

House of Commons
Committee of Public Accounts

PIPES AND WIRES

Fiftieth Report of Session 2001–02

*Report, together with
Proceedings of the Committee,
Minutes of Evidence and Appendices*

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Contacts

All correspondence should be addressed to The Clerk of the Committee of Public Accounts, Committee Office, 7 Millbank, London SW1P 3JA. The telephone number for general inquiries is: 0207-219-5708. The Committee's e-mail address is: pubaccom@parliament.uk.

Footnotes

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EVIDENCE (*Wednesday 8 May 2002*) (HC 831-i, Session 2001–02)

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FIFTIETH REPORT

The Committee of Public Accounts has agreed to the following Report:

PIPES AND WIRES

INTRODUCTION AND LIST OF CONCLUSIONS AND RECOMMENDATIONS

1. Pipe and wire networks provide households and commerce with the essentials of modern life—electricity, gas, telecommunications, water and sewerage services. The networks provide a high and reliable standard of service, and running them is a technically complex undertaking, which costs their customers some £20 billion a year.

2. Because of the costs and technical difficulties in duplicating the pipe and wire networks they tend to be owned by single companies, leaving no or limited scope for the competition that has been introduced into many other parts of the utility industries since privatisation. Industry specific regulators have been statutorily established to protect the interests of the customers of these networks, for example from excessive prices or inadequate quality of service. The Office of Water Services (OFWAT), the Office of Gas and Electricity Markets (OFGEM) and the Office of Telecommunications (OFTEL) are responsible, respectively, for water and sewerage services, energy and telecommunications. They have adopted a broadly common approach to protecting consumer interests through controls, which they periodically review, on the prices set by the regulated companies for specified services.

3. On the basis of a Report by the Comptroller and Auditor General¹ we took evidence from OFWAT, OFGEM and OFTEL on their regulation of the networks. As a result we make five main points:

- So long as there are practical limits to the competitive pressures on the companies that run the networks of pipes and wires that deliver essential services, price regulation is important for protecting customers. And it has brought benefits to consumers in terms of reduced prices and maintained or improved quality of service.
- But price regulation results in substantial costs for the regulators and the companies concerned in providing information, while the uncertainty arising from regulation may increase the companies' cost of capital. These costs ultimately fall on consumers and become harder to justify unless they can be shown to secure offsetting efficiency gains. The regulators say they are looking to reduce the costs and uncertainty involved in regulating prices. They should work together to make this a reality.
- In the absence of competition customers cannot express their preferences between price and quality. And while price regulation is imposed to protect customers, it removes much of the incentive for regulated network companies to deliver improvements not previously allowed for by the regulators. There is therefore an onus on the regulators to determine by thorough research what the public is willing to pay for, and to state clearly what improvements they would be happy to support.
- For regulated companies to gain access to their underground assets (for maintenance or enhancement) they often need to dig up roads. By sharing the provision and maintenance of trenches and ducts they might be able to reduce the disruption to the public and make the networks cheaper to run. The regulators should therefore work together to consider whether they can improve the incentive

¹ C&AG's Report, *Pipes and Wires* (HC 723, Session 2001–02)

for regulated companies to minimise the costs to customers and the public in this way.

- The move to a structure where most or all shareholder equity is replaced by long-term debt, as is happening in the water industry, may transfer risks from shareholders to the public to the extent that it reduces the companies' ability to absorb financial shocks. The regulators should discourage such changes unless they can be shown to benefit the company's customers.

