Anglian Water

PR19 CMA Redetermination

Working paper response – Leakage

Submitted 25 January 2021

Table of Contents

Contents **Page**

Chapter A: Leakage working paper response - Summary

1 Summary

(1) Maintaining Anglian's frontier position on leakage and delivering further improvements to push that frontier further in AMP7 is crucial to ensuring security of water supply for Anglian's customers in AMP7. This situation is now more urgent and acute than at the Final Determination, given the continued pressure on abstraction and the observed sustained increase in per capita consumption (a 12% increase in household consumption[1]) as a result of Covid-19. Therefore, to meet the needs of customers and the environment during AMP7, the CMA should ensure the redetermination reflects an appropriate cost allowance to cover both Anglian's base costs (to *maintain* current frontier performance) and its enhancement costs (to deliver *additional* activities to further improve its leakage position).

(2) Within this context, Anglian welcomes the opportunity to respond to the CMA's Working Paper on leakage ('Leakage Working Paper') ahead of the conclusion of the redetermination. Anglian supports the recognition of a number of key principles in the Leakage Working Paper. However, Anglian is concerned that these have not yet been translated into the corresponding base and enhancement allowances that the company requires to maintain its current performance and continue pushing the frontier of leakage reduction.

(3) The scope of the Leakage Working Paper is largely limited to enhancement totex expenditure. The detail of the CMA's thinking on base expenditure allowances is not provided. Anglian view this as a serious omission given the £106m[2] gap between Anglian's required base allowance and the Provisional Findings (PFs) position. This gap is more than all the leakage enhancement allowances for the disputing companies combined; the absence of information on the CMA's thinking on this key issue is concerning.

(4) Anglian also notes that the CMA has misunderstood the basis of its base leakage Cost Adjustment Claim ("CAC"). Unless this misunderstanding is redressed and the base cost funding allowance increased in the redetermination, the funding gap would threaten security of water supply in the Anglian region, as leakage is a core part of the demand management actions that must be delivered to maintain the supply demand balance. Given the scale of the shortfall (£106m gap on base versus £13m gap on enhancement) and consistent with previous discussions with the CMA, Anglian's main focus in this response is on the approach to setting base expenditure allowances.

(5) Anglian has previously provided a significant volume of evidence setting out the basis of its leakage expenditure, much of which has not yet been taken into account by the CMA. Anglian therefore points to this evidence and its importance in reaching the right decision on cost allowances, rather than providing new evidence[3].

(6) Anglian notes the CMA's reassurance that it will fully review Anglian's CAC ahead of its final redetermination. To aid this review, and at the CMA's request, Anglian provides with this response the list of relevant extracts from its previous submissions (Annexes 1-3 and Appendices to Annexes 1-3).

2 Base

(7) The approach to setting base leakage allowances outlined in the Leakage Working Paper would create a significant shortfall in the necessary expenditure required to ensure a resilient water supply-demand

[1] Anglian's submission following the November and December main party hearings, 17 December 2020, chapter B2.

[2] Based on the value of Anglian's Base CAC (£132m) minus the £25.7m base adjustment allowed in the PFs

[3] Specifically Annexes 1-3 and Appendices to Annexes 1-3 which cover Base leakage (annex 1), Enhancement leakage (annex 2) and the leakage ODI (annex 3)

balance in the Anglian region within the next five years, and on the industry's long-term ability to reduce leakage in future.[4].

(8) As highlighted by Peter Simpson in Anglian's 2nd December 2020 hearing, 60% of the entire supply/demand challenge that Anglian faces over the next 25 years impacts by 2025[5]. Supply side solutions only bring benefits after 2025, and so **leakage control and the rollout of smart metering are the only tools Anglian has to address this challenge. Consequently, the £106m base shortfall:**

(i) presents an immediate threat to the supply-demand balance of the Anglian region, making the region significantly less resilient;

(ii) presents an environmental risk, through increased reliance on abstraction to balance supply and demand, whilst there have been further EA restrictions on abstraction since the FD[6];

(iii) is inconsistent with customers' views on the importance of reducing leakage[7]

(iv) is inconsistent with the CMA's own view of enhancement costs which recognise the increasing marginal costs of leakage; and

(v) exposes Anglian to significant financial penalties through the leakage ODI.

(9) Anglian is deeply concerned that the Leakage Working Paper suggests the CMA will only make minor refinements to its PF approach.[8] Indeed, such rigidity regarding base leakage allowances reflects a lack of engagement and/or lack of understanding of the materials that Anglian has presented to the CMA during the redetermination to date.

(10) From the refinements the CMA is indicating it may make to its approach, the CMA has focussed mainly on the materials presented by Ofwat and placed limited or no weight on the evidence presented by Anglian[9]. An example of this is the misrepresentation of basis of Anglian's CAC in Annex 1 of the Leakage Working Paper.

(11) The CMA incorrectly states that the driver of the CAC is "for the challenges it faces with pipe and soil conditions in its operating area". **Anglian has consistently explained to the CMA that the CAC is for the higher costs associated with delivering its frontier level of leakage, which are not captured by base models[10].**

(12) Anglian considers the CMA's view has been principally informed by adopting Ofwat's reply to Provisional Findings responses in November 2020 without scrutiny and fails to reflect Anglian's evidence which responded directly to Ofwat's falsely drawn conclusions[11]. **Redressing these errors is critical given the materiality of the CAC (£132.5m)[12].**

[4] See chapter B.1 of this response.

[5] See Transcript page 5 line 6

[6] Anglian's reply to responses to the PFs, para 28

[7] Anglian's Water Resources Management Plan (SOC279), page 48.

[8] Leakage Working Paper, paras 9 and 129.

[9] Anglian has expressed similar concerns with other parts of the redetermination (including the cost of capital, cost of embedded debt, 2019/20 data and Elsham DPC) in a letter to Kip Meek on 18 January 2021.

[10] Anglian's submissions in relation to pipe materials and soil conditions (but also weather patterns) are not about the CAC, but rather were in response to the CMA's PF which indicated that the CMA had some concerns that Anglian's high performance is influenced by favourable regional differences. As set out in Anglian's response to the PFs, the analysis undertaken by Dr Farewell demonstrated that, far from being benign, East Anglia contains some of the most aggressive ground conditions for water networks in the UK.

[11] Particularly, Anglian's response to the PFs (chapter F), and Anglian's Reply to Responses to Pfs (chapter D3)

[12] See chapter B.2 of this response

(13) **Anglian's CAC provides a solution to the problem which is grounded in actual leakage control costs, includes bottom-up and top-down efficiency assessments and incorporates additional cost challenges**[13]. Applying Anglian's leakage CAC in the redetermination would also follow the principles that the CMA has affirmed in its Leakage Working Paper that it is appropriate to assess bottom-up costs in recognition of the increasing marginal cost for companies (like Anglian) of reducing leakage to lower levels[14].

3 Enhancement

(14) Anglian welcomes a number of overarching principles to the assessment of enhancement costs as set out in the Leakage Working Paper[15]. The recognition that a "one-size-fits-all" approach to assessing future leakage costs is not appropriate is an important precedent to inform the future assessment of leakage costs. It allows the CMA to take into account specific company circumstances - including the level of performance being achieved, which Anglian has demonstrated influences companies' unit rates for leakage reduction[16].

(15) Consistent with the evidence previously provided[17] by Anglian, **the Leakage Working Paper firmly recognises the link between leakage performance levels and the rising marginal cost of leakage reduction.** This sets a positive and rational precedent which could help to ensure that, in setting enhancement allowances in future price reviews, high performing companies are not penalised for their strong performance.

(16) Moving from the principle to the practical application to the derivation of enhancement costs, Anglian has outstanding several concerns with the robustness of the CMA's assumptions used to derive Anglian's enhancement allowance. Specifically, the CMA relies upon Ofwat's unsubstantiated conclusion that a proportion of Anglian's proposed enhancement costs are in fact base costs. This is incorrect. **Anglian has previously provided evidence, which is not referenced in the Leakage Working Paper, that all these costs are enhancement[18]. The Leakage Working Paper fails to reference this evidence and it is not reflected in the CMA's conclusions[19].**

(17) The CMA continues to apply a 10% efficiency challenge to Anglian's costs and suggests that Anglian has not provided sufficient evidence of efficiency[20]. The CMA has not referred to the evidence of efficient costs that Anglian has provided during the redetermination nor why it has considered this evidence insufficient[21]. Anglian also highlights that the 10% efficiency challenge was intended as a light-touch efficiency challenge, and not intended for instances where detailed assessment has been undertaken on enhancement costs, as has been the case for leakage.

