

September 2021

Innovation fund: Decision on intellectual property rights policy amendment for Breakthrough 2

About this document

This document sets out our decision following a consultation in August 2021 on a proposal to trial a change to Ofwat's intellectual property rights (IPR) policy for the second round of the Water Breakthrough Challenge (Breakthrough 2) in October 2021.

Executive summary

In August 2020, we published our [decision document](#) on the design and implementation of Ofwat's £200 million innovation fund. In this decision document we set out our intellectual property rights (IPR) policy for the innovation fund. Our IPR policy was designed to ensure all water company customers benefit from the projects that receive money via the innovation fund, which is collectively funded.

We are currently in the pilot period of the innovation fund (January 2021–March 2022) and have been capturing learning and feedback through the two competitions run to date, the Innovation in Water Challenge (IWC 1) and Water Breakthrough Challenge (Breakthrough 1). Feedback received from both competitions has suggested that our IPR policy, particularly in relation to background IPR, and its implementation may be a disincentive to some innovators.

IPR consultation

In August 2021, we published an [IPR consultation](#) in which we proposed to trial the relaxation of the requirement for a licence to be provided royalty free where a participant's background IPR is required for the use of the foreground IPR for the second round of the Water Breakthrough Challenge (Breakthrough 2).

We proposed that owners of background IPR will be able to charge a licence fee at a fair, reasonable and non-discriminatory rate, if use of the background IPR is necessary to receive the benefit of the foreground IPR. We stated that entrants will be required to demonstrate value for money and how, ultimately, customers will benefit from the project being funded, regardless of the licence fee.

We also sought feedback via the consultation on whether by removing the requirement for a background IPR licence to be provided royalty free where it is required for the use of the foreground IPR, the need to allow for requests for alternative IPR arrangements may be obsolete.

Our IPR decision

We received 13 consultation responses from a range of stakeholders, including water companies, a customer representative and the wider supply chain.

Based on the IPR consultation responses we received, **we have decided to proceed with the background IPR trial for the Catalyst stream** in Breakthrough 2. This means a licence fee can be charged where a participant's background IPR is required for the use of the foreground IPR for a Catalyst stream entry.

Based on the IPR consultation responses, for Breakthrough 2 **we have decided to make approximately half of the funding for the Catalyst stream available for the background IPR trial**. The other half of the funding for the Catalyst stream will be made available using the same terms in respect of IPR as for the round one competitions.

Based on the IPR consultation responses, **we have decided that, for the element of the Catalyst stream that is not subject to the background IPR trial, we will maintain the ability for entrants to request alternative IPR arrangements**

Next steps

Breakthrough 2 will open on 11 October 2021. It will provide a unified and streamlined process for water companies in England and Wales to access the funding through two streams:

- **Catalyst stream** will make up to £5 million available for projects seeking funding of between £100,000 and £1 million; and
- **Transform stream** will make up to £30 million available for projects seeking funding of between £1 million and £10 million.

For more information on Breakthrough 2 visit our [Innovation Fund](#) website. We will provide further information and guidance in relation to the background IPR trial in the Breakthrough 2 entrant handbook, terms and conditions and assessment criteria on 11 October 2021.

We intend to review our current innovation fund policies more fully towards the end of the pilot period which ends in March 2022. We will continue to work with stakeholders and third parties to design any changes which will be implemented for years 3-5 of the innovation fund.

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1. Background

For the 2020–25 period, we have created an innovation fund which will make up to £200 million of additional funding available through a series of innovation competitions. Funding is provided through an increase in company revenues as set out in the 2019 price review and is collected by water companies from their customers. Through the introduction of the innovation fund, our aim is to help the England and Wales water sector grow its capacity to innovate and meet the needs of customers, society and the environment, with funding targeted at tackling [key strategic challenges](#).

In spring 2020 we consulted on [the design and implementation of the innovation fund](#) and in August 2020 we published our [decision document](#) on the design and implementation of the fund, including key policy areas such as IPR.

