director of Environment



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Annex A – Question Answers

Intellectual Property Rights and 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.)?

Yes. We support the split between background and foreground IPR as set out. We would suggest that any IPR is recycled back into the fund to support future innovations with the view that it becomes self-financing over time. We feel this would increase the ambition of submissions, and support those which could grow GDP through selling ideas and technologies developed internationally.

Yes, we think these arrangements work for different types of projects and activities.

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

We feel that whatever body is set up to manage the fund, the merits of a not-for-profit structure should be considered, such that any profits, IPR or royalties could be returned to the fund to further benefit customers, now and in the future. Such an approach would also help the fund to become self-financing in time.

Open data and information

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

Yes, but only with regard to data arising from the results of the innovation work itself and not sensitive, personal or infrastructure related data which could represent a security risk for the sector and or our customers.

We agree that open data is an opportunity to accelerate the pace of innovation and drive value across the sector. The success of an open data approach relies on a collective effort from multiple players both within and beyond the water sector.

We recognise that a more open approach to data offers significant opportunities to drive innovation and to enable greater transparency and accountability across the water sector. Opening, and indeed sharing, data should be informed by a clear strategy and must be underpinned by good governance, a sustainable value-driven use case and the appropriate infrastructure to ensure data security and data quality.

Risk sharing

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

We agree with the proposed approach in so far that we would expect to leverage funding from multiple sources, including collaborating parties and other innovation funding (where eligible). 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.

However, Dwr Cymru Welsh Water, Scottish Water, Northern Ireland Water and Irish Water do not have shareholders. In those parts of the UK, customers will bear all the risk. Any system of risk sharing must respect the different ownership models we have.

The £200m innovation funding burden should be shared in proportion to the populations served by those companies inputting to the fund, as is currently the case with how UKWIR is funded. Funding support from Scottish Water, and Northern Ireland Water have yet to be discussed and resolved. This suggests that only the companies in England and Wales should be in a position to lead/sponsor projects, as their customers have contributed funding. That is not to say Scottish Water and or other water companies who have not committed funding cannot be involved, far from it, just they will not be in a position to lead such project proposals as we understand it.

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

No. Companies' customers are already contributing significant amounts to the fund to promote innovation. Unless the benefits of the innovation are limited to one region, e.g. as the innovation trial would result in new technology being applied in that region, thereby saving the lead company investment costs in future, we do not see the need for companies to provide any additional funding.

Notwithstanding the above, Companies should clearly support projects with resources, facilities and other materials which may well amount to 10% of the project value – and this should be accounted for. The manner and extent to which a project is supported should be a consideration in whether a project is supported by the fund, not a criteria for entry into the fund, as this could act as a disincentive to lead such proposals.

Types of projects funded

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

Yes. It is imperative that a flexible approach is taken to the types of project sponsored by the fund. This must include projects focused at enabling change in the regulatory frameworks the industry works within, together with national policy. If the industry is to move to a more sustainable footing such innovative change is considered essential. Without such innovative regulatory changes, many other innovations will remain stifled, and our customers will not see the benefits of this investment.

On this basis we are looking forward to the innovation competition unlocking both the high-potential high-risk projects that companies are not able to embark on currently, and also those innovations which are blocked by current environmental regulatory or national policy – which can be misaligned with the needs of the aquatic environment.

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?

Clearly it would be useful for any administrative effort required to access the fund to be proportionate to the size of the funding request. It is essential that the fund remain flexible to support both iterative, smaller scale projects and as well as game changing innovations, whether these be by changing regulatory frameworks and policy, or for example through the invention, trialing, and rollout of new technologies.

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?

Yes. It is essential that innovations are rolled out so that the value of the innovation can be established and so any future funding can be justified or not as the case may be. It is the value of innovations rolled out which matters to customers, and so should be measured and reported by the body responsible for the governance of the fund.

The industry (water companies and its supply chain) is already highly incentivised to drive innovation. Such partnerships should not require additional financial inducements for the partners to perform. Both leaders and fast followers can be rewarded by seeing the benefits customers and our environment will receive from the innovations, and the knowledge that their performance will impact on future bids. It should not be necessary for individuals or companies to gain financially or for financial inducements to exist, over and above those which exist already, to draw either party into the fund. Similarly, any governing body should not require financial inducements to perform. If they do

not perform, then they should be replaced when the governance work is hopefully retendered for AMP8.

