Preparing business plans for the 2014 price review – questions and answers

25 October 2013

In 2014-15, we will decide the price and service package (the 'price controls') that each of the monopoly water and sewerage and water only companies in England and Wales must deliver in each of the five years between 2015 and 2020. As part of the 2014 price review process (PR14) the companies are now preparing their business plans, which will set out their proposals for the next five years. They will submit these to us by 2 December 2013.

In 'IN 13/07: 2014 price review communications between Ofwat and water companies', we set out our approach for engaging with water companies and other key stakeholders during the 2014 price review. As of 1 October the price review has entered the restricted communication phase. During this phase Ofwat will only respond to business plan queries if we feel it is appropriate. If this is the case then we will make our responses to these queries available to all companies.

We have so far published two question and answer documents to clarify the business plan reporting requirements. The first was released on 23 September and the second on 18 October.

This third question and answer document presents further queries and answers received by Ofwat during the restricted communications phase for the benefit of all companies.

Cost of capital and financeability

Q1. In PR09, Ofwat evaluated financeability against financial ratios consistent with BBB+/Baa1 credit rating, and published numerical ranges for these ratios in the draft determination. In the PR14 methodology statement, you said that you will use the same financial ratios for debt again. Should we infer from this that you will again define financeability in terms of the BBB+/Baa1 credit rating agency bands?

As we said in 'Setting price controls for 2015-20 – final methodology and expectations for companies' business plans' (the 'methodology statement'), we will take a flexible approach to financial ratios and take a decision on the appropriate level for ratios when we review company business plans. Companies are responsible for ensuring that business plans are financeable and we will expect them to consider appropriate options to address potential constraints, including taking a flexible approach to financial ratios. We will consider evidence that companies provide in reaching a view about the appropriate level of ratios and companies should not assume that levels adopted in previous price controls will be adopted in PR14.

Q2. Generic queries on what happens if companies propose a weighted average cost of capital (WACC) lower than our assessment of the notional WACC?

Where a company proposes a WACC that is lower than our assessment of the notional WACC we will use our view to set its wholesale price controls.

Enhanced category companies

Q3. Generic queries seeking reassurance that enhanced category companies will not lose out as a result of securing enhanced status.

In the methodology statement we said that enhanced companies would benefit from financial, reputational and procedural rewards. To ensure that companies are encouraged to develop high quality business plans and to achieve enhanced status we are adopting a principle of 'do no harm' for these companies.

For example, if we published an early final determination for enhanced companies and then our assessment of the appropriate industry wide cost of capital changed, we would ensure that this revised cost of capital also applied to enhanced companies.

In 'Setting prices for 2015-20 – delivery plan', which we published in September 2013, we noted that we are actively considering whether it is possible to publish early final determinations for enhanced companies. This will depend on whether we can credibly commit to a 'do no harm' rule at the same time as ensuring full compliance with our statutory duties.

We therefore reaffirm our commitment in the methodology statement that:

> **"… companies in the enhanced category will be better off overall (taking into account all relevant factors) than companies in the 'standard' and resubmission categories."**