

**MINUTES OF THE JOINT REGULATORS' GROUP (JRG) MEETING
16 JUNE 2006**

Present:

Alistair Buchanan (JRG Chairman/Ofgem)
Chris Bolt (PPP Arbiter)
Bill Emery (ORR)
Philip Fletcher (OFWAT)
Sarah Chambers (Postcomm)
Nick Fincham (CAA)
Alan Sutherland (Water Industry Commission for Scotland)
Vincent Smith (OFT)
Sean Williams (OFCOM)
Maxine Frerk (OFGEM)

Andy MacFaul (JRG Secretary/Ofgem)
Professor Keith Palmer - Item 2

Apologies:

Dr Harry Bush (CAA)
Douglas McIldoon (OFREG)
John Fingleton (OFT)
Stephen Carter (OFCOM)

ITEM 1 Minutes of the 24 February 2006 meeting

1. The minutes of the previous meeting were agreed, subject to minor drafting comments.

ITEM 2 Financing networks

2. Professor Keith Palmer gave a presentation on some key issues involved in financing regulated network businesses: regulatory commitment, the financeability of capital programmes, and the market view of financeability.

3. Professor Palmer said that the markets were implicitly telling regulators that there was a significant premia for listed regulated companies, since there was very aggressive bidding for infrastructure assets at a significant premium to RAV. He said that a major cause of this was the very low cost of debt, which was well below the allowed cost of debt, combined with the very high liquidity of private equity houses and banks. He concluded that at present there was no financeability problem for any infrastructure company.

4. The JRG discussed the gap between the allowed costs of debt and the market cost of debt. The JRG also discussed whether regulators ought to fix a cost of capital for the lifetime of the assets, possibly index-linked, and whether doing so would be consistent with RPI-X regulation. The JRG discussed the approach to cost of capital in industries where investment is lumpy.

5. Professor Palmer said that regulators should expect the pattern of highly leveraged purchases by financial houses to continue. He said that regulators should obtain a very clear statement from the purchasers of their investment intentions at the time they buy the assets. Thereafter regulators should monitor their actions closely and make vigorous use of ring fencing and if necessary claw back provisions.

ITEM 3 Better Regulation issues

6. Maxine Frerk gave an update on the PWC administrative burdens exercise and said that Ofgem had commented on relevant parts of the draft report on DTI's activities (which covered Ofgem). It was suggested that the JRG discuss the issue of centrally-imposed targets for reducing burdens at its next meeting in September.

7. The JRG discussed the Legislative and Regulatory Reform Bill. Chris Bolt said that he had written, as ORR Chairman, to Hilary Armstrong and was waiting for a response. Philip Fletcher said that he would be discussing the Bill with Rick Haythornthwaite.

8. The JRG briefly discussed DTI's agenda for reforming consumer bodies.

9. The JRG was advised that the DTI/Treasury concurrency report had been published on DTI's website and that the deadline for responding was November. It was agreed the JRG should, as far as possible, prepare a joint response. Vincent Smith said that OFT would hold a seminar on the issues in September or October and draft a response on the actions that involved OFT for discussion at the next JRG meeting. Ofgem agreed to draft a response on the other aspects of the report.

ACTION: OFT/OFGEM

ITEM 4 Tour de Table

Ofgem

10. Alistair Buchanan updated the JRG in relation to the transmission price control review and said that Ofgem would publish initial proposals at the end of June.

11. Mr Buchanan gave the JRG an update on the Government's Energy Review and on the security of supply outlook for winter 2006/7.

12. Mr Buchanan reported that Ofgem was undertaking a major Competition Act case and had recently issued a Statement of Objections to National Grid.

13. Mr Buchanan reported that the Competition Commission had been minded to refuse permission for a party to appeal against a code modification decision on the grounds that the party was not of sufficient standing. He added that the party had itself decided to withdraw its appeal on grounds of cost.

OFCOM

14. Sean Williams reported the Court of Appeal's ruling that the Competition Appeal Tribunal had overstepped its powers by imposing a time limit on Ofcom when referring the *Floe Telecom* case back to OFCOM.