In January 2021 the IWC opened and made approximately £2 million available for entries up to the value of £250,000 each. In April 2021 we announced the [11 winning entries](#) for the competition.

In May 2021 we opened Breakthrough 1. This competition aimed to attract longer term, more strategic projects and made approximately £40 million available for entries valued at between £1 million and £10 million.¹ We will announce the winners at the end of September 2021.

1.1 Background to IPR policy

In our August 2020 [decision document](#) we set out our IPR policy for the innovation fund. Our IPR policy ensures all water company customers benefit from the projects that receive money via the innovation fund, which is collectively funded. We set this policy after considering other similar innovation competitions, such as [Ofgem's Network Innovation Competition \(NIC\)](#), and the feedback we received when consulting on our proposed competition design.

The current rules achieve this by ensuring that customers are not subject to additional costs for projects that they have funded (ie by not having to pay twice to access IPR developed using funding from customers).

1.2 Current IPR policy

Our IPR policy differentiates between background IPR and foreground IPR. We recognise pre-existing IPR, which exists prior to the submission of any projects to the innovation fund, as **background IPR**, the rights to which our policy states should be retained by the participants that developed it. Where access to that background IPR is required to enable the project to

¹ Entries with a lower value than £1 million were permitted for smaller water companies and NAVs if requested.

go ahead, we stipulate that an appropriate form of licence should be granted to all participants to enable that.

In respect of **foreground IPR**, this is new intellectual property that is created through a project funded by the innovation fund. To ensure all customers benefit from the innovation fund, our current policy states that foreground IPR must be made available royalty-free and in perpetuity to all 17 water and wastewater companies and new entrant water and wastewater companies. Where a participant's background IPR is required for the purposes of using foreground IPR, we expect a limited appropriate form of licence to be granted by the participant, royalty free.

1.3 Consultation on IPR policy

We are currently in the pilot period of the innovation fund and have been capturing learning and feedback from IWC1 and Breakthrough 1. Feedback received from both competitions has suggested that our IPR policy, particularly in relation to background IPR, and its implementation may be a disincentive to some innovators.

In August 2021, we published an [IPR consultation](#) in which we proposed to trial the relaxation of the requirement for a licence to be provided royalty free where a participant's background IPR is required for the use of the foreground IPR. We proposed that owners of background IPR will be able to charge a licence fee at a fair, reasonable and non-discriminatory rate, if use of the background IPR is necessary to receive the benefit of the foreground IPR. We stated that entrants will be required to demonstrate value for money how, ultimately, customers will benefit from the project being funded, regardless of the licence fee.

We also sought feedback via the consultation on whether by removing the requirement for a background IPR licence to be provided royalty free where it is required for the use of the foreground IPR, the need to allow for requests for alternative IPR arrangements may be obsolete.

2. Our decision

2.1 Our decision on the IPR trial for Breakthrough 2

We are retaining our current policy that all water company customers must benefit from the projects that receive monies via the innovation fund.

Based on the IPR consultation responses we received (see Annex 1), **we have decided to trial the relaxation of the requirement at clause 4** of the current terms and conditions for a licence to be provided royalty free where a participant's background IPR is required for the use of the foreground IPR **for the Catalyst stream**. This means that owners of background IPR will be able to charge a licence fee at a fair, reasonable and non-discriminatory rate, if use of the background IPR is necessary to receive the benefit of the foreground IPR.

Respondents were broadly supportive of the proposed background IPR trial for Breakthrough 2. With the trial being welcomed and seen as a constructive development to increase participation in the fund for innovators and third parties. Three respondents provided examples of entries that were not taken forward in the previous two innovation competitions as a result of the current background IPR policy position. These respondents commented that the background IPR trial may mean these entries may be taken forward in Breakthrough 2. One respondent commented that the trial may address two potential unintended consequences of the current IPR policy which may discourage companies from bringing forward projects that give them a competitive advantage or encourage companies to re-create solutions from scratch at additional cost to customers.