4. Our more detailed conclusions and recommendations are as follows:

The costs and benefits of regulation

- (i) The regulators' aim has been to protect customer interests from the possibility that companies might abuse their position where competition is not well established. But this approach cannot be as effective as competition. OFTEL and OFGEM have already reduced the scope of regulation where competition has developed and all three regulators should be alert to the opportunities for extending competition so as to reduce further the burden of regulation.
- (ii) The network companies have responded to the incentives provided by the regulators to achieve efficiencies. The regulators have been able to pass on these efficiency gains on to consumers, either as price cuts, or, in the case of the water industry, improved quality. But, while technological change should continue to drive down telecommunications prices, the prospect of further substantial price reductions may be diminishing in the other industries.
- (iii) The process of price regulation requires substantial amounts of information, can take up to two and half years and applies sophisticated analytical techniques. If the benefits of price regulation diminish, the cost and burdens on regulated companies arising from the ever-increasing complexity of the process may not be justified. The regulators should work together to identify, before the next round of price reviews, changes that can be made to streamline the process, building on the steps each of the regulators said were taking to reduce information burdens.
- (iv) The regulators' assumptions about achievable efficiencies draw where possible on benchmarking work, through which they compare the costs of companies undertaking similar activities. To help preserve their ability to make comparisons OFWAT have discouraged mergers between the 10 water and sewerage companies, despite the possibility of economies of scale. OFGEM, on the other hand, have allowed mergers between electricity distribution companies and have recently specified the benefits that should be passed on to consumers as a condition of allowing future mergers. OFGEM and OFWAT should jointly consider whether these differences in approach are justified and publish their conclusions.

The service delivered by the networks

- (v) Pipe and wire networks have an underlying resilience and it might take some time for inadequate or inefficient expenditure on maintaining them to show through in declining performance, especially as past expenditure may not be a reliable guide to future needs. The regulators are aware of this problem and have started to address it, for example through initiatives to improve the application of risk management techniques to the networks. The regulators should set out what they expect from company risk assessments, in terms of methodology and level of detail, before relying on the assessments in deciding how much companies need to finance the maintenance of the networks.

- (vi) Price limits may reduce the incentive for companies to institute improvements by constraining the scope to generate extra income from the investment. But some deficiencies in networks, such as those that cause sewer flooding, can have serious and unpleasant consequences for the public. The regulators should have robust arrangements for rewarding worthwhile investment to address problems identified between price reviews, and in particular OFWAT should provide sufficient incentives to reduce the incidence of sewer flooding to an acceptable level without awaiting the next price review.

The financing of regulated companies

- (vii) Regulators face a difficult judgement in determining the appropriate cost of capital for regulated companies, as a wrong judgement could result either in companies making an easy profit at the consumer's expense or in companies finding it harder to finance the extensive investment needed in their networks. The market valuation of companies in the water industry has fallen below that estimated by OFWAT, suggesting that it might in 1999 have set the cost of capital too low. The regulators have recently announced a joint review of setting the cost of capital, which will need to result in a consistent and robust approach that provides sufficient incentive to finance new investment.
- (viii) An unintended consequence of regulation is that regulatory uncertainty, for example over future policy for investment, may raise the cost of capital for companies and/or deter them from committing to necessary investments. OFWAT, in particular, have announced various measures to provide greater clarity as to their future approach to price regulation. Other regulators should similarly set out publicly their future intentions, with as much certainty as possible.

THE COSTS AND BENEFITS OF REGULATION

5. The planned costs of the three sector-specific regulatory offices total some £69 million in 2002–03 (Figure 1 below). These costs have varied over the years. For instance, OFTEL said that their staff numbers had risen from 180 to 230 since 1999 to meet new demands arising from the Competition Act 2000. OFGEM, on the other hand, said that their costs had been much higher (£80 million a year) two years ago when they had introduced a completely new electricity trading system.²

Figure 1: The costs of running regulatory offices	
Regulatory offices	Costs/ £ million a year
OFGEM	36
OFTEL	19.5
OFWAT	13.5
Total	69

Note: These costs are based on the figures for 2002–03 given in the Regulators' forward plans³

6. The costs of regulation are small compared to the size of the industries regulated, but nonetheless represent a burden on regulated companies, and ultimately on consumers through their bills. As competition advances, the need for such regulation may diminish as the Government can rely increasingly on the market place to protect customer interests,

² Q59

³ OFGEM, *Corporate Plan 2002–05*; OFTEL *Management Plan 2002–03*; OFWAT, *Forward Programme 2002–03 to 2004–05*

under the supervision of the Office of Fair Trading. All the regulators thought that sectoral regulation would continue for some time. OFGEM said that they had already removed price controls from 70 per cent of the activities that were subject to price regulation at privatisation, so that they only regulated the prices of the natural monopolies responsible for the high and low voltage electricity networks and the gas network. But as long as these activities remained monopolies, without the degree of entrepreneurial activity found in a competitive market, price controls would be required. Similarly OFTEL said that price controls on British Telecom were being lifted, and that for most of its retail activities had already been removed, but that the company would remain dominant for the foreseeable future in its core network where it retained a natural monopoly.⁴

