

Neil Copeland
Ofgem - London
9 Millbank
London
SW1P 3GE

21 November 2012

Reference: Non-statutory consultation on the draft Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) governance documents

Dear Neil,

Smarter Grid Solutions (SGS) is pleased to have the opportunity to respond formally to the emerging changes to the NIC and NIA governance documents, particularly in relation to Intellectual Property Rights (IPR). SGS has been involved as a partner in a number of Innovation Funding Incentive (IFI) and Low Carbon Network (LCN) Fund projects, has worked through various iterations of the governance documents to date and therefore is well placed to appreciate the effects that such governance has; particularly on technology based Small to Medium Sized Enterprises (SMEs) that are attempting to enter the industry supply chain supported in part by Ofgem innovation incentive and support schemes.

Before describing the issues that SGS believes exist with the proposed governance we think it of value to explain the perspectives of a UK-based and technology-based SME in relation to IPR. Finally, SGS sets out recommendations and a conclusion.

Perspectives of a technology based SME

SGS, like any other business and in addition to providing worthwhile products and services, strives to deliver company growth and associated rate of return to its investors and shareholders. In a technology-based business the value of the company is largely embedded in the products of the company and the IPR therein. Any risk to the ownership or ability to exploit those products and IPR at their full commercial value will have a profoundly detrimental impact on the ability of the business to raise venture capital or private equity finance to enter or grow in the sector. The consequence of this is less privately funded research and development, less new product development, less innovation delivered to DNOs, less ability to fund industry engagement

(participation in working groups, knowledge dissemination activities, etc.) and less new entrants to the supply chain. All of these implications are against the best interests of consumers.

The commercial interests of SGS are already aligned to that of the DNOs and the consumer. It is in our interests to develop new technology and products that deliver benefit to our DNO customers (and hence electricity bill payers). It is imperative that we are able to continue working closely with our DNO consumers to understand their needs and translate those needs into technology ideas and products – this is the life-blood of a technology based SME. It is also in our interests to disseminate the knowledge gained from projects to make other DNOs aware of the benefits of our solutions. However, the ability to own and fully exploit our IPR (in the form of ideas, inventions and products) is fundamental to our survival as an SME.

Concerns with the proposed NIA and NIC governance arrangements

SGS believes that the proposed governance around IPR will have (and is already having in LCN Funded projects) a material detrimental effect on the ability of technology based SMEs to collaborate with DNOs on NIC and NIA projects. This may in turn have an adverse impact on the drive for innovation and change in the industry. Whilst many of the general principles of the proposed changes appear reasonable their implications could be profound. This is because the proposed IPR governance rules may create unrealistic expectation of the value of IPR, may not reflect the real costs of generation and protection of IPR, do not provide real clarity regarding rights to exploit and could be expensive for DNOs to administer properly to achieve the desired outcome for consumers.

More fundamentally, SGS believes that the current focus on IPR governance may be distracting from the real benefit of such funding which is about providing funding and incentives to the DNOs to trial new technologies ready for wider adoption where they deliver consumer benefits and cost savings. These benefits and cost savings are those which deliver the real value for consumers rather than in IPR ownership. There is a real prospect of unintended consequences of these new IPR arrangements in taking the momentum out of the real advances in innovation which are starting to show real prospects of delivering significant consumer benefit.

These issues are expanded in the following sections.

IPR governance rules for the NIA may create unrealistic expectation of the value of IPR or cost to exploit

SGS welcomes the proposed changes to the NIC that enable technology based SMEs to charge for the use of Background IPR and the introduction of a new definition for commercial products. Both help to reduce the IPR risk to partners and suppliers and acknowledge the investment made by those parties in developing new technology for the benefit of DNOs and consumers. However, the NIA governance has introduced an area of concern for SGS in relation to the ability to properly realise the commercial value of the investment made in developing ideas, technologies and products for the sector.

At paragraph 7.2 the proposed NIA governance states a desire to “protect consumers against paying excessively for new products or approaches (to which they have contributed toward the cost of development by providing NIA funding).”. SGS agrees with this principle. The concern of SGS is with

paragraph 7.10 which attempt to specify the types of arrangements expected to deliver this principle and ensure best long term value to consumers.

It is worth considering that in NIA funded projects the technology is likely to be at lower Technology Readiness Levels. Therefore, it is more likely that it will be early stage proof of concept or prototypes products or solutions being developed or trialled. This compares with the NIC where the technology is already expected to be proven and is therefore closer to market. Paragraph 7.10 suggests that a long term agreement is required with the project partner or supplier to reflect the funding provided by the Project Partners. One of our concerns is that this does not consider the cost to a technology company to fully develop a commercial grade product from an early stage prototype or proof of concept project. Furthermore, paragraph 7.10 suggests a requirement to agree firm future pricing or discounts for products. In many cases the technology company will not yet know the full cost to develop and deliver a commercially viable product to the market and therefore not be able to agree firm pricing or discounts at that time.