(18) The CMA highlights that its proposed allowance is before adjustments for frontier shift and RPE[22]. Anglian's enhancement leakage costs already factor in productivity and RPEs. Were the CMA to reapply frontier shift and RPE this would result in a double count[23].

[13] See chapter B.3 of this response.

[14] See chapter B.4 of this response.

[15] See chapter C.1 of this response.

[16] Leakage working paper, paragraphs 40 and 120.

[17] Anglian's Statement of Case, figure 78.

[18] Letter to Douglas Cooper from Alex Plant, 20 November 2020, page 9.

[19] See chapter C.2 of this response.

[20] See Leakage Working Paper, paragraph 77.

[21] See chapter C.3 of this response.

[22] See Leakage Working Paper, footnote 43.

[23] See chapter C.4 of this response.

4 Request to the CMA

(19) **For base leakage costs**, Anglian urges the CMA to accept Anglian's CAC of £132.5m in full. This is imperative to ensure the immediate supply needs of the region are met within AMP7. Anglian has previously provided to the CMA the necessary information required to undertake a bottom-up assessment of these costs. Anglian is ready to provide any further clarifications the CMA requires in order to reach an appropriate conclusion on its leakage base allowance.

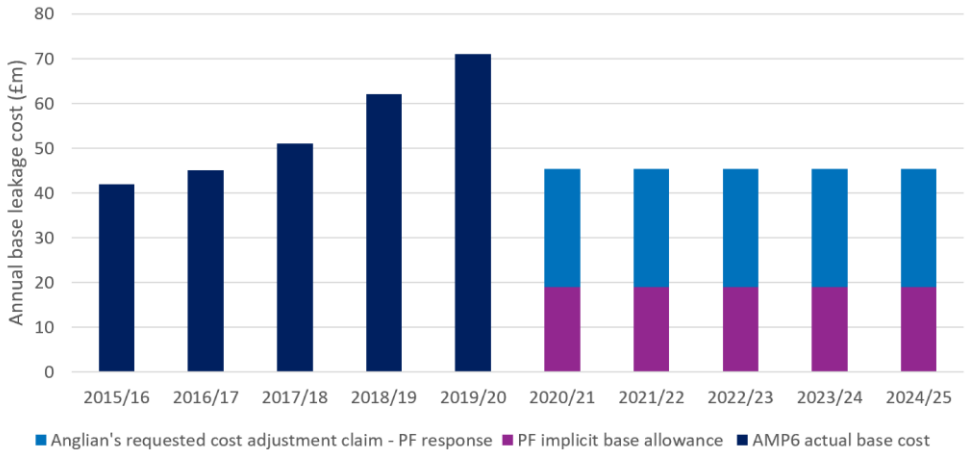
(20) **For enhancement leakage costs**, the CMA should retain its company-specific approach to cost assessment in its redetermination, including the bottom-up assessment of Anglian's costs. It should reverse its reduction of costs on the basis of its judgement of enhancement costs being partially contained in base costs. The CMA should also remove its shallow dive efficiency challenge. Having taken these steps, Anglian considers that the appropriate enhancement allowance would be £76.7m.

Chapter B: Leakage – Base cost allowance

1 The current approach to setting base leakage allowances would create a significant shortfall in the necessary allowance to ensure water supply-demand balance in the Anglian region

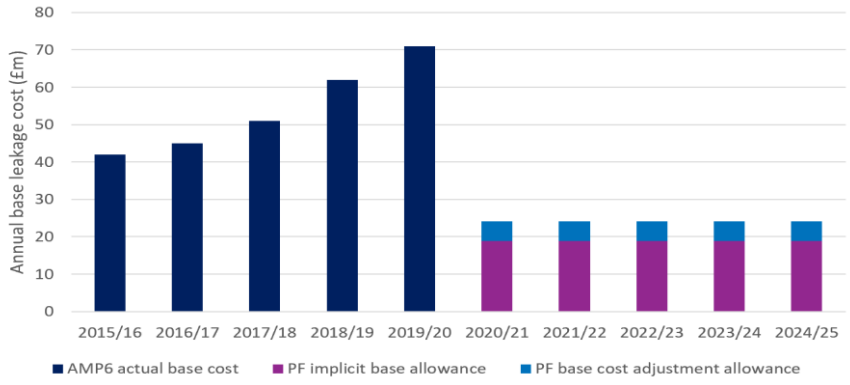
(21) Figure 1 below shows the impact of Anglian's proposed CAC on the allowances sought for AMP7. This shows that even if the CAC were allowed in full, this would still represent Anglian a significant cost challenge in AMP7 given the total base cost allowance (i.e. the sum of the implicit allowance and the CAC) **would be less than the actual base leakage costs incurred in AMP6 and already represents a significant efficiency challenge**.

Figure 1 AMP6 actual leakage base costs and AMP7 allowance with Anglian's CAC



(22) The CMA's PFs position, repeated into the Leakage Working Paper which fails to reflect the scale of costs required as set out in Anglian's CAC, implies an implausible cost efficiency challenge of over 50% compared to Anglian's actual incurred costs in 2019/20. This is shown in Figure 2.

Figure 2 AMP6 actual leakage base costs and AMP7 allowance with CMA's PF allowance

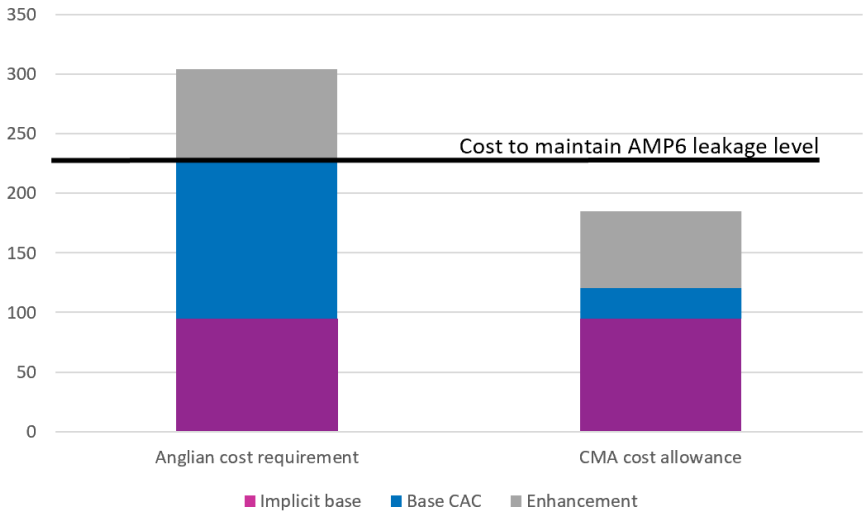


(23) The shortfall of £106m[24] in the CMA's proposed leakage base allowance more than outweighs the allowance it is proposing to make in enhancement. The scale of this shortfall means that **at present, Anglian's totex allowance is insufficient to maintain, let alone reduce leakage.** This is shown in Figure 3 below. On top of this, Anglian faces an ODI regime which would see it face an enhancement

[24] Based on the value of Anglian's Base CAC (£132.5m) minus the £25.7m base adjustment allowed in the PFs

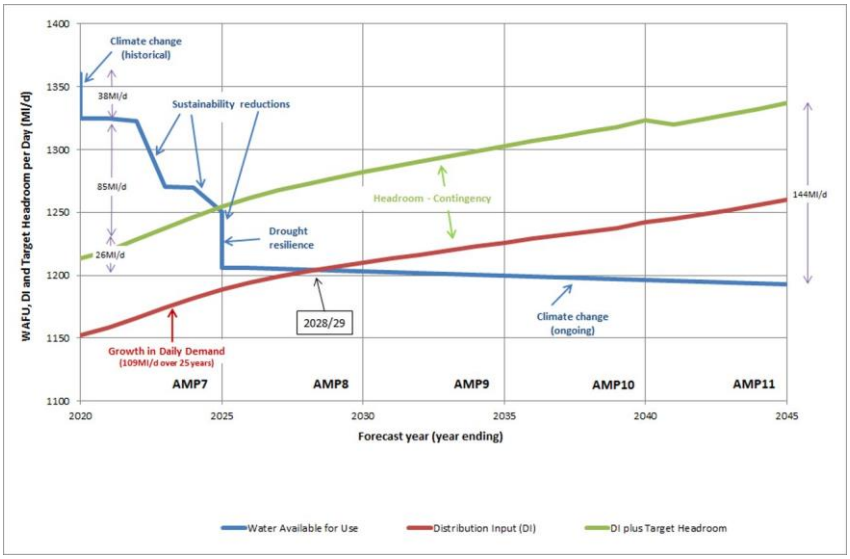
cost claw-back and an additional penalty rate if it delivers the level of leakage implied by the current totex allowance.