7. OFWAT said that competition had made only limited inroads in the water sector. The Government had announced that they would extend competition in a limited way through a Water Bill, but there were good reasons, such as the absence of a national water grid, why competition would take hold only slowly. Economic regulation in one form or another would continue to be necessary to look after the interests of customers.⁵

8. In order to deliver benefits to customers where competition has yet to take hold, the regulators have adopted an approach known as RPI-X, whereby prices charged by regulated companies are allowed to rise each year by the general movement in the Retail Prices Index, less an X factor established by the regulators every four or five years.⁶ The system provides a strong incentive for the regulated company to achieve efficiencies beyond those anticipated by the regulator. By doing so the regulated company can keep the resultant profits for up to five years until the regulator next reviews prices. This incentive has been associated with considerable efficiencies, without any reduction in the reliability of the networks. For example:⁷

- in the electricity industry, the overall operating costs of distribution companies fell by around 25 per cent in the period 1994/5 to 1997/8, while the National Grid Company has reduced controllable operating costs by 50 per cent since 1990;⁸ and
- for water companies, OFWAT said that efficiency had improved by roughly 4 per cent a year since privatisation in 1989.⁹

9. As the costs of the regulated companies have fallen so the regulators have been able to pass these savings on to customers as price cuts – for example, OFTEL told us that since privatisation of the telecommunications industry, there had been significant falls in costs, contributing to an overall fall in prices to the domestic consumer to 50 per cent of its pre-privatisation level.¹⁰ In the water industry, OFWAT has passed on the benefits of increased efficiency to consumers through higher quality for a given price level alongside explicit price cuts. The reductions in the costs of the networks have been accompanied by increased or maintained reliability across all the industries in terms of interruptions to the provision of

⁴ Q9

⁵ *ibid*

⁶ C&AG's Report, para 1.14

⁷ *ibid*, paras 2.2–2.7

⁸ *ibid*, Figure 17

⁹ Q70

¹⁰ Q1

essential services.¹¹ For instance, properties subject to unplanned interruptions in water supply fell from four per thousand properties in 1991 to one per thousand in 2000–01.¹²

10. This does not necessarily mean that price regulation can continue to deliver large efficiency gains in future and the regulators had varying views on the future opportunities for such gains. OFTEL said that the combination of technological innovation, volume increase and price controls would continue to enable prices to fall in the foreseeable future. Technology and market demand were not changing as fast in the electricity and gas industries where OFGEM had been careful to strike a balance between price reductions and enabling the monopoly businesses to maintain the required high levels of investment. They nonetheless believed that there would be some scope for further efficiencies. OFWAT said that technological change was still less in the water industry, and they would make no predictions about what would happen to prices at the next periodic review from April 2005.¹³

11. While there may be uncertainty about the future benefits from the approach to price regulation adopted by the regulators, it is clear that the process is complex. Reviews can last up to two and a half years and can be costly (Figure 2). The regulated companies told the National Audit Office that the costs they incurred from the price setting process were even greater, particularly as they are required to supply a large volume of information to the regulator. There is a strong perception among regulated companies that regulators ask for too much information, and do not use all of the information they request.¹⁴

Regulatory offices	Costs/ £ million
OFWAT	7
OFGEM (electricity distribution)	2.5
OFGEM (electricity transmission)	0.8
OFTEL	0.3

12. The regulators were aware of this perception. OFTEL said they were consciously seeking to respond to criticism that they asked for too much information, by looking much more at the materiality of their information requests, and whether given pieces of information would make a difference to the final price control determination. OFGEM said that they had no incentive to ask for information they regarded as unnecessary, but that they were at a disadvantage to the companies in the information available to them and it was necessary for them to have the right to ask for any information they believed to be relevant. Nevertheless, they were seeking to stop the present bunching of information requests once every five years, and to establish a more coherent basis of exchange of information between the companies and the regulator that would reduce overall requirements. OFWAT said they were seeking to conduct their next price review over a shorter time period, two rather than the two and a half years, partly to reduce the number of requests for information. They

