[redacted]
Ofwat
Centre City Tower
7 Hill Street
Birmingham, B5 4UA

Direct line: [redacted]
Email: [redacted]

Date: 24 June 2020

Dear [redacted]

Re: Ofwat consultation on innovation funding and competition

Thank you for your emails regarding this consultation. Please find our response to your questions below.

1. **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.)?**

After consultation with a number of third parties with whom we already have links in the innovation space, we note that there is a significant risk that the proposed approach to managing IPR and royalties will discourage third parties (other commercial organisations including supply chain partners, education and research establishments) from joining any projects that use funding from this scheme. Such an arrangement would directly limit their commercial revenues from innovation.

2. **What alternative arrangements should we be considering for IPR/ royalties?**

We agree with the need for protection and retention of background IPR as this would be crucial for attracting the support of commercial and academic third parties.

With regard to licences, this something that we would expect to deal with as a matter of course in a partnership with collaborators or suppliers of products and services.

We believe that the question of Foreground IPR is more problematic – particularly given the commercial value placed on data. While we agree with the broad principles of open data as a means of propelling innovation, automatic free availability of knowledge and information generated by funded projects could dissuade more disruptive and innovative companies from participating – especially start-ups and university spin-offs. Consequently, there is a risk that this stipulation could narrow the field of potential participants, especially some of those who would want to retain some of the royalties in exchange for their investment.

3. **Do you agree with the principle that data generated through the innovation competition should be open by default?**

Our response to this question relates to our views on questions 1 & 2, given the high value placed on data. We would like to see proper consideration of a middle position, i.e. that for some projects, some of the data would be made available, but not all of it. For example, if a project gave rise to new models or algorithms, one could imagine there being open access to the project's raw data and findings, but not the model or algorithm that had been created.

So we believe that this question needs some careful thought to distinguish between different types of data and foreground IPR, rather than a blanket all-encompassing prescription.

4. **Do you agree with our proposed approach and that we should consider alternative arrangements beyond company contributions?**

We have concerns about requiring companies to contribute 10% of the costs. It is unclear what benefits the companies would receive for this investment, as the future benefit streams are being returned to customers. Equally, the requirement to share knowledge throughout the industry significantly limits early adopter benefits.

This creates an imbalance in the risk and reward package. In such a scenario, companies would be required to take a the vast majority of the risk, whilst customers take the vast majority of the reward.

In light of this we think that it is essential to consider alternative arrangements, preferably without an up front company contribution. As a competitive process will exist to access this funding, only the highest quality projects with full commitment from the company should receive funding. Therefore, this extra level of protection is not required.

If this route is retained, then it seems right that companies should retain some form of the reward – in terms of royalty payments (or equivalent) for wider use of the innovation.

5. **Do you agree that a guideline minimum company contribution of 10% is appropriate in this context?**

As mentioned in our response to question 4 we do not agree with this requirement.

We would suggest that companies could choose to bear more of the risk by making a contribution subject to them also retaining some of the reward (in the form of royalites or equivalent).

Companies wanting to take part in the competition will ask themselves whether the risks and cost are in balance with likely (or potential) rewards. It should be borne in mind that costs include staff time and also opportunity costs.

As such, a minimum combined company contribution could present an extra barrier to involvement. This is certainly the case where projects have a smaller number of companies involved. To take an example of a project valued at £20m with four water company collaborators: given the financial constraints of the next five years, smaller companies are likely to struggle to offer £0.5m of a £2m combined company contribution.

Wessex Water
Claverton Down
Bath BA2 7WW
Tel 01225 526 000
Web wessexwater.co.uk

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Registered in England No 2366648

6. **Do you agree with the overarching approach we set out here?**

Whilst we agree that implementation and rollout are critically important and will define the success of these innovations over the longer term, there is often a tension. At one end, we can envisage technologies at a low technology readiness level (TRL), or ways of working that are very novel, where the level of innovation is high but the likelihood of scaleability and rollout is currently very uncertain. Companies leading these can be considered as pioneers. At the other end are near-to-market technologies that are not established in the UK but have demonstrated their capability elsewhere in the world. For these the likelihood of rollout is much higher but in a global context they are not especially innovative and those participating would be best classed as fast followers in those instances. And it is important to cater for these. However, we feel that trade-off will often be felt; placing too great an emphasis on rollout could limit the degree of true innovation that the competition generates. See Q8 for more on this point.

7. **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?**

It would be reasonable to have a light touch for smaller projects, in terms of scrutiny, post-project appraisal, etc.

While the most likely definition of small-scale is in terms of the financial scale of the project, there could also be consideration of geographic scale. There could well be projects that we would like to pursue that are tied to geographical features that are not ubiquitous in the UK, but are found only in specific parts of the country, e.g. innovative methods of improving the biodiversity of chalk streams.

8. **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?**

The sweetspot of projects that are <u>both</u> truly innovative <u>and</u> reasonably likely to be rolled out is very small. And for low TRL items it should be recognised that the timescales from invention to mass adoption in the commercial world is typically decades, even for the technologies such as LCD television that have had the fastest movement up the TRL ladder. We can't expect scaling in a few years of things that are truly innovative.

So overall, we would like to see a balance of projects with proportionate expectations about roll-out for each – although we agree that bids should at least give some attention to how rollout post 2025 might happen. Either way, not everything that gets funded should be adjacent to rollout because that would limit the level of innovation.

Ultimately, the actual net benefit achieved by an innovation is what matters the most, rather than a numerical roll-out figure.

Wessex Water
Claverton Down
Bath BA2 7WW
Tel 01225 526 000
Web wessexwater.co.uk

9. **What practical arrangements should we introduce to ensure adequate ring-fencing of the innovation funding?**

We note that your proposed approach in stage 1 for company contributions to the pot is likely to create working capital issues. Our view is that this could be eased by requiring the funds be paid by the end of the charging year in which they are collected. This will reduce the liability that sits with companies without completely removing it.