Protecting the innovation funding

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

1. The governing body for the fund should be independent of any part of the sector - the water companies, supply chain, its regulators or other stakeholders. It could usefully be structured as a social enterprise, i.e. not for profit or for shareholder to ensure as much of the fund as possible remains accessible for innovation.
2. All funding must be ringfenced and used explicitly for the purpose of innovation in the sector, as directed and supported by those Companies whose customers are paying into the fund.
3. Companies and other stakeholders involved in projects such as the supply chain should not make a profit from the payments made to undertake a trial or evaluate an innovation. Water Company profits resulting from efficiencies and savings made when innovations are adopted should be retained by Companies and dealt with through the periodic review as normal.

Partnerships and collaboration with third-parties

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?

Yes. Each innovation proposal will have at least one if not considerably more water companies in support of it. The Companies have every reason to engage with small, medium and large enterprises to pursue innovative solutions to their challenges. There is no shortage of incentives within the industry to innovate. A key unknown here is the appetite of other parties in the sector, and their willingness to engage and share risks associated with the changes needed. Incentivising the sharing of risks and enabling companies in both the supply chain and sector as a whole to fail and learn quickly, will be key if the sector is to progress innovations – at any scale.

It would be better if the innovation competition was to run twice a year as UKWIR's research call does. UKWIR have found this biannual approach has enabled much improved engagement.

The industry could also run a 'dragon's den' style event every six months, where the pitches are made by other members of the sector, and interested parties internationally. The companies would be able to buy into proposals and confirm to the governance body their interest and how they could support

the project. As you say, this would ensure third parties are able to pitch and be awarded funding, whilst at the same time ensure companies remain accountable for the projects. For this to work, a single company would need to agree with other water companies to lead the project.

Protecting customers' interests

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?

No. All unused funds should be returned to the fund for use in driving innovation and its value for customers, the environment and society as a whole. If surplus funds exist it would signify a failure of the fund to attract new innovations, or of the regulatory frameworks we work within to enable such innovations to be taken up by the sector.

Interactions with the price review

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

Yes

Updated principles

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?

Yes – but with caveats. We very much support the view that a wide range of innovations should be supported by the fund, including those which support business process and changes to the regulatory frameworks themselves.

Principle 4 should focus at the UK, not solely at England and Wales i.e. the cash funding bodies. This is because Scotland, Northern Ireland and the Republic of Ireland will no doubt not only contribute to projects, but in turn also receive benefits from these.

Principle 5. We cannot support this as we do not have shareholders. Our customers are our shareholders, and the Company is owned, managed and run for and on their behalf.

Principle 8. Whilst we support the open by default approach to data, this can only apply to the data generated by the innovations themselves and should not compromise the security or GDPR needs of the business or indeed their customers.

Design and implementation of the competition - Piloting the innovation competition and innovation activities (2020-21)

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

The new sector innovation strategy will set out the focus, strategic themes and overall approach for the competition. It is for the new Governing body however to manage the delivery of any competitions.

We do have some practical concerns for the implementation of a financially acceptable structure which we would like to raise. There are two Treasury related issues that a number of water sector peers who have Whole Business Securitisation Financing Structures are likely to have in common. These relate to legal restrictions arising from their Common Terms Agreement (CTA) designed for the protection of securitised creditors and are as follows:

- 1) Mandated Ringfencing of cash receipts: This is confirmed by the CTA typically having a requirement to route all cash receipts through one designated Income Account without exception
- 2) The express prohibition of the setting up of any third-party Joint Venture arrangements, furthermore any third-party Guarantees entered into in the ordinary course of business are either prohibited or severely constrained.

Innovation financing structures would therefore be required to navigate these constraints in order to be successfully implemented by all participating Water Companies.

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

Until the architecture and governance arrangements required to facilitate the fund, and interactions with the supply chain are clear it is not possible to define this. As the consultation suggests this should be determined after the first year is complete and we understand a little more about the way in which the fund will be managed.

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?

The proposals as set out are very ambitious. Having said that it is essential that all components of the new fund are properly trialled and tested in year 1 if possible to ensure that the fund can progress and enable the changes needed in the sector – and in particular to influence the approaches used by Companies in their planning for PR24.



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Key implementation considerations

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

Yes. We welcome the proposal to appoint a supporting organisation to design and run the innovation funding competitions and to recruit an independent expert panel to advise Ofwat on project funding decisions and look forward to working with both to develop and implement the mechanisms and evaluation criteria that will underpin the funding programme.

We also welcome the assurance that decision making will be flexible, proportionate and efficient (and, we hope, rapid) and look forward to working with Ofwat to consider opportunities for transformational change in utility and environmental regulation in support of sector-wide innovation.

Monitoring the value of innovation has long taxed many sectors and will be key if we are to understand and relate to our customers the importance of continuing to fund such investments into AMP8 and beyond. We would suggest that how the investments are valued be a key criteria for the selection of a suitable partner to run the fund.



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