¹¹ C&AG's Report, paras 2.16, 2.21

¹² Q71

¹³ Q1

¹⁴ C&AG's Report, paras 3.35, 3.39, Figure 33

¹⁵ *ibid*, Figure 32

considered, however, that some complication was inevitable for the control regime to be effective.¹⁶

13. An important technique that all the regulators use is benchmarking with other companies in Britain and overseas to assess the potential for future efficiencies. OFTEL said they frequently compared the costs of fax, short—and long-distance telephone calls in the UK with those in other OECD countries. Both OFGEM and OFWAT told us that they had undertaken international comparisons but it was difficult to find robust comparators. OFWAT had found comparisons with Australian companies useful, and also comparisons with Scottish Water which was in public ownership and separately regulated.¹⁷ OFGEM said that they found it more useful to conduct benchmarking within Britain¹⁸ and both they and OFWAT were able to conduct comparisons between companies conducting the same activities in different parts of the country.¹⁹ For instance, OFWAT said that they had the advantage of 23 companies in ‘comparative’ competition with one another, and that they took the example of the best to drive the less well-performing companies up to that level.²⁰

14. If regulated companies within the same sector merge, the scope for the regulator to compare companies reduces. The regulators’ attitudes to the loss of a comparator vary. OFWAT said that, should there be a merger between two water companies, there would be a loss of comparators, and in their view water company mergers should either not happen at all or only proceed in return for a reduction in prices.²¹ OFGEM said that there was an interesting balance: while there was a value in having a number of comparators in electricity distribution, it was not in OFGEM’s interests to stop mergers if there were genuine efficiencies from combining two companies. In future mergers between electricity distribution companies, OFGEM said they would address this balance by reducing the combined price limits of the merged companies by £32 million, so that benefits would pass through to customers. This figure represented their estimate of the cost to regulation of the loss of a comparator.²²

THE SERVICE DELIVERED BY THE NETWORKS

15. As the Comptroller and Auditor General reported, price regulation results in some risks to the investment in networks needed to sustain and improve the quality of the outputs delivered. These outputs include the resilience of the network to unexpected events (such as severe weather) and the quality of service received by consumers, for example number of supply failures in a given period.²³ In the case of the water industry, outputs also include environmental enhancements, which according to OFWAT represented £7.4 billion of the water industry’s £15.6 billion of capital expenditure during the current period.²⁴ There is likely to be a continuing need for substantial investment. OFGEM, for instance, told us that over the coming 10 years the electricity industry would face a significant re-investment programme to deal with developments such as renewable energy.²⁵

¹⁶ Qs 2–4

¹⁷ Qs 40–46

¹⁸ Q 44

¹⁹ C&AG’s Report, para 2.5

²⁰ Q10

²¹ Qs 81–83

²² Qs 84–85

²³ C&AG’s Report, para 3.2

²⁴ Q39

²⁵ Q10

16. Regulated companies are in effect paid – through the prices they are permitted to charge as a result of the price review process – in return for providing a given set of outputs during the period to the next review. OFGEM characterised this as a form of contract between the amount of revenue allowed to the company and what they undertake to deliver in terms of investment and quality of supply, and said that they were moving the RPI-X approach to something closer to a contract.²⁶

17. For this ‘contract’ to work in the interests of consumers, the required outputs must be clearly specified and reflect what consumers actually want. In a competitive market, consumers can make choices reflecting the types of service for which they are prepared to pay and competition takes the form of product differentiation as well as competitive pricing. Both OFGEM and OFWAT outlined steps they were taking to ascertain consumer preferences. OFWAT, for instance, were working with Water Voice (the customer representative body), government departments and quality regulators to launch a combined customer survey to give them as good a picture as possible of what customers would want given a choice.²⁷

18. One unintended effect of regulation, in OFGEM’s words, was to give regulated network companies an incentive to defer investment projects until after the next price review. OFGEM said that their Information and Incentives Project was designed to give companies incentives to sustain quality that would spread beyond any five-year price control period. This project was introduced in January 2002, and was intended to put at risk up to 2 per cent (or around £4 million) of the electricity distribution companies’ revenues if they did not attain quality standards, relating to minimising the number of interruptions to customers’ electricity supply.²⁸

