

# Information notice

[www.ofwat.gov.uk](http://www.ofwat.gov.uk)

## 2014 price review – Ofwat’s approach to the assessment of a company-specific uplift on the cost of capital

This information notice sets out further information for companies intending to submit proposals on a company-specific uplift to the cost of capital as part of their business plan submissions in June.

This is part of our 2014 price review.

The 2014 price review is our process for setting the price and service packages (‘price controls’) that each monopoly company must deliver over each of the five years between 2015 and 2020.

### Background

In ‘[Setting price controls for 2015-20 – risk and reward guidance](#)’ (our ‘risk and reward guidance’), which we published in January, we set an appointee level real weighted average cost of capital (WACC) of 3.85% and a wholesale WACC of 3.70%.

In the December business plan submissions, the water only companies proposed adjustments to the WACC to reflect the effects of their size and the fact that they

only supply water services to their customers. These adjustments related to increases to the:

- allowed cost of equity; and
- cost of debt.

None of the water only companies explained the level of benefit to customers that results from their smaller size and/or from the potential efficiency benefits from Ofwat being able to draw cost comparisons from a larger number of companies.

In our risk and reward guidance, we said that companies would need to demonstrate that they face a higher efficient cost to raising finance, and that there is an offsetting benefit to customers to justify such an uplift to the WACC. We noted that those proposing company-specific uplifts had put forward arguments about why raising finance is more costly, but had not set out any evidence of offsetting benefits. We will not accept an increase to customers’ bills for the water only companies without evidence of the benefits those customers will see.

Neither of the enhanced companies – South West Water and Affinity Water – sought adjustments to the WACC proposed in our risk and reward guidance in their revised business plans.

### Information requirements for the assessment of a company-specific premium

Before companies send us their revised business plans for the August draft determinations, we set out four factors that they may wish to consider if they are making a case for a company-specific premium.

### The cost of finance

Companies should set out evidence on why their specific circumstances increase their efficient cost of finance. This evidence should be based on the notional capital structure used in our assessment of the WACC, rather than the company’s actual capital structure or its own cost of finance. These costs should be incremental to those included in the cost of capital set out in our

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water sector in England and Wales.

risk and reward guidance and relevant to the 2015-20 period.

### Customer benefits

Companies should provide evidence, including quantifiable benefits to customers over the 2015-20 period. These benefits should at least match the incremental costs. Companies should be clear on the counterfactual they are using as the basis of any analysis used to demonstrate benefits.

### Overall assessment

Companies should present an overall assessment that includes the incremental company-specific costs and the additional customer benefits.

### Implications of no company-specific risk uplift to the WACC

Companies should also set out any likely implications on their business plans if we were to disallow any specific uplift to the WACC.

For the avoidance of doubt, it is up to the companies themselves to decide whether or not to seek an

## More information

'Setting price controls for 2015-20 – final methodology and expectations for companies' business plans', July 2013

'Setting price controls for 2015-20 – risk and reward guidance', January 2014

'Outcomes of the risk-based review and next steps', April 2014

[2014 price review web pages](#)

uplift to the WACC and, if they do, to set out the evidence that substantiates a specific uplift. We have not committed to making an adjustment to the WACC for one or more companies. And we are not actively encouraging companies to propose an adjustment.

### Enquiries

If you have any questions about this information notice, please send them to [price.review@ofwat.gsi.gov.uk](mailto:price.review@ofwat.gsi.gov.uk).

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500

Fax: 0121 644 7533

Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)

Email: [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk)

May 2014

© Crown copyright 2014

You may reuse this information (excluding logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/version/2/> or email [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this publication should be sent to us at [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk).

This document is also available from our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk).



**Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water sector in England and Wales provides consumers with a good quality and efficient service at a fair price.**