Figure 3 CMA leakage allowance vs actual cost to maintain leakage at AMP6 level



(24) As previously stated, leakage reduction is not a "nice to have" for Anglian. Such reductions are imperative given the need to reduce leakage in AMP7 in order to maintain a supply-demand balance. Figure four reiterates, the pressures on Anglian's water resources[25] during AMP7 which informs the importance of leakage reduction during AMP7[26].

Figure 4 Pressures on Anglian's supply demand balance[27]



(25) **The CMA is therefore placing Anglian in a situation where it is not funded to deliver its core statutory functions and where the resilience of its region to drought would be significantly reduced.** Anglian cannot see how such an outcome is consistent with the resilience duty.

[25] PF013 – Professor Jim Hall - The urgent challenges to water supply in the South and East of England

[26] Anglian's response to the PFs, Chapter F2.

[27] Anglian's response to the PFs, figure 4.

(26) Furthermore, **the CMA's current approach sets a damaging precedent for long term leakage reduction across the industry**. As the frontier performer on leakage, Anglian has shown that reducing leakage is not just achieved through one-off enhancements. Additional (and increasing) recurring base expenditure is also incurred[28]. The CMA's approach to leakage base allowances sets a precedent that these additional recurring costs will be almost entirely unfunded. Given the scale of Anglian's base leakage cost gap (c.£106m at PFs), **this sets a significant incentive for others not to aim for frontier performance, so as to avoid additional base costs associated with maintaining improved performance being unfunded in future periods.**

(27) This situation arises because of the CMA's current approach to setting the leakage base adjustment, which gives no consideration to Anglian's CAC; and derives its allowance (£25.7m) based on an arbitrary calculation of performance beyond the industry UQ performance which bears no relation to the costs of achieving the associated level of performance. This is at odds with the CMA's own approach to deriving enhancement allowances set out in the Leakage Working Paper which does reflect the increasing marginal costs of delivering leakage improvements.

(28) **The CMA should rectify these shortcomings by removing its current base adjustment and allowing Anglian's base CAC of £132.5m.** This would make an appropriate allowance for the costs of maintaining Anglian's frontier leakage performance during AMP7 and be consistent with the CMA's recognition of the reality of rising marginal costs associated with improved leakage control in relation to enhancement costs.

2 The CMA's working paper fails to consider the evidence previously provided by Anglian. This results in a material allowance shortfall.

(29) Anglian is very concerned at the lack of engagement with the evidence it has presented on base leakage. Anglian's resulting shortfall on base costs (£106m) is greater than the entire leakage enhancement allowance the CMA has made to all disputing companies. There is little evidence that the CMA has engaged with the material already provided that relates to fundamental aspects of Anglian's CAC.

(30) Anglian notes the CMA's recent reassurance that it will fully review Anglian's CAC ahead of its final redetermination. In this response, Anglian summarises the points previously raised with the CMA on base leakage[29] that have not been reflected in its Leakage Working Paper. To aid this review, and at the CMA's request, Anglian provides with this response the list of relevant exhibits from its previous submissions[30].

2.1 Anglian's full cost adjustment claim is required to ensure sufficient expenditure is allowed to maintain the frontier level of performance achieved during AMP6.

(31) The rationale for Anglian's CAC rests on three pillars:

(i) the models used to derive companies' base cost allowances included no drivers for leakage. This means that allowances were provided only to achieve the leakage performance achieved on average by the whole industry across the modelled period. They are therefore incapable of reflecting Anglian's full base leakage costs as a frontier performer;

[28] Anglian's response to RFI012, supplementary information.

[29] Specifically Annex 1 and Appendix to Annex 1: Base leakage.

[30] See Appendix to Annex 1: Base Leakage, Appendix to Annex 2: Enhancement leakage and Appendix to Annex 3: Leakage ODI

(ii) the unit cost of leakage control increases as the level of leakage falls (as the CMA acknowledges for enhancement); and

(iii) Anglian's leakage level is substantially better than the industry average. If it operated at industry average leakage levels, its three-year rolling average leakage in 2019-20 would have been c.269Ml/d[31] rather than the 194 Ml/d[32] which it achieved.

(32) Ofwat's FD also acknowledged the inability of the base models to capture Anglian's costs and therefore proposed alternative model specifications which derived additional, albeit insufficient additional cost allowances for Anglian in respect of its leakage performance[33].

(33) By making an adjustment to Anglian's base costs, the CMA also acknowledges (but currently insufficiently reflects) the shortcoming of these models and the need for a cost adjustment reflecting the Anglian's frontier level of leakage performance.

(34) As presented in Anglian's CAC[34], Anglian derived the values by comparing its historic annual leakage performance against the actual base costs required to maintain that level of leakage in each year (in 2017/18 price base). Anglian used this relationship to compare the base costs of maintaining its AMP6 outturn level of leakage against the SELL[35]. This analysis showed a £27.4m annual cost differential, or £136.9m over the AMP.

(35) As previously highlighted[36], this analysis excludes the costs incurred in 2018/19 and 2019/20, which (as shown in Figures 1 and 2 above) were higher as a result of efforts to mitigate the impacts of, and recover from, the Beast from the East. Including these costs would have increased the estimated costs of maintaining the AMP6 level of leakage, and therefore increased the size of the CAC. In not including these costs, Anglian is both setting itself a stretching efficiency challenge associated with maintaining its AMP6 leakage performance and bearing the financial risk of a similar climatic event occurring in AMP7.

(36) Following Oxera's review of Anglian's CAC[37] submitted alongside its PF response, Anglian also applied a frontier shift challenge of £4.5m to the CAC, reducing the value of the CAC to £132.5m.

(37) **The full CAC is required to address the shortfall of base leakage costs, which are not covered in the base models**. Anglian provided further details on how the CAC was developed and how it has ensured it is based on efficiently incurred costs in two recent submissions:

- Chapter F5 of Anglian's response to the PFs;
- Chapter F of Anglian's submission following the November and December main party hearings.

[31] Based on leakage levels reported in Ofwat's RFI025 supporting calculations, average leakage equates to 278Ml/d on a km of main basis and 259Ml/d on a per property basis.

[32] On AMP7 reporting basis. On AMP6 reporting, Anglian's leakage level was 185Ml/d in 2019/20.

[33] Securing Cost Efficiency Technical Appendix (SOC243), chapter 3.1.13

[34] DD Leakage CAC (SOC173).

[35] Whilst the botex models fund leakage to the average level of leakage, not SELL, Anglian has not operated at the industry average level of leakage for a long period of time. Therefore it would have had to extrapolate to estimate the costs of maintaining industry average leakage levels. With that in mind, Anglian based its inferred implicit base allowance on SELL because it has operated at this level more recently and thus, more reliable cost data is available. At 211Ml/d, Anglian's SELL is significantly below, the industry average level of leakage.

[36] For example, Anglian's submission following the November and December main party hearings, 17 December 2020, paragraph 86.

[37] Oxera report on leakage cost adjustment claim (PF015).

2.2 The CMA has mischaracterised Anglian's CAC, suggesting it has either misunderstood the CAC itself, and/or the evidence on leakage presented during the redetermination

(38) In the Leakage Working Paper, the CMA states that Anglian *"additionally requests consideration of a cost adjustment claim of £132.5m* ***for the challenges it faces with pipe and soil conditions in its operating area****"* (emphasis added by Anglian). **This is incorrect.**

(39) **Anglian's CAC is for the additional costs of maintaining the frontier performance levels of leakage achieved in AMP6 which are not reflected in Ofwat's botex cost assessment models**. The botex models include no service parameters. They take an aggregate view of the base costs for the industry and therefore can only reflect the costs which the industry incurred to maintain industry-average leakage performance over the modelled period. Through the proposed (albeit insufficient) adjustments made by both the CMA and Ofwat, this principle is not disputed.

