

## **Innovation Fund:**

*Consultation on amendment to intellectual property right policy for the second Breakthrough Challenge competition.*

### **Feedback from Business Modelling Associates**

#### **Context:**

- Business Modelling Associates (BMA) are a niche technology firm specialising in innovative modelling (Advanced Digital Business Twin) solutions based on an proprietary software platform which has been developed over the last ten years.
- Whilst the technology is sector agnostic, BMA have a strong track record of value creation within the utilities sector, both within the UK and internationally, including a number of live Water and Wastewater solutions operating in UK WaSCs. Many of our *Business-As-Usual* (BAU) and *annually licensed* solutions were initially funded through water company innovation programmes.
- The clear and tangible benefits provided by our BAU solutions more than justify the ongoing licencing cost. As an example, on full implementation, our Bio-Resource Production Planning solution at Anglian Water provided a return on investment of less than 6 months, with seven figure year-on-year savings now flowing through to customers. This BAU solution started life as an Innovation project.
- The ongoing value provided through our solutions, underpinned by a subscription licence model which supports the ongoing development of Background IPR, is visibly reflected through exceptional Client retention.
- Having supported an unsuccessful *Bio-resource Markets* proposal within the first *Innovation in Water Challenge* (led by Anglian Water), BMA are typical of the SME organisations referenced in Paragraphs 2 & 3 on Page 7 of the consultation document. We understand that the *Bioresource Markets* proposal was dismissed (without further consultation or discussion) on the grounds that BMA could not meet the Background IP requirements for the challenge.
- In this context, but of direct relevance to this consultation, BMA recognise there are many forms of innovation and Background IPR. However BMA are a recognised leader in the field of Analytical Decision Support Software (as per Paragraph 2, Page 7) across many sectors and geographies. We are therefore well qualified to comment on the management of Background IPR and associated commercial implications.
- However, in the context of this consultation, it is appropriate that we declare bias in that it would be in our interests to relaxing controls associated with Background IPR. However, we also believe it is in the best interest of UK water customers and for that reason and without prejudice we have been candid in feedback, recognising the value of honest and transparent consultation.

#### **General Feedback:**

- We are in agreement that the Innovation funds should allow for the licensing of Background IPR to enable the development and use of Foreground IPR. We do not understand the need or advantage of this to be piloted as the flaws in the current approach are clear. Furthermore, from the document provided, it is unclear what rationale or benefit was envisaged in applying the relaxation to the smaller fund (Catalyst stream – IPR Option1) as the value of the innovation project has no bearing on the fundamental issue.
- It is likely any vendor required to provision Background IPR would incur cost at some level (3<sup>rd</sup> part licensing of components, infrastructure costs, support cost etc). These costs, as well as the associated investment to build out the Foreground IPR, could not be provisioned without recovery.

- Any vendor (whether niche provider, SME or global player) who has invested in Background IPR will likely continue to invest therein and enhance the Background IPR; this IPR is likely to be a commercial component of other solutions or applications they make available to other clients. If Ofwat are requiring the vendor to supply the Background IPR free of charge, recipients would receive additional benefit from ongoing enhancements and improvements to the technology, long after the innovation project has terminated. However, this will come at an additional cost to the vendor and will dissuade them from entering the competition.
- If the vendor is expected / required to indefinitely provision and support the Background IPR free of charge without provisioning enhancements, they would effectively increase their cost base by having to support a version of the technology which is not aligned to a single source application development path. In turn, this could lead to reliability issues with the solution which in turn would increase reputational risks for the vendor.
- Is the principal question of how the innovation funds are structured not the issue? If the provision of Background IPR to support the development of high value Foreground IPR is only required for a fixed duration i.e. the duration of the innovation project, surely this would resolve the issue?
- A key outcome of any innovation project is to prove or disprove the case for BAU adoption and build a high-level case. Once a business case has been established through the innovation project (thereby demonstrating the value proposition for **all** stakeholders), funding for commercialisation, BAU deployment or ongoing operation (including any licencing, royalties or development / configuration unique to individual clients) could then be pursued by the interested party. However, and critical to this argument, the Water Company would only proceed with a BAU deployment (tailored to their specific requirements) if the business case was robust and has a positive impact for their customers.

**OFWAT 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.*

- In specific response to Point 1.a), the policy change will allow improved access to the fund for innovators and third parties for projects up to the value of £1m. However, if this is a key objective, it would be difficult to justify why this policy change is not being applied to both the Transform Stream as well as 50% of the Catalyst Stream, and also why the Catalyst Stream is constrained to 50%? If 100% of the Catalyst Stream is consumed by projects requiring a relaxation of the Background IPR Policy but they are clearly the best projects, why shouldn't they all be allowed? To prevent or artificially constrain the selection of such projects would not be in the best interest of customers.
- In specific response to Point 1.b), we expect that many of the projects previously excluded or not even submitted on the grounds of 'not meeting the Background IPR Policy', will be submitted for the first time or re-submitted. To that extent, we expect that a broader range of projects (particularly those which are digital / technology enabled) will be submitted. The 'extent' is clearly difficult for BMA to assess. However, given that Ofwat are proposing constraints on the number of projects that might be submitted by only applying the Policy change to 50% of the Catalyst Stream, the number of projects considered could be constrained by this decision. Again, BMA do not understand the rationale for this pilot approach?

