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UKRN



16th November 2022

Attricia,

### [UKRN guidance for regulators on the methodology for setting the cost of capital — consultation](#)

Thank you for the opportunity to comment on your draft guidance to regulators for setting the cost of capital in price controls.

The BEIS review of economic regulation set out the expectation that regulators would work towards greater consistency and towards a common methodology for the WACC in setting price controls, where appropriate. It stated that alignment would encourage greater confidence in the price control for consumers, businesses and investors.

We agree with this. However, for a common methodology to provide the desired benefits, it must be grounded in a solid foundation and provide a fair approach to estimating the WACC. This is particularly important given the high levels of investment that will be required across the infrastructure businesses in the decades ahead, to improve services to customers, increase resilience and protect the environment.

We are concerned therefore that the guidance appears to be based on a fairly superficial assessment of the issues, appears to be endorsed by a small segment of the relevant regulators and provides weak guidance, in that regulators only have to have regard to the guidance and can "depart from the guidance" if they so wish.

We note, for example, that two regulators - the CAA and Utility Regulator for Northern Ireland - have recently largely followed the approach used by the CMA in the PR19 re-determinations to set the risk-free rate, yet the draft guidance rejects this approach, without any strong rationale.

It is also notable that the proposed approach appears to opt for an approach that will tend towards a low value for the WACC. Whilst this may reduce consumers costs in the short term - it may not be good in the longer term, if the rate is too low to attract the required investment that is needed for the longer-term benefit of customers and the environment. The approach to estimating the cost of capital needs to be sustainable and fair to all parties.

Water UK are providing a detailed response to the consultation on behalf of the water industry. We endorse these views and do not repeat them in this response.

In terms of the specific questions for consultation:

Question 1) Do you agree with the proposed recommendations?

We agree with only a limited number of the recommendations, in accordance with the details set out in the Water UK industry response. We consider that the current proposals are not based on a thorough assessment of the options and depart from the practices of a number of regulatory bodies without a strong rationale.

Question 2) Do you have views on how this guidance could evolve over time, including views on potential issues for further investigation?

We consider that it would be better if all the relevant economic regulators, working with the CMA and experts, and in consultation with the relevant industries undertook a more thorough and balanced assessment of a sustainable approach to setting the WACC, which would allow firmer guidance to be provided and the benefits arising from a more consistent approach to be realised

If you have any queries on the response, please do not hesitate to contact me,

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Yours sincerely

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