Five respondents were concerned that the trial would only apply to the Catalyst stream and considered that by applying the trial to both streams, Catalyst and Transform, it may avoid confusion for entrants and may attract more new innovators and third parties to Breakthrough 2. We have considered these concerns in making our decision. As we indicated in the IPR consultation, we want to use the pilot period to test different approaches to inform our future policy decisions. By applying the background IPR trial to the Catalyst stream we will be able to test if this does encourage broader participation from smaller, early-stage innovators and alters the types of projects brought forward in a controlled, lower risk environment.

Respondents asked for more information on what entrants will need to provide in their entries and how a background IPR licence fee will be assessed. As we indicated in the IPR consultation document, we expect entrants to provide evidence to demonstrate why the project is value for money and how all water company customers will ultimately benefit. We expect entrants to demonstrate why the licence fee is fair, reasonable and non-discriminatory. We will provide guidance in the Breakthrough 2 documentation published on 11 October.

Based on the IPR consultation responses, **we have decided that, for the element of the Catalyst stream that is not subject to the background IPR trial, we will maintain the ability for entrants to request alternative IPR arrangements.** A majority of respondents (11 out of 13) were supportive of maintaining this. Two respondents considered that having the ability to both propose alternative IPR arrangements and also propose amendments to background IPR may cause confusion for applicants. In both previous competitions, applicants have had the opportunity to propose alternative arrangements for IPR, and this option has been taken up by entrants.

Taking into account the concerns raised, we will ensure the Breakthrough 2 entry form clearly sets out the two options available to an entrant: option 1 – the background IPR trial and option 2 – the same IPR terms² as for Breakthrough 1 (including the ability to request alternative IPR arrangements). Given the largely supportive response to the proposed changes, we are satisfied that this is a positive move forwards for applicants.

To confirm for Breakthrough 2, we will not amend:

- the definitions of foreground or background IPR in the current terms and conditions, or
- the requirement for an appropriate form of licence to be granted to all participants in any project to enable it to go ahead, or
- the current position on royalties.

We are not making any changes to the current position on **foreground IPR**. A number of respondents to both the IPR consultation and our previous consultation in May–June 2020 have commented that our approach to dealing with foreground IPR may be considered a barrier for some entrants. We also note that foreground IPR is that created through a project funded by water company customers through the innovation fund. We do not consider that water companies' customers should have to pay twice to benefit from the foreground IPR, once to fund the project, and then again to access the benefit.

Three respondents felt this trial did not go far enough and other changes (including to foreground IPR) should be considered to attract a broader spectrum of innovators and third parties. We note that the background IPR trial for Breakthrough 2 goes further than some other similar innovation funds do in relation to IPR. It also provides the opportunity to conduct the trial in a controlled, lower risk environment to ensure our clear principle that all innovation fund projects must demonstrate value for money for customers is maintained. The insight we receive as a result of this trial will allow us to assess what, if any, impact these changes have, and if we should make further policy amendments for future rounds. As we signalled in the IPR consultation, we intend to review our current innovation fund policies more fully towards the end of the pilot period. **We will continue to work with**

² Or similar terms, where consequential amendments are needed to the terms and conditions to accommodate option 1.

stakeholders and third parties to design any changes which will be implemented for years 3-5 of the innovation fund.