(40) Anglian has previously demonstrated that achieving exceptional leakage performance is borne out of the necessity of securing scarce water resources in the region against the increasing pressures of growth and climate change, and the step change reduction in available water driven by the Environment Agency's reductions in the amount of water Anglian is able to abstract. In addition, Anglian are seeing a sustained increase in per capita consumption driven by Covid-19. Unlike other companies, Anglian's proposed AMP7 leakage reduction is not driven seeking to respond to an arbitrary challenge laid down by Ofwat.

(41) These regional challenges have been set out in the respective reports produced by Professor Jim Hall[38] and Dr Tim Farewell[39]. The former set out the regional water challenges, whilst the latter demonstrated that, far from making leakage control in the Anglian region easier, regional factors actually make leakage reduction in the Anglian region more challenging. This is principally driven by adverse pipe, soil and climatic conditions in the region.

(42) Anglian has explicitly set out its CAC is not driven by these regional factors. For example, during Anglian's December hearing Alex Plant stated:

"I just wanted to be really clear that the cost adjustment claim that we put in, has nothing to do with the regionally specific factors that we face, we just take that on the chin. The cost adjustment claim is all about the fact that we are not funded for the level of base leakage performance, that we need to maintain in order to ensure the supply/demand balance[40]."

(43) To aid the CMA, Anglian recaps in table 1 below the relevant evidential exchanges:

Table 1 – Previous statements on Cost adjustment Claim

Date	Activity
March 2020	Anglian submits Statement of Case to CMA, including the CAC to reflect the additional costs of maintaining frontier leakage performance[41], as included in Anglian Business Plan and Draft Determination Representation[42].
June 2020	Peter Simpson responds sends a site visit follow-up letter to Kip Meek[43]. It followed a question asked at Anglian's site visit about whether its topography

[38] The urgent challenges to water supply in the South and East of England (PF013).

[39] The impact of environmental factors on leakage in the Anglian Water region, and 12 August 2020 Hearing follow-up letter from Peter Simpson to Kip Meek (PF014), page 3.

[40] Anglian Main Party Hearing transcript, page 34, line 24.

[41] Anglian's Statement of Case, chapter H3.

[42] DD Leakage CAC (SOC173).

[43] Letter from Peter Simpson to Kip Meek, 19 June 2020

	makes leakage control more or less challenging than for other water companies. In the letter, Anglian highlighted the challenges imposed by its older water mains, pipe materials and soil types.
September 2020	CMA publishes its Provisional Findings. Within, it states in relation to base leakage: "We have some concerns that the **reasons for high performance are likely to be a combination of regional differences**, historical levels of investment and past efficiency in achieving targets" (emphasis added by Anglian).[44]
October 2020	Anglian commissioned a report by Dr Tim Farewell on the regional factors that impact leakage control following on from a previous third-party submission on the matter. The report highlighted that there is no evidence that Anglian benefits from regional differences. Indeed soil, pipe and climatic conditions are likely to increase the cost of leakage control. Despite these findings, **Anglian made no adjustment to its CAC to reflect these challenging regional conditions.**
November 2020	Ofwat responded to Anglian's October 2020 submission and stated: "*There is no basis for making an adjustment to Anglian Water's allowance to account for company specific factors.[45]".* This mischaracterised the basis of Anglian's base CAC (despite Ofwat previously having made a base adjustment, not for regional factors, but to reflect level of service). It also contradicts the CMA's Provisional Findings which appeared to justify the disallowance of part of Anglian's CAC based on regional factors (whereas Ofwat says here that there should be no adjustment).
December 2020	In Anglian's 2 December hearing, Anglian reaffirmed that the CAC "*has nothing to do with the regionally specific factors that we face".*
January 2020	CMA publishes its Leakage Working Paper stating Anglian's CAC is "*for the challenges it faces with pipe and soil conditions in its operating area*". This appears to follow from Ofwat's November mischaracterisation, and not from Anglian's submissions or the additional clarification provided in the December 2020 hearing.

(44) Procedurally, Anglian is concerned that the CMA has not reflected Anglian's previous submissions in reaching its position in the Leakage Working Paper. The continued mischaracterisation of Anglian's CAC appears to be influenced unduly by erroneous claims in Ofwat's November submission which Anglian has previously corrected.

(45) Anglian asks the CMA to confirm in writing if there is anything in its CAC that remains unclear following the submission of this leakage working paper response.

2.3 The current base cost adjustment proposed by the CMA is inconsistent with the approach taken to derive the CMA's enhancement cost assessment and is wholly insufficient to enable Anglian to maintain its frontier level of performance achieved during AMP6

(46) In its PFs, the CMA proposed to allow a base cost adjustment for Bristol and Anglian based on performance relative to the Upper Quartile (UQ) on a leakage per km of main basis. The calculation of

[44] CMA's Provisional Redetermination of Ofwat's Price Control 2020-25, paragraph 8.46.

[45] Ofwat's Reference of the PR19 final determinations: Costs and Outcomes – response to provisional findings responses, page 63.

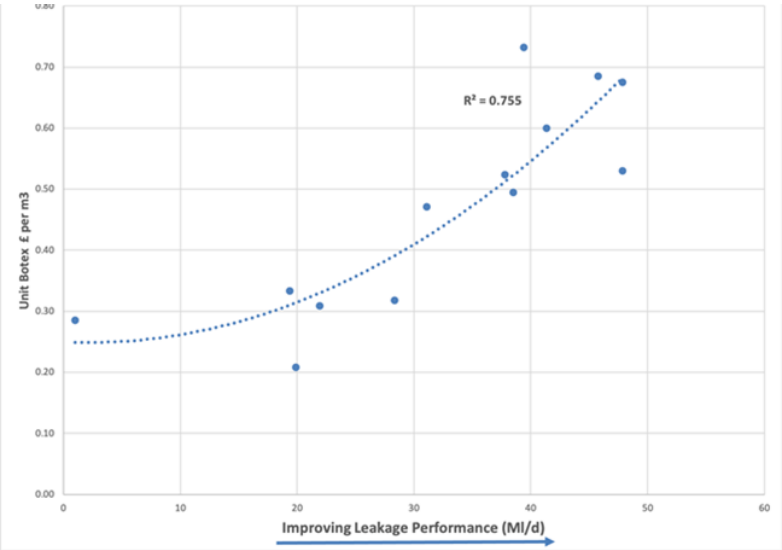
this adjustment assumed a linear relationship between performance relative to the UQ benchmark and the proportion of Anglian's leakage costs that should be allowed as an additional base allowance (i.e. Anglian outperformed the UQ benchmark by 19%, so was allowed 19% of its proposed cost adjustment claim as an additional allowance).

(47) Anglian's response to the PFs highlighted several flaws within this approach[46]. Principally, that the relationship applied to calculate the value of the PF adjustment has no sound economic basis. The assumed linear relationship failed to reflect Anglian's evidence of the increasing marginal cost of maintaining leakage as the level of leakage reduces[47].

(48) Based on the Leakage Working Paper, this approach is now inconsistent with the CMA's approach for enhancement costs, which does acknowledge that Anglian's unit rate of leakage costs are higher as a consequence of the activities required to operate at the frontier[48].

(49) Anglian presented evidence[49] in its SOC of the increasing marginal costs of base leakage.

Figure 5 Marginal base cost of leakage - Anglian historical leakage base cost and performance



(50) In its PFs response, Anglian provided further evidence highlighting the increasing marginal cost of leakage control activity as performance increases[50]. This is driven by:

(i) the increasing difficulty (and therefore cost) of detecting leaks as the size of leaks diminishes and;

(ii) the increase in the number of repairs that have to take place to deliver the same level of leakage control as other companies.

[46] Anglian's response to the PFs, section 5.2.

[47] Anglian's response to the PFs, para 300.

[48] Leakage Working Paper, para 77b.