19. One of the most important outputs that regulated companies must provide is a resilient network, which can withstand changes in environmental conditions or use. Ascertaining the current condition of assets that comprise the networks, however, is not straightforward. As OFWAT pointed out, the bulk of water and sewerage assets were buried beneath the ground, and it was therefore not straightforward to understand how well those assets were performing.²⁹ Although the serviceability of the water and sewerage networks was broadly stable or improving, they recognised that it was very important that the networks should continue to deliver essential services. OFWAT had therefore launched consultation papers, as part of the preparations for the next price review, on the next steps towards water companies achieving a better understanding of the serviceability of their assets. This exercise was based on a series of studies carried out with the companies and the quality regulators (the Environment Agency and the Drinking Water Inspectorate) to ensure that the infrastructure would be maintained and would give a broadly enhanced rather than deteriorating service.³⁰

20. The extent to which the regulators are willing to give companies an incentive to take into account wider environmental costs and benefits is variable. OFGEM said that they gave companies specific incentives to discourage wastage and encourage energy efficiency, and that they sought to ensure there were no artificial incentives on companies to encourage

²⁶ Q97

²⁷ Q71

²⁸ Qs 5, 94

²⁹ Q6

³⁰ Qs 6, 92

overuse of energy. It was, however, for the Government to make decisions where there were significant economic costs associated with environmental policies.³¹ OFTEL similarly said that while they had a social responsibility under legislation to make sure that British Telecom provided a universal service, there were no duties on them to make sure that companies spent money on potential environmental improvements.³² OFWAT, on the other hand, said that environmental issues were at the heart of the water and sewerage sector, and that they worked closely with the quality regulators.³³

21. Sewer flooding is one of the important environmental challenges facing OFWAT. They said that cases of sewer flooding caused by blocked or broken sewers were fairly rare, but where flooding occurred due to heavy rainfall, there tended to be sewage in the floodwater due to shared drains. This had unpleasant consequences for the households concerned. OFWAT explained that much of the infrastructure dated back to the 19th century, many drains served dual purposes (drainage and sewage) and it would not be cost effective to create a new system from scratch. They confirmed that, although the incidence of sewer flooding had been reducing over time, people increasingly considered it unacceptable and OFWAT were therefore undertaking a consultation exercise which would help inform the price review in 2005 and might lead to an allowance for remedial expenditure before then. Furthermore, there was already some allowance for companies to deal with unsatisfactory sewer outfalls where these were covered by the Urban Waste Water Treatment Directive.³⁴

22. Many of the network assets lie underground and there are potential social costs caused by the regulated companies digging up the roads to gain access to them. Such road works can impose costs in terms of delays and noise to road users and households, and can be particularly frustrating where it appears that water, electricity, gas and telecommunications companies have not co-ordinated their road works to minimise the disruption to the public. The Government have provided the regulated network companies with some incentive to reduce disruption through a power to fine companies that cause disruption for a longer period than planned, and are trialling a lane rental system. We wondered whether the regulators could also have a role in providing incentives. The X factor in RPI-X approach is set by reference to what the regulator thinks is possible for the future efficiency of the companies concerned. For instance, OFWAT set price limits on the basis of what can reasonably be achieved over the following five years taking advantage of new technology, better working practices and better procurement. The companies running the different networks in a particular area should therefore have an incentive to save money by sharing the provision and maintenance of underground assets.³⁵

23. The regulators told us, however, that they did not make specific allowance for efficiency gains for multiple uses of the same hole in the ground. Nor indeed were they clear about the scope for efficiencies from greater sharing. For instance, OFWAT were not in a position to be sure that companies using a single hole in the ground would necessarily yield gains. The X factor within RPI-X was set by reference to what they thought was possible for the companies as a whole, not for a particular element of their operations, because the regulators wished to avoid micro-managing the companies' operations.³⁶

³¹ Qs 36, 39

³² Q39

³³ Qs 38–39

³⁴ Qs 38, 72–4; OFWAT, *Annual Report 2001–02*

³⁵ Qs 27–28, 31

³⁶ Qs 27, 32–33, 35

OFTEL acknowledged that they had encouraged the mobile phone industry to share the use of the infrastructure of masts in rural areas. But co-ordination was much harder between sectors where upgrade programmes might not coincide. Although OFTEL were not sure that it was the regulator's job to intervene, they said that they would consider the issue further with the other regulators.³⁷