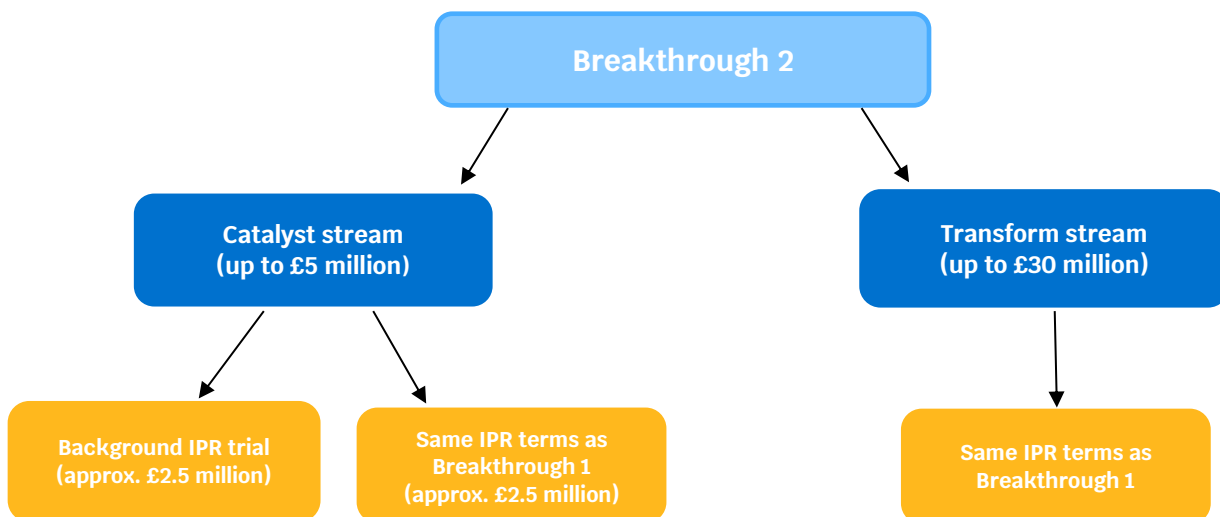
2.2 Our decision on the funding split for Breakthrough 2

Breakthrough 2 will have two streams of funding for innovative projects which will deliver benefits for customers, society and the environment and are aligned to our [5 strategic themes](#):

- **Catalyst stream** will make up to £5 million available for projects seeking funding of between £100,000 and £1 million; and
- **Transform stream** will make up to £30 million available for projects seeking funding of between £1 million and £10 million.

Based on the IPR consultation responses, for Breakthrough 2 **we have decided to make approximately half of the funding for the Catalyst stream available (approximately £2.5 million) for the background IPR trial**. The other half of the funding for the Catalyst stream (approximately £2.5 million) will be made available using the same terms in respect of IPR as for the round one competitions (including the ability to request alternative IPR arrangements). See figure below.

Figure 2.1: Funding available for Breakthrough 2



This approach was broadly supported by the consultation respondents. Four respondents asked for more reasoning as to why the available funding was being split as they were concerned this could cause confusion for entrants. As we indicated in the IPR consultation document, by making half the funding pot available for entries that wish to adhere to the same terms in respect of IPR as for the round one competitions will provide a more direct counterfactual to help us evaluate the impact of the trial and better inform future decisions on this important policy area. It also provides the opportunity to conduct the trial in a

controlled, lower risk environment to ensure our clear principle that all innovation fund projects must demonstrate value for money for customers is maintained.

In the Breakthrough 2 entry form for the Catalyst stream, entrants will need to choose which IPR option they would like their entry to be considered against. Entrants will need to make a clear choice taking their specific project circumstances into account. Entrants will not be permitted to change options once their entry has been submitted.

The same terms in respect of IPR as for the round one competitions will be maintained for the Transform stream of Breakthrough 2 (including the ability to request alternative IPR arrangements).

One respondent asked us to provide clarification on how the background IPR licence fees will be recovered and if this will be an additional cost to customers in future. The purpose of the fund is to aid the establishment of innovative ideas which ultimately deliver benefits to customers, the environment and society, regardless of whether a licence fee for background IPR is charged. The licence fee will only apply to those water companies that adopt the innovation after an innovation fund project is complete. Any licence fee payment will form part of a water company's business as usual costs which are collected from customers via bills. Whilst costs may be incurred by water companies in paying for the licence fee, this should be offset through benefits received by customers, the environment and society from the project outcome.

2.3 Evaluation of the background IPR trial

Respondents offered a broad range of suggestions as to how we could evaluate the impact of the background IPR trial to inform future rounds (see Annex 1 for a detailed summary). These primarily involved monitoring both the volume of projects submitted and their proposed and actual impact, alongside ongoing engagement with participants during the Breakthrough 2 process.