15. Mr Williams reported that following consultation OFCOM had decided to remove BT's retail price controls with effect from 31 July 2006.

16. Mr Williams noted the European Commission's proposal to impose price controls on international roaming charges for 2G mobile networks.

17. Mr Williams said that broadcasters had a lot of work to do in relation to digital switchover and said that they needed to communicate better with customers.

18. Mr Williams said Ofcom did not support moves to extend the remit of the Television Without Frontiers Directive in order to regulate the content of the internet.

CAA

19. Nick Fincham gave a detailed update on Grupo Ferrovial's bid for BAA, which now looked highly likely to succeed and which would lead to a significant increase in BAA's gearing. The CAA's powers to protect users against the detrimental consequences of high gearing were more limited than those of other regulators. The CAA's strategy had therefore been to flag up in public statements the importance of any current or potential owner of BAA adopting financial arrangements that were capable of supporting future user and/or regulatory requirements, with a view to putting the CAA (and airport users) in a relatively strong position if such financial arrangements proved not to be.

20. He reported that during the bid process, the OFT had announced that it was considering undertaking a market investigation and confirmed that the CAA would assist OFT in its market study of airports in any way it could. Mr Smith said that the timing of OFT's market study announcement had been influenced by the European Commission's merger clearance process, and noted that OFT would publish the terms of reference for the market study and call for evidence by the end of June.

Office of the PPP Arbiter

21. Mr Bolt said he had received a request for guidance from Tube Lines relating to the treatment at Periodic Review of investment incurred in one 7½ year review period with payback in subsequent review periods. He said that he expected to issue conclusions around the end of September.

22. Mr Bolt said that he had received two references for guidance as to whether the two Metronet infracos had performed their activities in an overall efficient and economic manner and in accordance with good industry practice. He said that he expected to publish a consultation document at the end of June and conclusions in November.

23. Mr Bolt said that he had been reappointed as PPP Arbiter until December 2010.

Ofwat

24. Mr Fletcher reported that Ofwat had been pressing Defra to establish a special administration regime, but said a lack of legal resources at Defra meant it would be delayed.

25. Mr Fletcher said that he and colleagues had been briefing the new Ministerial team on drought and leakage issues amidst a backdrop of high company profits.

26. Mr Fletcher updated the JRG in relation to quality of information issues, and associated enforcement action.

27. Mr Fletcher reported that Ofwat would shortly be announcing its new Chief Executive.

ORR

28. Bill Emery said that ORR had assumed rail health and safety responsibilities on 1 April and that ORR was in the process of integrating former HSE staff in the ORR's new offices in Kemble Street.

29. Mr Emery updated the JRG on ORR's decision to grant rights to Grand Central to operate additional passenger services on the East Coast Main Line.

30. Mr Emery said that ORR had published a document on the structure of Network Rail's charges, and that ORR awaited Network Rail's investment plan.

Water Industry Commission for Scotland

31. Alan Sutherland said that he would shortly be announcing proposed leakage targets for Scottish Water covering the next two years.

32. Mr Sutherland updated the JRG on the separation of Scottish Water's retail arm from its wholesale business. Mr Sutherland flagged that he would be publishing by the end of June a consultation on an agreement between the wholesale and retail businesses, including an operational code.

Postcomm

33. Sarah Chambers said that since market opening at the beginning of the year Royal Mail had retained 96 per cent of the mail market and that Postcomm had issued licences to 16 other companies.

34. Ms Chambers reported that in May Royal Mail had agreed its price control, which would be backdated to April 2006. She drew particular attention to provisions for dealing with the pension deficit and anti-competitive behaviour.

35. Ms Chambers mentioned the Government's financing package for Royal Mail, which she had been told would be on normal commercial terms.

36. Ms Chambers reported on three investigations under the Postal Services Act which had led to the imposition of financial penalties.

37. Ms Chambers said that Postcomm was conducting a high level strategic review of the future of postal services in the UK, on which it would consult in the summer.

ITEM 5 Any other business

38. There was no other business. The next JRG meeting is on 22 September.

Andy MacFaul, Secretary, JRG
9 August 2006