THE FINANCING OF REGULATED COMPANIES

24. The regulators' estimates of a reasonable return on capital are one of the most important elements of the price setting process. There are two complementary risks in setting the allowed return on investment. On the one hand, if regulators set too high a level of return companies could make excessive profits. The networks are capital intensive operations and returns on capital can constitute a sizeable proportion of the bill paid by consumers – up to one third in the case of water. On the other hand, if the regulators set too low a level companies could struggle to raise finance for new investment.³⁸

25. OFTEL said that they sought to produce an estimate of the return that would be needed to ensure that British Telecom renewed its network and invested in new technology. They did so by estimating a range of figures for return on capital (in percentage terms) after consultation with British Telecom and other operators on both methodology and the detailed figures. From this range, they chose mid-points.³⁹ OFWAT said that they took into account the perceptions of the markets at the time of setting the cost of capital to reflect a stable, robust company. OFGEM added that they set the weighted average cost of capital in a comparable way to the other regulators and by reference to capital market information.⁴⁰

26. There is an incentive within the price capping process for companies to seek to lower their own financing costs below the level estimated by regulators. To the extent that debt finance is cheaper than equity finance, a regulated company has an incentive to reduce its financing costs by altering its financing structure to increase the ratio of debt to equity. As OFWAT said, if the company were to beat the regulator's assumptions, then that would be a benefit that they would keep until the next price review.⁴¹ In the water industry, several companies have moved to a financial structure dominated by debt. The most prominent example is Glas Cymru, a company limited by guarantee which purchased Welsh Water in 2001. Glas Cymru is funded entirely by debt, though it has substantial reserves because it purchased Welsh Water at a discount to its regulatory capital value. Other water companies adopting a heavily indebted structure include Mid Kent Water and Portsmouth Water.⁴²

27. There may be risks to consumers arising from these structures. A heavily indebted company may have less flexibility to respond to unexpected events, such as a sudden increase in operating or financial costs, than a company with a substantial equity reserve. If a company has insufficient equity reserves to call on, there is a risk that it may have to pass on unexpected cost increases to consumers through higher prices. OFWAT said that Glas Cymru was the only water company wholly financed by debt, and that they had only

³⁷ Qs 32, 97–98

³⁸ C&AG's Report, para 3.15

³⁹ Q8

⁴⁰ Q11

⁴¹ Q13

⁴² OFWAT, *Annual Report 2001–02*

allowed this transaction to proceed after very carefully considering the dilemmas posed by the new structure. They pointed out that the Glas Cymru proposal had clear support in Wales, and had a very clearly articulated set of precautions to guard against the risks of brittleness and inflexibility that were inherent in a wholly debt-financed company.⁴³

28. Other water companies had not been proposing that equity should disappear, but were increasing the proportion of debt in their financial structure. In these circumstances, OFWAT had aimed to introduce licence amendments to ensure that customers' interests were fully met, for example by reviewing procurement plans where an increase in debt finance is accompanied by an increase in outsourcing. They expected a company largely or wholly financed by debt to respond to external events just as well and efficiently as other companies but would not bail out a company that had chosen a particularly risky structure.⁴⁴ But it was not clear to us how the regulator could avoid allowing higher charges to customers if a company was unable to call on shareholders' funds to withstand a large shock, such as increased borrowing costs.⁴⁵

29. OFTEL said that British Telecom had been reducing its debt to a level below 40 per cent in the face of market pressures. OFGEM said that in the electricity industry the level of debt was in the region of 50 to 60 per cent and that they would have reservations about companies having a very high level of debt.⁴⁶

30. One test of the appropriateness of assumptions made by regulators is the relationship between the Regulatory Capital Value (the capital base on which the company earns the percentage rate of return estimated by the regulator)⁴⁷ and the value placed on companies by financial markets, for instance through the publicly quoted share price. A significant and sustained divergence between the regulator's and market's estimate could indicate that the regulator has made inappropriate assumptions. OFWAT acknowledged that for several years, since just before the most recent price review, the valuation placed on companies in the water industry by financial markets had been lower than OFWAT's valuation, but noted that recent prices paid in acquisitions of water companies indicated that market values were not very far from the Regulatory Capital Value. They considered that differences between market and regulatory valuations were a common part of regulatory systems when new price limits are introduced. They would, however, bear the relationship between these two variables in mind as they prepared for the next price review.⁴⁸