- In specific response to Point 1.c), BMA can conceive of circumstances where the limited policy change could improve the quality of submitted proposals which require Background IPR. Where the funding of Background IPR is constrained, suppliers might be encouraged to use 'lesser' software or spreadsheet type solutions, as is often the case with leading consultancies who do not invest in niche tools, particularly prevalent in the 'optimisation' space. It is frustrating that we received very positive feedback on our *Bioresources Markets* submission, and yet no opportunity was afforded to the lead Water Company (Anglian Water) or BMA to enter into a discussion on Background IPR (despite our understanding that there was a Policy commitment to do so).
- In specific response to Point 1.d), BMA would suggest that the current approach could be viewed as anti-competitive in that it disadvantages vendors that have invested considerable sums in the perpetual development of Background IPR as a mechanism to both create competitive advantage for themselves but also, and crucially, drive innovation and create sustainable value for their Clients (and the consumers of the services provided by those Clients). It would appear that vendors that do not typically invest in Background IPR would therefore unfairly benefit through a lack of competition i.e. by excluding those that do. It is entirely possible that customer money could be wasted developing 'new' Foreground IPR, but which is already available as Background IPR in the market, but excluded for consideration as a result of what would appear to be a draconian Policy. **We live in an age when huge value and innovation is driven through technology transfer and digital solutions. If Ofwat wish to exploit this and deliver best value to their customers through their Innovation Programme, surely the objective should be to seek mechanisms which attract as many high-quality proposals as possible, rather than creating policies which create barriers to entry?**

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

- As per BMAs response to Q1, we see the relaxation in the policy for the Catalyst Stream as a step in the right direction. However, we regard Ofwat's overall approach to Background IPR as being draconian, anti-competitive and not in the best interests of the customer. The current Policy, if retained following the pilot, would continue to constrain the number and range of projects that can be considered. The nature of the vendors which are likely to be compromised by the policy tend to operate in disciplines which have a demonstrably strong track record of delivering innovative solutions which return value to Client organisations, benefits which can in turn be passed on to customers.
- Therefore, BMA see no reason for the Policy in the first instance - it only serves to disadvantage organisations that have already invested huge sums to develop innovative services and solutions, generally have something very meaningful and of value to offer. But the greatest disadvantage is to the customer. Furthermore, BMA see no long-term customer benefit in running a Pilot study. For a level playing field approach to project selection, the potential sector benefits of each project should be weighed against the risk profile and the overall project costs. Surely, whether those overall costs include the cost of Background IPR or not is largely an irrelevance? The important questions relate to the impact of the project and probability of success, specifically *what value will the project return* and *how likely is it that that value will be returned* i.e. how risky is the project?
- It could appear to external observers that Ofwat are more concerned with artificially controlling / constraining potential vendor profit rather than creating the conditions for the effective adoption of innovation that delivers tangible value, through the application of that innovation. Any potential future profits for the vendor should and would of course be managed and controlled through the

subsequent commercial discussions and contractual arrangements between vendor and water company, prior to BAU implementation.

**OFWAT 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.*

- As per our previous responses, BMA are of the opinion that the current policy constrains the number and scope of projects that the fund is able to consider. If Ofwat are to pursue their current proposal and permanently relax the policy for 50% of the Catalyst Stream, then we would of course argue that there is merit in retaining the option to propose alternative IPR arrangements for other aspects of the competition, particularly the Transformation Stream. However, this response is predicated on our view that the policy is not required at all.
- Whilst BMA (and potentially other vendors) might be willing to consider relaxed / reduced royalty costs for the purpose of an innovation project, it is highly unlikely that we would agree to provide royalty free solutions in order to participate in an innovation project. For the reasons explained earlier, this is certainly not something BMA could afford to do in perpetuity.
- To be clear, BMA would not have any issue in providing royalty free Foreground IPR across the sector where the development of that Foreground IPR has been funded through the Innovation Programme / Breakthrough Challenge. We see this as a fundamental purpose of the Innovation Programme.

**OFWAT 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?*

- In our opinion, a lot of unnecessary effort appears to be going into the development of an intricate Policy to unnecessarily manage Background IPR. It would now appear that this activity is to be extended into the development of a new measurement framework to assess the value of a partial policy change ...to an unrequired policy? Is this really the best use of customer money?
- Our view remains; consider the merits of each proposal without differentiating on the individual cost components and arbitrarily ruling out proposals because they contain a legitimate cost to cover Background IPR. This Policy change could be made quickly and without the need for additional measurement.

#### ***In Conclusion:***

- As a niche provider of innovative modelling solutions with a track record of returning Client value, we remain concerned that the proposed partial Policy change is, by its nature, is unambitious and remains constraining. Moreover, it risks perpetuating a traditional 'consultant' view of the world which propagates the same old solutions and perspectives by creating barriers to entry. Surely this outcome is in direct conflict with the whole ethos of an innovation competition?
- BMA are active across several sectors and geographies, including the UK Gas Sector. We have never experienced constraints associated with Background IPR other than the UK Water sector.
- Again, to an outside observer, it might appear that the sector has a relatively low appetite and immature approach to annual subscription software costs. We appreciate that these costs would appear as an operational cost on the ledger and there is a natural bias towards capially funded

solutions within the sector (despite a move to TOTEX accounting). However, whilst more challenging to initially fund, such tools will enable valuable new internal capabilities which are sustainable and deliver ongoing operational value. This is in contrast to the traditional often 'one-off' decision support 'reports' which attract capital expenditure, often delivered through expensive, hourly based framework partners and independent specialist consultants.

- Ofwat (and the Innovation Competition) need to recognise the ongoing value of software solutions and the new capabilities they enable through the innovation adoption, improved working methods, driving sustainable value and supporting better decisions. The development and maintenance of such software tools and platforms does not come for free. It is time to remove the shackles.