[49] Anglian's Statement of Case, figure 78.

[50] Anglian's response to the PFs, section 4.6

(51) This is demonstrated by the charts below[51]. The increasing marginal cost of leakage has also been highlighted to the CMA by other companies[52].

Figure 6 Leakage actual base expenditure and repair numbers

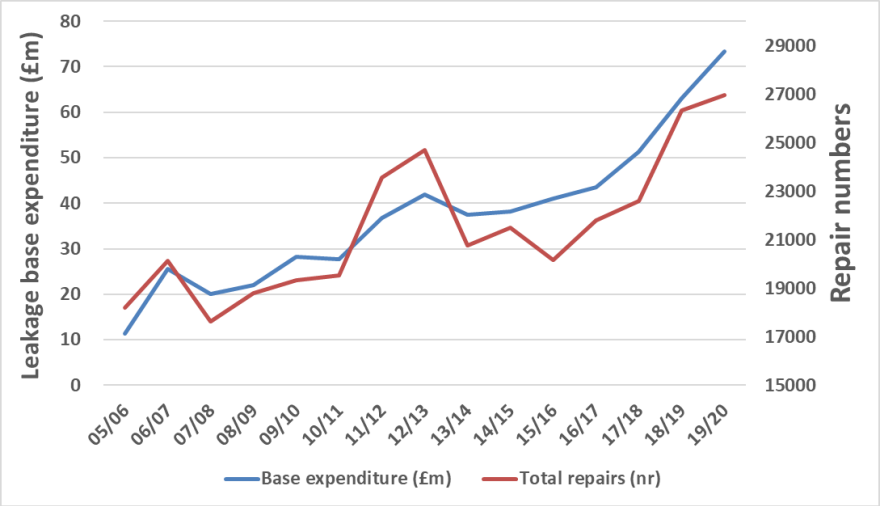
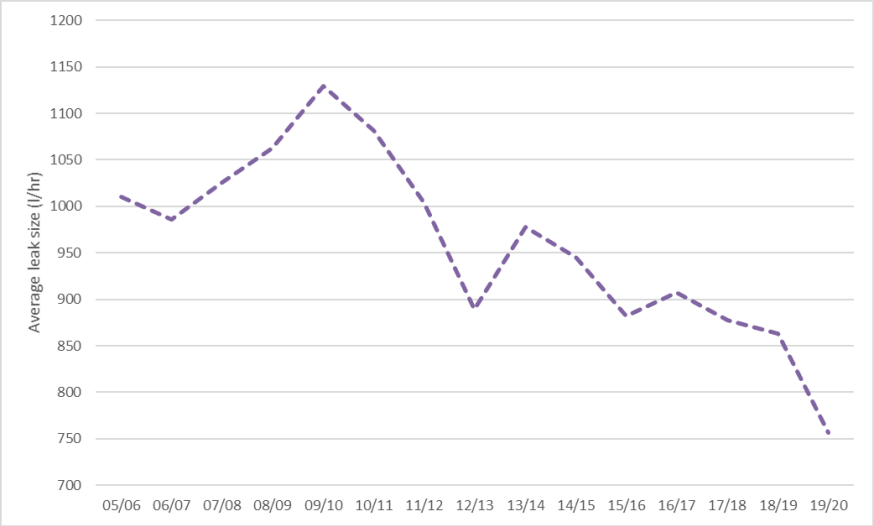


Figure 7 Average volume of leaks repaired



(52) In its response to the PFs, Anglian also highlighted an error in the CMA's approach which incorrectly assumed Anglian's CAC represented its full base cost requirement for leakage.

(53) In fact, **it only represented the additional cost of leakage reduction beyond that implicitly allowed in base models.** The full base cost requirement for the AMP7 period is £231.5m[53].

(54) **The minor refinements that the CMA referred to in annex 1 of the Leakage Working Paper are very partial**, reflecting only the adjustments proposed by Ofwat in its PF response, while making no reference to the concerns expressed by Anglian in relation to both the shortcomings of this approach to calculating Anglian's necessary adjustment and the inadequate assessment of its CAC.

(55) **Anglian is concerned that the approach set out in Annex 1 of the working paper only reflect arguments that Ofwat has presented while failing to reflect Anglian's previously presented**

[51] Anglian's response to the PFs, Figures 9 and 10.

[52] See for example, Bristol Main Party Hearing Transcript, page 7, lines 11-17.

[53] Anglian's response to the PFs, para 313.

evidence. Anglian notes that the CMA has confirmed that it is undertaking a further review of Anglian's CAC ahead of its redetermination which it hopes can redress this imbalance.

3 Anglian's Cost Adjustment Claim incorporates significant cost efficiency challenges

(56) In this section, Anglian summarises how its proposed CAC reflects an appropriate and efficient allowance for maintaining the frontier leakage performance achieved in AMP6.

3.1 Anglian has presented evidence that its base leakage costs are efficient

(57) Anglian has applied multiple controls and challenges, which provide assurance that the base costs efficient. These have all been presented to the CMA in Anglian's previous submissions but are not reflected in the CMA's current approach.

(58) Firstly, Anglian has applied bottom-up challenges to its base leakage costs. For example, Anglian has assessed the bidders for its Integrated Maintenance and Repair (IMR) alliance on metrics which included commercial criteria to ensure cost efficiency such as their hourly rates for staff and rates for plant and equipment. Anglian undertakes productivity monitoring and has a leakage incentive scheme in place for leakage teams. Further to this, the total revenue price control provides an incentive to deliver base costs efficiently. Full details of these bottom-up controls were presented in Anglian's response to RFI018a[54].

(59) Secondly, on a top-down basis, Oxera has shown that Anglian's historical leakage costs, upon which its claim is based, are efficient by examining treated water distribution renewals opex and capital maintenance costs across the industry[55]. Whilst these costs cover more than just leakage, this is the most granular level at which base leakage costs are consistently reported across the industry.

(60) Thirdly, the forecast of required cost allowance in AMP7 was calculated before the inclusion of 2018/19 and 2019/20 cost data. Anglian has highlighted that these two years saw the greatest leakage cost of the AMP in table 13 of its response to the PFs (copied below). If these costs had been included in Anglian's leakage cost adjustment model, they would have increased Anglian's AMP7 cost estimation.

(61) In not including these costs, Anglian is both setting itself a stretching efficiency challenge associated with maintaining its AMP6 leakage performance and bearing the financial risk of another climatic event comparable to the Beast from the East occurring in AMP7.

(62) At £227.5m over AMP7, or £45.5m per annum, this presents a significant efficiency challenge compared to AMP6 actual costs (see table below).

Table 1 Anglian's total AMP6 base leakage costs (£m 2017-18 prices)

Year	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Leakage base expenditure (£m)[56]	42	45	51	62	71	271

(63) Finally, the CMA has raised that Anglian's efficiency challenges are based on internal comparisons[57]. Firstly, as demonstrated above, the value of base costs Anglian is seeking have been subject to both

[54] Anglian's response to RFI018a, question 1d.

[55] Oxera Report on Leakage Cost Adjustment Claim (PF015).

[56] Values 2017-18 price base.

[57] For example, Anglian Main Party Hearing Transcript, 2 December page 32, lines 2-3: "*One of the points they focus on in terms of the efficiency is they stress the fact that it is all an internal comparison essentially*".

top-down and bottom-up analysis and do not include for the impact of any extreme weather impacts comparable to the Beast from the East.

(64) Secondly, the limited availability of external benchmarks is not as a result of Anglian being unwilling to compare with others (indeed it has done so at the most granular level at which there is comparative cost information in its top-down analysis), it is a reflection of the reality Anglian faces, namely that:

(i) Anglian is the frontier company on leakage in the industry and there is therefore a lack of equivalent benchmark;

(ii) there is a marginal increase in costs on leakage reduction, and;

(iii) there is currently no consistent reporting of leakage costs across the industry.

(65) The CMA's own Leakage Working Paper now recognises these challenges which inform its favoured bottom-up approach to assessing Anglian's leakage enhancement costs. Anglian should not be penalised if there is limited availability of benchmarks for its given level of performance.

