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Innovation IPR consultation
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

By email: innovationconsultation@ofwat.gov.uk

6th September 2021

Dear Ofwat,

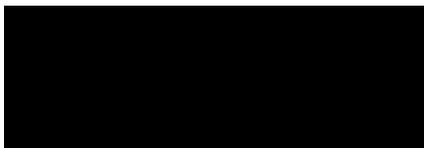
Innovation Fund: Consultation on amendment to intellectual property right policy for the second Breakthrough Challenge competition

Thank you for the opportunity to respond to your proposal to test a change to intellectual property rights (IPR) policy for the second Breakthrough Challenge competition.

We raised our concerns over foreground IPR being made “royalty-free” when the design and implementation of the innovation fund was first being proposed. We note that the consultation’s proposed change is intended to enable owners of background IPR to charge a licence fee at a fair, reasonable and non-discriminatory rate for the use of the background IPR solely to the extent necessary for water companies to receive the benefit of the foreground IPR. We think this is an improvement to the current policy as it provides a fair incentive for third parties to participate in the fund. We also note that Ofwat do not propose to make any other changes to the background IPR policy.

Our responses to the consultation questions can be found overleaf. Please let us know if we can be of further assistance.

Yours faithfully,



Iain McGuffog
Director of Strategy & Regulation

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Q1. In relation to the proposed policy changes which will allow participants to charge for a license for background IPR, to what extent do you think this may, or may not, result in:

- a) better access to the fund for innovators and third parties;**
- b) a broader range of projects;**
- c) higher quality of projects; and**
- d) any other benefits or disadvantages.**

Please provide any evidence and / or examples, including from your experience with the fund so far.

We had previously raised concerns about the default arrangements for managing IPR and royalties in 2020 when re responded to the consultation on the design and implementation of the innovation fund.

The previous arrangements did not materially incentivise water companies and supply chain partners to take part in the competition. On Foreground IPR being made “royalty-free”, we cautioned that this appeared to mean that there would be no benefit of ownership of the IPR beyond the water companies (so only own for export or cross-sector use). Indeed, since that time, there have been practical reasons why many innovators were not in a position to accept the existing arrangements for the dependencies between background and foreground intellectual property rights (IPR). For example, some were already tied into existing IPR arrangements and non-disclosure agreements with third parties and existing investors.

From our discussions with potential innovation partners, the current arrangement is a disincentive to smaller innovators. For larger companies the IPR arrangements are less of an issue as they can mitigate the lack of profit from licensing the IP in the UK through the speed by which they can leverage existing international customers, or customers outside of the water industry – a luxury smaller companies might not have.

Furthermore, royalty free arrangements (whether background or foreground) make the UK water industry unattractive when it already has a weak profile among early-stage investors and new innovators. Fintech, pharma and renewables, for example, will always be more attractive. If there is any transferable application of the new innovation, they will target those industries first. In addition, the arrangements do not incentivise solutions to issues that may be UK specific e.g., solutions in response to our country’s legislation or standards, geographic constraints (distance / abstraction etc.) etc.



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Q2. To what extent might the proposed approach benefit or disadvantage customers in comparison to the current policy?

The proposed approach will benefit customers as it will encourage smaller companies to participate in the innovation fund. If successful these projects will directly benefit customers.

We agree that customers should not have to pay twice, however, the 'in perpetuity' rule puts the balance too far in favour of the customers and would exceed the benefits expected if the customers were acting as investors in the new solutions.

Arrangements can be offered that allow the existing, paying, generation of customers to benefit from the solutions with a suitable return, benchmarked against the equivalent return that venture capitalists would seek from an early-stage investment. Once that return is achieved it would stop. Future generations of customers would benefit from how that innovation influences the performance of the water companies e.g., cheaper operation leading to cheaper bills, or higher levels of service without increasing cost. This is an option that we explored with one partner as we tested understanding of smaller innovators on the IPR expectations in the innovation fund. Whilst the principle of protecting customers in their rights following use of their funding is sacrosanct, it is right to explore whether there are alternatives which provide equivalent value against this principle.



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Q3. Is there any merit in retaining the option to propose alternative IPR arrangements when submitting a bid given the changes we're proposing within this consultation document? If so, where do you consider that we should allow flexibility in the scope for any alternatives – e.g. Foreground IPR? Please provide specific examples in answering this question.

There is generally merit in retaining flexibility as not all circumstances can be foreseen in advance. Therefore, we agree that the option to propose alternative approaches should be retained.

In particular, retaining the option for alternative IPR arrangements in the Transform stream is important: it's not unlikely that an innovation will progress from the Catalyst stream to the Transform stream. If, between doing so, a new commercial entity is formed with equity funding of a venture capitalist, the new shareholders would have certain requirements and expectations around how the IP license and equity can be distributed. Therefore, the option for flexibility is important so as not to prevent any further progress which was initiated and funded through the Catalyst fund.



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Q4. How do you think we could evaluate the impact of our proposed IPR policy changes to inform the next competition, including areas such as access to the competitions and ultimately the benefits to customers? What additional information do you think we should collect in order to help us to evaluate?

The plans to split the available funding for the Catalyst stream of Breakthrough 2 to trial the different approaches to licensing background IPR, as outlined on pages 8-9 of the consultation, are reasonable and appropriate. Comparing the number of bids at the entry stage might be a useful indicator to the success of the new IPR policy.