31. There are clearly good reasons why the regulators should pay particular attention to the allowance for cost of capital in their next price reviews. They have established a joint working group to learn from each other in making assumptions about the returns on capital they should allow so as to avoid unnecessary differences in approach. As OFTEL told us, its purpose would be to assess whether the regulators' fundamental model was sound and to look at any differences in their approaches, so that there would be a clearer justification for the approach adopted.⁴⁹

⁴³ Qs 12, 18

⁴⁴ Qs 19–20

⁴⁵ Q23

⁴⁶ Qs 22–23

⁴⁷ Ev 18–19, Appendix 1

⁴⁸ Qs 12, 90

⁴⁹ Q95

32. There are some indications that the returns on capital that investors require may be affected by their perception of regulatory uncertainty. Unexpected changes in regulatory policy and approach may deter investors from providing funds to regulated companies, hence making it harder for them to finance their functions. According to a survey by the National Audit Office, virtually all the regulated companies considered that regulators needed to give priority to reducing of uncertainty about the regulatory approaches to controlling prices in the long term.⁵⁰

33. OFWAT agreed that reducing unnecessary risk was very much part of their job, adding that regulatory uncertainty should be interpreted more widely to incorporate Government as well as their own actions. As part of their drive to make their regulatory stance clearer and increase transparency they have announced that they will in future share the financial model they use to calculate price controls with regulated companies. They also said that they were aiming to publish their forward perspective on companies' regulatory capital values, and that this would help the financial markets to be clearer about OFWAT's approach to this issue. They did not, however, believe that they could remove all regulatory risk without affecting the interests of customers.⁵¹

34. Both OFGEM and OFWAT felt that the Utilities Act 2000 had helped reduce regulatory uncertainty by creating a regulatory authority for OFGEM consisting of 11 individuals. OFWAT expect the forthcoming Water Bill to provide for a similar move to a regulatory authority for the water industry.⁵²

⁵⁰ C&AG's Report, para 3.29

⁵¹ *ibid*, para 3.30; Qs 17, 91-92; Ev 18 -19, Appendix 1

⁵² Qs 17, 97

MINUTES OF PROCEEDINGS OF
THE COMMITTEE OF PUBLIC ACCOUNTS

SESSION 2001-02

WEDNESDAY 8 MAY 2002

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Geraint Davies
Mr Barry Gardiner
Mr Nick Gibb

Mr Brian Jenkins
Mr David Rendel
Jon Trickett
Mr Alan Williams

Sir John Bourn, KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Brian Glicksman, Treasury Officer of Accounts, was further examined.

The Comptroller and Auditor General's Report on Pipes and Wires: Regulating prices and quality of networks delivering essential services (HC 723) was considered.

Mr Philip Fletcher, Director General, Office of Water Services; Mr Callum McCarthy, Chairman and Chief Executive, Office of Gas and Electricity Markets; and Mr David Edmonds, Director General, Office of Telecommunications, were examined (HC 831-i).

A division of the House being called, the Chairman suspended the meeting for ten minutes.

The Committee resumed.

The witnesses were further examined.

The witnesses withdrew.

The Committee further deliberated.

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[Adjourned until Monday 13 May at Four o'clock.

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WEDNESDAY 3 JULY 2002

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon

Mr Ian Davidson

Geraint Davies

Mr George Howarth

Mr Brian Jenkins

Mr Nigel Jones

Mr George Osborne

Mr David Rendel

Mr Gerry Steinberg

Mr Alan Williams

Mr Tim Burr, Deputy Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Rob Molan, Second Treasury Officer of Accounts, was further examined.

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Draft Report (Pipes and Wires), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 3 read and agreed to.

Paragraph 4 postponed.

Paragraphs 5 to 34 read and agreed to.

Postponed paragraph 4 read and agreed to.

Resolved, That the Report be the Fiftieth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

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[Adjourned until Wednesday 17 July at Four o'clock.]