(66) **Anglian's CAC is based on the actual costs of delivering frontier leakage performance in the Anglian region, appropriately reflects the rising marginal cost of leakage control, and incorporates stretching efficiency challenges.**

4 The CMA is not following the principles that it has applied to leakage enhancement costs in its approach to base allowances

(67) Absent of correcting the approach taken to deriving base leakage allowances, the CMA's approach to enhancement cost assessment creates an inconsistency between its approach to base and enhancement allowances. For example:

(i) the use of bottom-up analysis for enhancement, but not for base;

(ii) the identification of a rising marginal cost of leakage control for enhancement, but not for base;

(iii) recognition of the suitability of different approaches for different companies for enhancement, but not for base;

(iv) an incorrect calculation of the geometric mean of leakage levels; and

(v) a fundamental error in considering setting the base allowance on future (2024-25) performance, despite base representing maintenance of existing performance, and the CMA setting an enhancement allowance to achieve future performance.

(68) These are considered in turn below.

4.1 Bottom-up analysis

(69) For Anglian's enhancement allowance, the CMA states that it is "*proposing to base our assessment for Anglian solely on the bottom-up assessment, as the top-down approach would not be reliable"*[58]*.*

(70) The application of a "bottom-up" assessment to Anglian's enhancement expenditure rightly acknowledges the limited value of cross sector cost assessment in deriving the costs for frontier performance given the evidence of increasing marginal costs.

(71) Despite this assessment, the CMA's indicative approach to base is to maintain its top-down approach. However, a bottom-up approach is just as appropriate for base costs as enhancement, as the principles

[58] Leakage Working Paper, para 79.

on which the CMA has determined that a top-down approach is inappropriate for enhancement costs also apply to Anglian's base costs[59].

(72) Anglian has already provided the CMA with a breakdown of the activities which make up its base allowance, and the costs associated with each of these activities in its RFI012 supplementary information submission. A version of this table is provided below, with minor revisions reflecting the application of frontier shift added in Anglian's response to the PFs, and showing the full base costs, not just the proportion included in the CAC. Note that 2019/20 expenditure refers to actuals from one year, whereas contribution to AMP7 forecast shows to costs over five years. The AMP7 annual forecast (c.£45.5m) thus represents a reduction in base costs by over a 35% compared to 2019/20 costs.

Table 2 Anglian base costs

Area of botex expenditure	Description	2019/20 expenditure (£m)	% of 2019/20 base leakage costs	Contribution to AMP7 forecast (£m)	One-off or recurring activity?
Leakage detection and repair	All costs associated with proactive detection and repair. This includes staff time of the leakage team including detection technicians, analysts and managers. It includes the day to day equipment used by technicians, correlators, lift and shift noise loggers (but not fixed noise loggers which are part of enhancement expenditure), PPE and vans, spares, scheduling, and the costs of the commercial team and the streetworks team.	28.4	39%	88.02	Recurring
Reactive repair	Repair costs for customer-raised leak repairs. It includes the equivalent costs to the line above for proactive repairs	26.4	36%	81.83	Recurring
Large bursts	Repair of large bursts	8.1	11%	25.11	Recurring
Network technicians reactive time costs	Network technician time spent investigating customer-raised leakage calls (i.e, the number of hours spent per job x hourly rate for technicians)	5.3	7%	16.43	Recurring
District Meter Area (DMA) Meters and stop taps	Maintenance and replacement of District Meter Area meters which are used to monitor night flows, and the costs incurred	4.7	6%	14.57	Recurring

[59] i.e. Leakage Working Paper, para 74: "*a top-down assessment may not work well where it is very difficult to identify an appropriate unit cost to utilise for that company. This was the case for Anglian. Whilst it has a higher submitted unit cost rate than the other three Disputing Companies, this may be justified by its low leakage position already, which suggests it may already have exhausted low-cost leakage control options*".

Area of botex expenditure	Description	2019/20 expenditure (£m)	% of 2019/20 base leakage costs	Contribution to AMP7 forecast (£m)	One-off or recurring activity?
	for stop tap replacements when they leak or are faulty.				
Non-household Loggers	Maintenance and replacement of loggers. These monitor large non-household consumption.	0.2	0.3%	0.62	Recurring
Surveys of domestic and industrial consumption	Maintenance of household and non-household consumption monitoring	0.1	0.2%	0.51	Recurring
Beyond the Boundary Box (BTBB)	Costs for the team managing the waste notice procedure.	0.1	0.1%	0.32	Recurring
Total		**73.4**	**100**	**227.5**	

(73) **There is no overlap between the activities in this table and those included in Anglian's enhancement activities as assessed in the CMA's enhancement bottom-up analysis.** Therefore, the CMA should be mindful that any costs for activities in the above table which are not allowed will be completely unfunded (i.e. they will not be covered by the enhancement allowance[60]).

(74) **The principles set out in the Leakage Working Paper support the use of a bottom-up assessment for base leakage costs. Anglian has previously provided to the CMA all of the information it needs to be able to conduct this assessment.** Should the CMA consider that it needs further clarification in order to carry out an appropriate assessment of base costs, Anglian is ready to provide this.

4.2 Reflecting the rising marginal costs of leakage control

(75) In setting enhancement allowances for companies, the Leakage Working Paper acknowledges that marginal costs of leakage control increase as performance improves[61]. Whilst this principle is applied by the CMA for enhancement, it is not applied to base costs. **Anglian's CAC does this in a way which reflects efficiently incurred actual base costs.**

4.3 One size fits all approach

(76) The CMA states in its Leakage Working Paper that "*In setting the level of base allowances, we propose to take a similar approach for Anglian and Bristol at the Final Determinations*"[62]. It does so despite setting

[60] See also chapter C,2.

[61] E.g. Leakage Working Paper para 77b: *"We recognise that an appropriate unit rate for Anglian may be higher than others because it may already have exhausted low-cost options"* and paragraph 60d: "*Given that Yorkshire has relatively high leakage levels, the marginal cost of leakage reductions should in theory be lower."*

[62] Leakage Working Paper, para 129

out in its approach to enhancement why, for several reasons, it is appropriate to take company-specific circumstances into account. Anglian notes that the CMA has now provided assurance to Anglian that it will consider its CAC on its own merits.

4.4 Error in the use of the geometric mean

(77) The CMA states in the Leakage Working Paper that the leakage level on which it will make a leakage botex allowance is based on the geometric mean of normalised leakage on a per property basis and normalised leakage on a per km of main basis[63]. It states that on a geometric mean basis, Anglian performs 10.3% below the UQ.

(78) In response to a request from Ofwat for the supporting calculations for the geometric mean figures, the CMA provided the following table, setting out its working for Anglian's 10.3% UQ outperformance value.

Table 3 CMA calculation of geometric mean – Extract from CMA query response

	2019/20			Anglian		
	3yr UQ	3yr median		19/20	% from UQ	% from median
litres/prop/day	88.9	116.5		87.43	-1.7%	-25.0%
m3/km of mains/day	6.2	7.2		5.03	-18.9%	-30.1%
average of 2 measures					-10.3%	-27.5%

(79) This table shows that the CMA has summed Anglian's outperformance of 1.7% versus the UQ for leakage per property, and of 18.9% versus the UQ for leakage per length of main and divided by two. **This is not the geometric mean.**

(80) The geometric mean is calculated by multiplying the two normalised performance values and taking their square root. The CMA has already completed this calculation for all companies in its PFs[64], which **clearly shows that Anglian outperforms the industry UQ by 16%**. This is the UQ outperformance value which has also been recognised by Ofwat[65].

(81) Notwithstanding Anglian's primary concerns that the CMA's existing top-down approach to base leakage allowances is arbitrary and contradictory to a number of principles set out in its Leakage Working Paper for enhancement, **if the CMA is to utilise the geometric mean for leakage performance it must do so correctly**. This would recognise Anglian's UQ outperformance of 16%, not 10%.

4.5 Possible application of 2024-25 Upper Quartile

(82) On Ofwat's suggestion, the CMA highlights that it *"may consider the upper quartile three year rolling position in 2024/25, based on the varying ambition in leakage PCs in AMP7, rather than in 2019/20 which had been the approach taken at PFs*."

(83) This statement misunderstands what base costs are intended to cover. As highlighted in this response, and previously in relation to Anglian's base cost requirements, base leakage covers the **costs required**

[63] Leakage Working Paper, para 123.