SGS is concerned that these factors may create an unrealistic expectation as to the certainty of long term pricing and may prevent the technology partner or supplier from fully reflecting the wider and long term costs of developing and bringing a product to market. It is our view that this may be difficult to implement and prevent a technology based company from realising the full commercial value of its wider IPR.

IPR governance rules are expensive for DNOs to administer properly

While SGS understands that IPR can have value it can also be extremely expensive to protect, administer and license, requiring the application of specialist professional skills. Paragraphs 9.19 to 9.22 describe the various IPR warranties that Participants must provide. As a Participant in the projects these rules therefore also apply to DNOs who do not at present have all of the necessary skills or experience within their core businesses. By implication they require DNOs to establish new capabilities in order to:

- Identify and document all IPR associated with and created by the project
- Undertake patent and or Freedom to Operate searches to ensure that any IPR does not infringe any third party IPR
- Incur registration fees (for example for patenting) to protect the IPR for licensing to others

The management of IPR is a specialist and continuously moving area and often requires close engagement with patent attorneys. For a technology based SME, such as SGS, these obligations are reasonable as technology and IPR is fundamental to the success of our business. However, the obligations do not seem reasonable to apply to DNOs where the development of technology and IPR is less critical to the successful delivery of the business.

To discharge these obligations, where the DNO is also a Participant, SGS expects that DNOs will need to establish dedicated IPR staff with access to specialist IPR advice to identify, document and protect IPR which may or may not have any commercial value. SGS believes that this could incur significant additional cost with potentially little or no return to the consumer. Investing time and resources identifying and assessing the IPR with potential commercial value and ensuring it is protected and licensed properly to ensure value for the consumer may end up actually costing the consumer more.

IPR governance is distracting from the true benefits of NIA/NIC funding

SGS believes that in the details of trying to protect consumers by creating greater scrutiny and administration around IPR the real benefit of the funding to the consumer has been lost. The real benefit for consumers from the NIA and NIC funding is the ability for DNOs to fund the demonstration of technology with sufficient realism and scale to prove the technical and commercial benefits to facilitate widescale Business as Usual roll-out through a well-justified business case. SGS believes the benefit from the NIA and NIC should not and will not be from commercial returns for DNOs through IPR licensing. It is the well-justified business plan or business case, demonstrating the financial or non-financial benefits to the consumer of the product or solution, which will ultimately protect the consumer.

Furthermore, SGS believes that it is important for Ofgem to use the opportunity afforded by innovation funding to provide a fair playing field for any innovative participant (including SMEs) to deliver long term value for consumers by encouraging competition in the supply chain. SGS invests significantly in its intellectual capital; employing many highly educated and experienced engineers capable of identifying opportunities to help our DNO consumers with cost effective and practical solutions. However, the resources available to an SME to undertake these activities are dwarfed by the research and development budgets of the few multi-national vendors that currently dominate the sector. SGS believes that Ofgem should encourage DNOs to work with SMEs and to use this as an opportunity to attract new entrants to the sector. IPR arrangements should encourage new and diverse entrants into the innovation sphere without too much complexity, cost or uncertainty over future opportunities to exploit that innovation. DNOs and their consumers stand to gain most under those arrangements.

Conclusion

SGS welcomes the proposed amendments to the IPR arrangements for the NIA and NIC, particularly the changes to Background IPR and the introduction of a Commercial Products definition. These changes will remove some of the barriers that previously existed when trying to agree contracts under the terms of the LCN Fund governance.

To further improve the proposed governance SGS suggests that Ofgem consider the following recommendations to address the identified concerns:

Concern: IPR governance rules for the NIA may create unrealistic expectation of the value of IPR or cost to exploit.

SGS recommends that DNO and the other parties are only expected to have in place a mechanism to agree fair and reasonable terms (for example, to cover license, firm pricing or discounts) in the future. This would provide time in order to identify and assess the reasonable commercial value of the IPR and the additional non-funded contributions required to realise any product and commercial return.

Concern: IPR governance rules are expensive for DNOs to administer properly

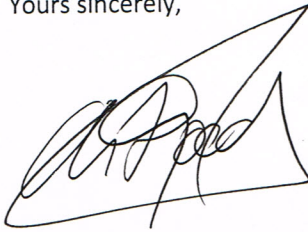
SGS recommends that either an allowance be made available to DNOs to fund IPR management or the warranties are made less onerous to comply with.

Concern: IPR governance is distracting from the true benefits of NIA/NIC funding

SGS recommends that the IPR governance arrangements be simplified to state a requirement for the DNO, through whatever means applicable, to consider the most cost effective means of protecting the consumer when undertaking any specific project (e.g. writing a 'pathway to consumer value' statement at the project inception stage). This will be most applicable to the NIA governance where the IPR would be less mature at the end of the project and may be a material time and cost away from a commercially viable product or return.

SGS would be pleased to discuss these issues further with Ofgem to explore the perspective of a UK SME playing an important role in delivering innovation and change to the industry.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A Gooding', enclosed within a simple rectangular box.

ALAN GOODING

Managing Director