One respondent raised a concern as to whether the data received through Breakthrough 2 will be sufficient to draw reasonable conclusions for future rounds. We believe that the trial will provide useful insight that will help to inform our future decisions.

We will take into account the responses we have received to this consultation as we develop our approach to evaluating this element of innovation fund pilot period.

3. Next steps

Breakthrough 2 will open on 11 October 2021. For more information on Breakthrough 2 visit our [Innovation Fund](#) website. We will provide further information and guidance in relation to the background IPR trial in the Breakthrough 2 entrant handbook, terms and conditions and assessment criteria on 11 October 2021.

We intend to review our current innovation fund policies more fully towards the end of the pilot period which ends in March 2022. We will continue to work with stakeholders and third parties to design any changes which will be implemented for years 3-5 of the innovation fund.

A1 Summary of responses

We received 13 responses to our August 2021 IPR consultation. We received responses from a range of stakeholders, including water companies, a customer representative and the wider supply chain. Overall there was broad support on our proposal to trial a relaxation of background IPR for Breakthrough 2. However some respondents sought greater clarity or raised concerns on specific areas which are summarised in the table below and which we respond to in Sections 2.1, 2.2 and 2.3.

Question	Summary of responses
<p>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:</p> <p>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.</p> <p>Please provide any evidence and / or examples, including from your experience with the fund so far.</p>	<ul style="list-style-type: none"> • Supportive that Ofwat is considering the IPR policy • Proposed approach may make fund more attractive to SME's and innovators • Proposed approach may generate more ideas and high quality projects • Active IP market is essential to innovation and invention but must be linked to returns • May avoid unintended consequence of bringing forward projects that give companies a competitive advantage • Concern that the relaxation will only apply to the catalyst stream - should consider applying to both streams • Concern that splitting the catalyst stream pot by IP approach could cause confusion and lead to bidders spending more time considering IPR than the bid itself • Concern that projects may be brought forward to benefit from the proposed trial to benefit from royalties rather than being in customer interest • Concern that proposed trial does not go far enough and should consider changes to wider innovation fund policies
<p>To what extent might the proposed approach benefit or disadvantage customers in comparison to the current policy?</p>	<ul style="list-style-type: none"> • Proposed approach will have moderate benefits for customers • Will encourage a wider range of innovators and companies to get involved with the fund • will avoid the unintentional incentive to re-create solutions from scratch • process needed to monitor that the benefit to customers is over and above the cost of the licence fee • unclear if background IP royalties will be recovered via the fund or if this will be an additional cost to customers • unclear who will determine and how a fair, reasonable and non-discriminatory licence fee charge will be determined and what oversight will be in place when fee is charged • Ofwats overall approach to background IPR is draconian, anti-competitive and not in the interests of customers - no reason for the policy
<p>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?</p>	<ul style="list-style-type: none"> • Loosening of arrangements around foreground IPR could be worth consideration • Both streams of Breakthrough 2 need the ability to offer alternative IPR arrangements • Having new IPR and alternative IPR options may cause confusion • Ofwat should have better guidance as to what is acceptable for alternative IPR to assist companies in deciding whether to apply to Breakthrough 2

<p>Please provide specific examples in answering this question.</p>	
<p>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?</p>	<p>The following concerns were raised in responses to this question:</p> <ul style="list-style-type: none"> • Data from Catalyst Stream may not be sufficient to draw reasonable conclusions • Management of background IPR is wasteful and prohibitive <p>The following suggestions were made with regard to how we should evaluate the impact of our IPR changes:</p> <ul style="list-style-type: none"> • Comparative no. of applications • Number of non-sector organisations involved in bids • Ask why applicants chose their particular application track/ would they have applied under old rules • Further consultation with water companies • Measure scale up and roll out of projects - especially beyond the applicants/ No. of non-applicants paying to exploit background IPR • Comparative assessment of customer value of old IPR projects vs flexible IPR projects • Level of intellectual property activity as measured by patent activity as this shows 'innovation intensity'

**Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.**

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