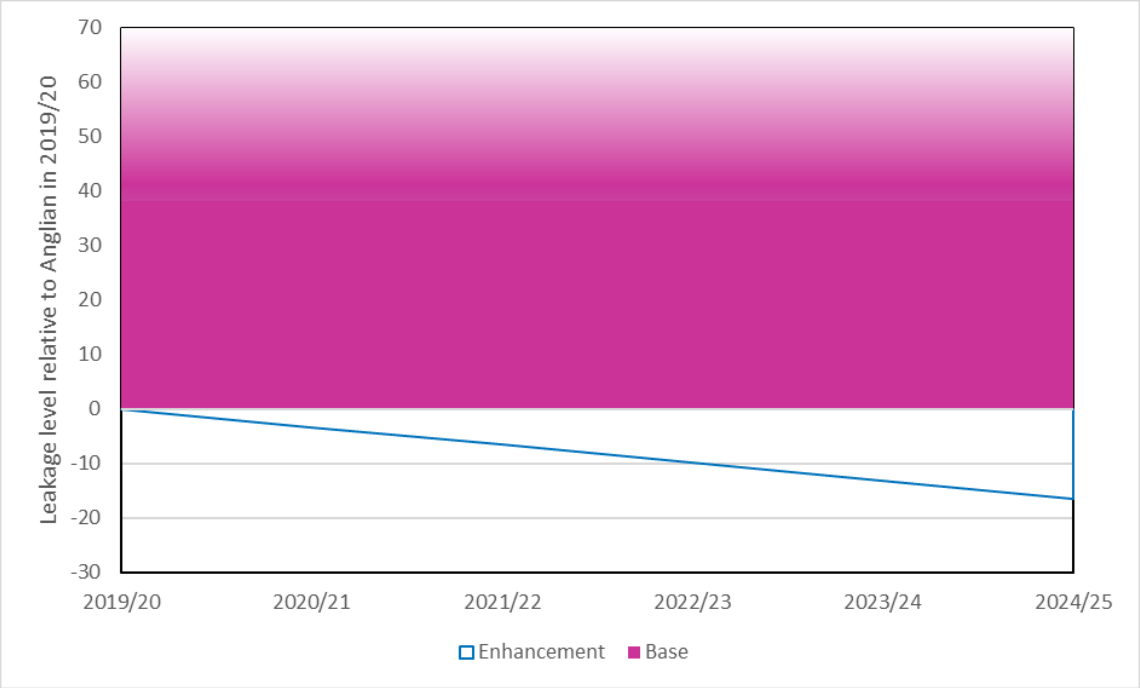
[64] Leakage totex calcs tables 8-2 & 8-3 PFs, UQ analysis tab, rows 48-64.

[65] Ofwat: Costs and Outcomes – response to provisional findings responses table A3.2 –"Company performance is therefore in a range of 2 to 16% beyond 'upper quartile' depending on the choice of 2024-25 or 2019-20".

to maintain an existing level of leakage. It does not reflect the costs of further reducing leaks in AMP7 which are covered by enhancement costs. To illustrate, if Anglian were not to propose any further leakage reduction in its plan, the base costs would still be required to maintain its current frontier position.

(84) Therefore "varying ambition in leakage PCs in AMP7" should play no part in the CMA's consideration of base cost allowances. This should already be reflected in the CMA's enhancement allowances. The chart below illustrates the performance that base and enhancement allowances are intended to cover: base (purple) covers all the ongoing costs of maintaining leakage at a certain level, whereas enhancement (blue line) covers the costs of achieving new lower levels of leakage. It should be noted that Anglian has not sought a base allowance for the recurring costs to maintain the leakage levels reached through its enhancement allowance (clear section of the chart above the blue enhancement line).

Figure 8 Base and enhancement cost coverage



(85) It therefore follows that it is inappropriate to base an allowance that Anglian is proposing to maintain current leakage levels on a forward-looking benchmark which will take into account the leakage levels achieved by companies through enhancement allowances.

Chapter C: Leakage – Enhancement cost allowance

1 Anglian supports the CMA's general bottom-up assessment of its enhancement costs

(86) The CMA recognises that stronger performers on leakage will face an increasing marginal cost in delivery of their future leakage reduction activities. For example, in Anglian's case:

"We recognise that an appropriate unit rate for Anglian may be higher than others because it may already have exhausted low-cost options"[66].

(87) The CMA concludes that a bottom-up assessment to Anglian's leakage enhancement costs is more appropriate than a top-down approach. Anglian agrees.

(88) Anglian supports taking company specific approaches to determining leakage allowances. A company-specific approach can account for companies' relative performance on leakage and acknowledge regional factors such as supply-demand challenges in addition to the legitimate differences in current leakage performance. The Leakage Working Paper rightly highlights potential factors, both regional and performance driven, that will impact on companies' costs[67].

(89) The CMA's findings set an important precedent in assessing future cost allowances for service improvements. Whilst companies will still have to demonstrate that costs are appropriate and efficient, the CMA's approach will go some way to ensuring the frontier performers are not penalised for having a higher unit cost which is driven by the exhaustion of the lower cost options that may still be available to poorer performing companies.

(90) These principles are not reflected in the CMA's approach on base allowances, where the CMA is minded to take a similar top-down approach to that taken in the PFs. Chapter B of this response highlighted Anglian's concerns in this area, which essentially retain a cost-service disconnect for base leakage costs. Anglian has previously set out how its CAC resolves these outstanding issues.

2 There is no robust basis for the CMA's conclusion that some of Anglian's enhancement costs should be considered base costs

(91) The CMA has removed some of Anglian's enhancement costs driven by a view that these costs relate to costs of base activities. In its ANH bottom-up assessment extract (copied below) the CMA highlights that it has allowed 80% of the costs of line 6 as enhancement and allowed 50% of lines 7 to 11 as enhancement.

Table 4 CMA working paper derivation of Anglian enhancement leakage costs

	Anglian			
		Anglian	**Ofwat**	**CMA**
		£m	**£m**	**£m**
6	Advanced pressure sensors	17.4	7.8 - 11.7	13.92
7	Automated network assets	2.8	0	1.4
8	DMA splits	1.35	0	0.675
9	INS - Advanced flow sensing	2.18	0	1.09
10	ILPM Leakage reporting software	1.16	0	0.58
11	MADB DMA & meter mgt software	0.24	0	0.12

[66] Leakage Working Paper, para 77b.

[67] Leakage Working Paper, paras 40 and 120.

(92) **There is no evidence to support the assertion that a proportion of these costs are for base activities.** The CMA recognise the limitations of their approach, specifically the statement that:

"*Our view is that it is not feasible to precisely assess the extent to which proposed expenditure would already be covered by base totex allowances*"[68].

(93) The accords with Ofwat's assertion that these enhancement costs must somehow overlap with base costs, and therefore drives a requirement to judge what proportion of costs this relate to. This is incorrect and Anglian challenges this assertion.

(94) **Anglian has previously provided evidence explaining how each of the proposed activities relate enhancement activities only[69]**. The CMA fails to reference this evidence which Anglian assumes means it has not been taken into account. Anglian invites to the CMA to reflect this evidence in reaching its redetermination. For ease, the relevant submission is copied below.

Table 5 Anglian evidence of enhancement expenditure

Leakage		
Table A3.3	*Assessment of Anglian Water's enhancement allowance*	Ofwat proposes the reduction/removal of allowance in several areas of leakage enhancement expenditure on top of the 10% efficiency and frontier shift challenges. Notwithstanding that it is for the CMA, not Ofwat, to determine efficient costs Anglian challenges the grounds upon which Ofwat does this: **Advanced pressure sensors**: Ofwat removes 25-50% of the requested allowance because it considers it covered by an implicit base allowance. However, costs associated with further leakage reduction are <u>not</u> reflected in base allowance; the full requested allowance is needed to deliver the coverage of advanced pressure sensors, which enable other components of leakage reduction. Removal of the allowance would be a policy change implying some leakage enhancement is covered in base allowances. **Automated network assets**: Ofwat proposes the complete removal of the enhancement allowance for this activity. This is an innovative approach to provide additional operational and asset insight, allowing us to respond more quickly to leakage events, reducing the runtime of leaks and reducing average pressures across larger systems with a direct link to reducing leakage. This expenditure forms a key part of delivering the further 30Ml/d reduction and should therefore be allowed as enhancement expenditure. **DMA splits**: Ofwat proposes an allowance of £0m for DMA splits on the assumption that it is expenditure historically recorded in base expenditure. However the proposed DMA splits go beyond network management activity and is required in order to deliver <u>additional</u> leakage reduction. It must therefore be considered enhancement. **Intelligent Network Systems:** Advanced flow sensing. Ofwat says that the replacement of existing batteries is an activity included in base allowance. However, the allowance requested is only the <u>additional</u> cost of battery replacement required to enable <u>improvements</u> to DMA meter loggers. It must therefore be considered enhancement. **Leakage reporting software/ DMA and meter management software**: Ofwat states that software upgrades are normal operating activity with costs included in base allowance. However, these upgrades are required in order to process the smart meter, pressure and noise sensor data needed to reduce leakage. This is distinct from software improvements undertaken to improve base activities.

