



news release

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FINANCING NETWORKS – OFWAT AND OFGEM ISSUE JOINT DISCUSSION PAPER

Water industry regulator Ofwat and Ofgem, the energy regulator, have today published a [joint discussion paper](#) looking at ideas for regulating the efficient financing of utility companies' capital investment programmes.

The paper also looks at ways these companies and the regulators could deal with the financial constraints arising from the need to deliver large capital programmes.

Although the focus of the discussion paper is on the water and energy sectors, the analysis will also have relevance to other regulated sectors such as rail and civil aviation.

The publication, Financing Networks, was commissioned by Her Majesty's Treasury (HMT) and the Department for Trade and Industry (DTI) who wanted to look at financial issues facing regulated utility businesses.

The discussion paper covers:

- Issues relating to capital structure and specifically the impact of relatively highly geared structures on management incentives and the ability of management to deliver efficient levels of investment;
- Issues around the robustness of debt markets and the implications for regulated businesses of possible disruption to these markets;
- How levels of gearing impact on the regulatory framework and steps that regulators have taken to protect consumers;
- The ideas developed by academics Dr Dieter Helm and Professor Colin Mayer around efficient risk allocation and the concept of regulatory commitment;

- Whether aspects of the present approach to setting price controls make it unduly difficult for licence holders to finance their activities, and whether there are adequate incentives for debt and equity investment; and
- Options for dealing with financeability constraints and whether regulators should change their approach to using the financial ratios used by the credit rating agencies to assess financial robustness.

The discussion paper does not set out firm policy conclusions, but is designed to stimulate further debate. A joint seminar will be organised allowing further discussion of the issues set out in the paper. In light of views expressed Ofwat and Ofgem will set out how they intend to take this work forward.

Any changes to the future approach to setting price controls will only be made following further consultation by individual regulators. In the case of the gas and electricity transmission and gas distribution price control reviews, which are underway, further consultation will be incorporated into the ongoing review process as appropriate.

Notes to Editors:

1. The Director General of Water Services is the economic regulator of the water and sewerage companies in England and Wales. He exercises his powers in a way that he judges will allow them to carry out their functions properly, and finance them. His duties include protecting the interests of consumers, wherever appropriate by promoting effective competition. He will be succeeded by the Water Services Regulation Authority on 1 April 2006.
2. Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the gas and electricity industries in Great Britain. Ofgem's aim is to bring choice and value to all gas and electricity customers by promoting competition and regulating monopolies. The Authority's powers are provided for amongst others by the Gas Act 1986, the Electricity Act 1989 and the Utilities Act 2000. In this information note, the functions of the Authority under the relevant Acts are, for simplicity, described as the functions of Ofgem.
3. The discussion paper, [Financing Networks](#), will be available on the Ofwat website, www.ofwat.gov.uk, and from the Ofwat Library on 0121-625 1373, and on the Ofgem website, www.ofgem.gov.uk Hard copies can be ordered from the Ofgem Distribution Centre on 020 7901 7116 or by email from distribution@ofgem.gov.uk
4. Responses should be sent to either Martin Crouch, Director, Electricity Distribution, Ofgem, 9 Millbank, London SW1 3GE, email: martin.crouch@ofgem.gov.uk, or to Emma Cochrane, Head of Corporate Finance, Ofwat, Centre City Tower, 7 Hill Street, Birmingham B5 4UA, email: emma.cochrane@ofwat.gsi.gov.uk The consultation closes on 5 May 2006.

5. In 2004 the Treasury and the Department of Trade and Industry both expressed some concern about the increasing proportion of debt finance (or gearing) that is being used by regulated businesses. They suggested that two pieces of work be undertaken. Ofgem was asked to lead a project looking at new ideas for encouraging equity to remain in the energy and water sectors, working with Ofwat and other regulators. They suggested that Ofwat should chair a group to consider how regulators might develop indicators of financeability as a long-term complement to those of credit rating agencies. After further discussion it was agreed that the two regulators should approach these two pieces of works as a single project.
6. Gearing is the level of a company's debt compared with its total capital, and usually it is expressed as a percentage. So a company with gearing of 60% has 60% of its funding provided by debt and 40% by equity capital.
7. Dr Dieter Helm is a fellow in Economics at New College, Oxford. He has research interests in regulation, environmental economics and industry. Professor Colin Mayer is Dean of the Saïd Business School at Oxford University. He has an international reputation in the fields of corporate finance, corporate governance, regulation and taxation.
8. For media enquiries to Ofgem Press Office, contact either Chris Lock: 0207 901 7225 or 07766 511470 or Mark Wiltsher: 020 7901 7006 or 07774 728971. For media enquiries to Ofwat Press Office, contact Peter Mandich on 0121 625 1442