However, we believe strongly that money should be made available as soon as projects are ready to proceed. Any costs relating to providing this working capital (or interest received from funds not yet commited) should then be borne by the innovation pot. This approach provides clear ring fencing of the pot at this stage.

Whilst better value could be provided by using a body of industry players, we can see the benefit (providing costs are kept as low as possible) of using a third party to administer the pot.

It is clearly important that funds are not misspent. However, we are also conscious of the regulatory burden being applied to a relatively small amount of money (at a project level, at least). For example, we believe that clear project monitoring activities and clear recording of transactions that relate to the investment would be sufficient to ensure that the spending is ring fenced (in lieu of requiring a separate bank account).

We agree with the need to ringfence funding allocated for innovation projects. Our main concern would be about timing, i.e. when funds are released during the five years. It would be unfortunate if significant projects are curtailed because the amount of money available is rationed each year; e.g. a fixed maximum for £40m for each year of the competition.

10. **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?**

The innovation in water challenge has potential to introduce a relatively quick route to multi-region trials for smaller innovators subject to a considerable reduction in process requirements. We have already experienced the benefit of challenge-based innovation through the Wessex Water Marketplace.

Our main concern is that the approach set out in the consultation on page 24 looks cumbersome: a) solution providers pitching to water companies, b) water companies identifying which solutions they wish to sponsor; c) the independent panel then recommending which of those should be funded; d) then Ofwat making the final decision.

We think these steps could be condensed considerably, with solution providers pitching to the water companies and the independent panel at the same time, even potentially with Ofwat involved at that point also. Or, better still, it could be left to the water companies to decide and get on with running projects. This could be preceded by dialogue with the independent panel and Ofwat on the challenges to be addressed via this route.

11. 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 agree that funds not used should be returned to customers. However, we think that specific care should be taken when assessing whether funds have been misspent or have not complied with funding conditions. It would be easy to dissuade innovators from taking part if they felt that projects not producing results or taking longer than anticipated could result in significant refunds.

Consideration should also be given to the creation of incentives to continually drive efficiency when delivering these innovations. If all unused money is returned, this is likely to disincentivise parties to seek cost reductions.

We agree with the principle of protecting customers' interests, but it needs proper definition. On its own, 'acting in customers' best interests' is somewhat nebulous and could mean different things. Further, participating third-parties must consider more than just customer interests (notably, their own commercial interests).

Specifically, we would need to understand how Ofwat defines 'misspent'. If a project has been approved be Ofwat in the first place, money spent on that project should, by definition, be in the customers' interests.

12. Do you agree with our proposed approach for managing interactions with the price review?

We agree with the default position that no derogations be granted.

However to test truly transformative innovation we do see scenarios where failure could result in material ODI failures. In these cases there should be an avenue to confirm and exclude the impact from the calculation of ODI penalties as it will have already been agreed that the innovative approach was in customers' interests. On the other hand, we believe that it would still be appropriate to earn outperformance payments as both the innovation in and of itself, and the outperformance are of customer benefit.

13. 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?

Both of these updated principles could severely limit the potential of the competition.
If clear roll-out plans are a requirement, we are unlikely to see the most innovative entries that are at low TRL levels. For these the first challenge is proof of concept, and roll out plans will be very provisional.

The minimum 10% contribution requirement could also curtail company involvement, as noted in our answer to question 5.

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

All of the major strategic themes in the consultation are worthy of focused attention; our one caveat is our view that open data is not an end in itself, but a means to achieving other ends. As such it is more of a cross-cutting principle for innovations addressing any of the social and environmental themes highlighted.

We understand the rationale for the three proposed strands i.e. the main competition, the innovation in water challenge and enabling activities. It is also clear, however, that this will introduce more complexity in the early stages.

We are not convinced about a focus on close-to-market solutions during year one.
While it might be tempting from a publicity perspective to seek quick wins for the competition in the first year, the danger is that the levels of innovation achieved will be diluted. An emphasis on commercialised high TRL projects could detract from the more innovative, potentially transformational approaches that have the potential to be trialled, even if they are further from commercialisation. Additionally, there are other mechanisms already running, e.g. Isle TAG, that focus mainly on close-to-market offerings.

Furthermore, more time is going to be needed for more innovative lower TRL items to be tested and validated. If anything, it could be argued that is these that should be focused on in the first two years.

Finally, a counter option would be to aim for a similar spread of varying types of projects throughout the five years of the competition. We would be comfortable with this approach.

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

Should all three activities go ahead, we do not think that a split should be predetermined.

Investment should be given to the most impactful projects, regardless of which pot they fit into. Not doing this will result in a sub-optimal mix of innovations being funded and not maximising the benefit to customers.

16. 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?

We believe would be able to respond and participate within the timescales outlined in annex 3. Beyond our more general concerns about the three types of activity, we are less certain about the feasibility of running all three types of activity in the pilot year, unless an administrator is appointed very soon.

Either way, we would advocate for an early focus on a small number of collaborative projects involving sector-wide challenges that might lead to capital investment during 2025-30, and where options that are new to the UK sector need to be tested e.g. addressing nitrous oxide emissions from wastewater treatment.

17. Do you agree with our proposed approach to key implementation considerations outlined here?

We are happy with the approach outlined in 2.2.

If you have any questions or would like further clarifications, please do not hesitate to contact me.

Yours sincerely

[redacted]

[redacted]
Director of regulation

Wessex Water
Claverton Down
Bath BA2 7WW

Tel 01225 526 000
Web wessexwater.co.uk

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