[68] Leakage Working Paper, para 81.

[69] Letter to Douglas Cooper from Alex Plant, 20 November 2020, page 9.

(95) For the avoidance of doubt, none of the 11 enhancement lines for leakage reflects activity which is covered in the bottom-up assessment table in table 2 of this response. Therefore, if costs are excluded from Anglian's enhancement allowance on the basis of being base costs, they should be added to Anglian's base cost adjustment allowance. If not, this will present activity for which Anglian will not be able to recover costs.

(96) Anglian also notes that in reference to lines 6-7 and 9-11 above, the CMA stated: "*Anglian's submission included a number of investment categories which appeared to be technically justified, but where Anglian had not provided an assessment of the link between the AMP7 spend and the AMP7 leakage reduction. Specifically, Anglian's presentation of evidence had categories of spend that had no leakage benefit assigned."*

(97) This is a gross oversimplification of the information Anglian provided in response to RFI020 Q1, in which Anglian highlighted that these activities were enablers for the entire leakage reduction programme. Attributing leakage benefit to these lines would be a double count and artificially change the unit rate of other leakage activities.

(98) **The CMA incorrectly reduces Anglian's enhancement costs and presents insufficient evidence for doing so. These reductions should be reversed in the CMA's redetermination.**

3 The CMA's proposed efficiency challenge is inappropriate and incorrectly suggests that Anglian has not provided sufficient evidence of efficiency

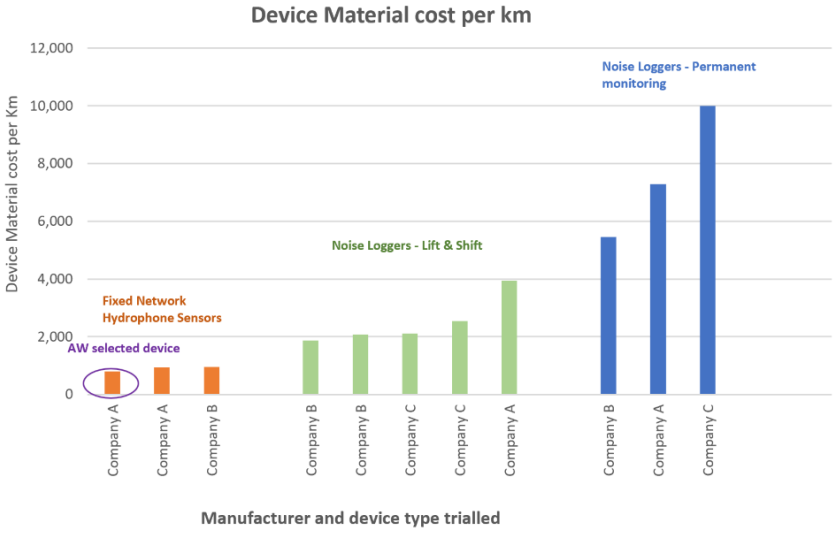
(99) As per its PFs, the CMA retains a 10% efficiency challenge on five lines of enhancement activity. These are shown in the table below.

Table 6 CMA leakage working paper – Enhancement costs

		Anglian	Ofwat	CMA
		£m	£m	£m
1	ALC: additional leakage detection	2.6	2.3	2.3
2	New sensors	28.6	25.7	25.7
3	Targeted mains for leakage	13.9	12.5	12.5
4	New pressure management	3.79	3.4	3.4
5	Optimise existing pressure mgt	2.7	2.4	2.4

(100) This efficiency challenge is retained without any reference to the evidence that Anglian has provided to the CMA setting out how it is assured of the efficiency of its costs. Taking the largest cost component of new sensors, for example (line 2), Anglian provided detail on how its costs were developed for and how Anglian had assurance that the costs were efficient in response to RFI020 Q2a. The chart below has been extracted from that response, showing the cost per km of different types of noise logger that Anglian tested.

Figure 9 New sensor cost per km



(101) Anglian also set out in that response that "***The solution as now developed for delivery in AMP7 is in fact around £0.7m more expensive than Anglian's original business plan totex estimate*** *for advanced noise sensors, but will achieve the same benefit in leakage reduction.*". This evidence from actual AMP7 delivery shows that the costs included in Anglian's business plan were very stretching. From the Leakage Working Paper, Anglian is concerned that the evidence that it has provided on the efficiency of its costs has not been fully considered in the CMA's assessment of enhancement allowances.

(102) Anglian also notes that the 10% efficiency challenge has been intended as a "*light-touch, proportionate approach to assessing these costs*[70]" and that "*it represents a proportionate approach to dealing with these lower materiality enhancement costs*[71]". Having now conducted a deep-dive, bottom-up assessment of Anglian's individual leakage cost lines with its own individual working paper, Anglian considers it inappropriate to add an additional shallow-dive efficiency challenge on top of the CMA's deep-dive analysis. As these quotes from the PFs show, the efficiency challenge is no longer serving the purpose for which it is intended.

(103) **In light of the CMA's deep-dive approach to leakage, and the evidence of the efficiency of individual leakage activities that Anglian has presented, the 10% efficiency challenge is no longer appropriate and should be removed from the CMA's leakage enhancement cost allowance in its final redetermination.**

[70] CMA's Provisional Findings, para 5.154.

[71] *Ibid*.

4 The CMA notes the proposed allowance is prior to adjustments for frontier shift and RPE. Anglian has shown that its leakage costs already factor in productivity and RPEs; therefore no further adjustment is required

(104) The Leakage Working Paper states that "latest allowances are currently expressed pre any adjustments that may be made for RPE adjustments and frontier shift[72]".

(105) Anglian contests that no further adjustment is required. Anglian has already applied an assessment of RPE and frontier shift. Were the CMA to apply this again, this would be a double count. Therefore, further **frontier shift and RPE should not be applied to Anglian's enhancement costs.**

[72] Leakage Working Paper, footnote 42.

Chapter D: Conclusion

(106) **Anglian requests that by taking into consideration this response and the full suite of materials previously presented to it by Anglian[73], the CMA reflects in its redetermination:**

(i) Anglian's full leakage CAC (inclusive of the efficiency challenges Anglian has already applied to the claim) of £132.5m; and

(ii) Anglian's leakage enhancement allowance of £76.7m.

(107) Anglian's CAC is the only suitable method to ensure that it has an appropriate base funding on leakage. This would address the current £106m gap, which jeopardises the supply-demand balance of the Anglian region and carries forward disincentives for further leakage improvement for all companies into future price reviews.

(108) The CAC addresses the errors and misinterpretations around Anglian's base leakage allowance, as set out in this response.

(109) **Not rectifying these significant issues with the CMA's current approach risks Anglian not being able to balance supply and demand in AMP7 and would be inconsistent with the proper discharge of the CMA's resilience duty.**

(110) The CMA's approach on enhancement presents a potential positive step in the assessment of leakage enhancement costs and the precedent for this in future AMPs. However, this is currently compromised by unjustified exclusion of Anglian's efficient base costs as a frontier performer on leakage. This response has shown how the CMA can rectify these issues in its redetermination, consistent with the approach to leakage enhancement allowances in its Leakage Working Paper.

[73] As referenced in Annexes 1-3 and Appendices to Annexes 1-3 which cover Base leakage (annex 1), Enhancement leakage (annex 2) and the leakage ODI (annex 3) to this response.