# Anglian Water

# PR24 Redetermination

## Reply to Ofwat's Response to Disputing Companies' Statements of Case

**Submitted 27 May 2025**

**PR24: Anglian Reply to Ofwat's Response**

## I. Introduction

Anglian replies to Ofwat's submissions of 29 April and 15 May ("**Response**", "**Further Response**" and "**Reply**").[1] Anglian has, as required, limited its Reply to 10 pages and new Ofwat information / arguments across key topics for Anglian, together with its "**Joint Reply**" with other Disputing Companies. Anglian maintains in full its SoC position, including in relation to any specific topics, details and arguments raised by Ofwat which are not addressed in this Reply, and reserves its right to respond more fully as appropriate on any matters upon which the CMA seeks to rely for the purpose of its redetermination.

## II. Key overarching issues across the Response

Before addressing specific points in the Response, Anglian makes the following general observations.

Anglian welcomes that Ofwat (i) recognised the need for significant revisions across the price control between DDR and FD to reflect new statutory requirements and guidance, developments, and the significant new information available to it; and (ii) largely endorsed Anglian's updated plan and funding requirements, concluding that it remained efficient (OF.AS¶ 6.8). However, Ofwat's Response fails to reflect the same level of engagement on several of the, targeted but material, issues which Anglian has raised in its SoC or indeed the importance of basing the Redetermination on the full set of available evidence.

Notably, the Response contains generalisations about the Disputing Companies, conflates the SoCs in certain areas and fails to recognise the specifics of Anglian's case. In some key areas, the Response does not address the arguments and evidence raised in Anglian's SoC (e.g., regarding the long-term investment needs of the sector, and Anglian's leakage CAC), and instead relies on Ofwat's previous arguments to justify its FD. Anglian identifies such areas below for ease of reference.

Elsewhere, the Response is mistaken in its characterisation of a number of core areas of Anglian's SoC (e.g., Anglian's gravity sewers and storage points UIOLI request (OF.CAC¶4.1) and the specifics of its boundary box CAC), including as to whether such issues are 'new' (e.g., referring to the allowed return figure from the DDR to the SoC as a change in 'methodology' rather than 'data' (OF.PRES¶44)). Anglian has sought to correct and clarify a number of such misunderstandings in this Reply.

As regards Ofwat's concerns regarding new information since FD, and its request to apply fixed cut-offs, Anglian notes the CMA's ability to take account of *'current circumstances and information which is now available'*, *'seek further evidence'* and *'relevant additional and updated information available'* in reaching its determination (CMA205¶3.10). This is consistent with the redetermination framework and Ofwat's own approach between DDR and FD. Anglian disagrees with any suggestion that the CMA should close its mind to relevant evidence.

Similarly, as regards Ofwat's deprioritisation proposals, including due to alleged proportionality and parallel processes, Anglian notes that its SoC is limited to material concerns which distort the balance of risk and reward and which are capable of resolution via the Redetermination (AS¶Chapter B, page 23). Ofwat's proposed parallel processes e.g., on asset health, outcomes, PCDs and business rates do not provide the certainty required (e.g., per the below and AS¶353-361). On that basis, Anglian strongly disagrees that aspects of its SoC should be deprioritised.

Finally, Anglian disputes any claim that its SoC lacked transparency, including regarding bill impacts (OF.OV¶4.9 and OF.AS¶7.94-7.96). The SoC explains upfront the bill impact at PR24 (AS¶79-80), together with a more granular breakdown in relevant chapters and also expressed to the CMA Group at the Initial Presentation. Anglian can of course provide a YoY breakdown as required. Anglian has been fully cognisant of the impact on bills for current customers, but also of the consequences for future customer bill profiles of delaying investment (AS¶76-81). It has carefully balanced that with customer preferences, broader interests, and future needs, as well as mitigating measures for vulnerable customers.

[1] Key abbreviations: **AS** (Anglian's Statement of Case); **BB** (Boundary Box); **BP** (Anglian's PR24 Business Plan); **CMA205** (Competition and Markets Authority Guide CMA205); **DDR** (Anglian Water's Draft Determination Response); **NAO** (National Audit Office reports); **OF.AAH** (Ofwat's Response Addressing Asset Health); **OF.AS** (Ofwat's Response to Anglian Water's SoC); **OF.OV** (Ofwat's Overview of its Response to Statements of Case); **OF.RR** (Ofwat's Risk and Return Common Issues); **OF.EACI** (Ofwat's Expenditure Allowances Common Issues); **OF.CAC** (Ofwat's Expenditure Allowances Cost Adjustment Claims document); **PR24 FM** (PR24 Final Methodology); **UKRN Guidance** (UKRN Guidance on the Cost of Capital). Terms not defined herein are as defined in Anglian's SoC and response to other Disputing Companies SoC.

## III. Investability and Financeability

Ofwat's risk and return response comprises 188 pages and two economic reports. The Joint Reply addresses much of the new evidence and arguments. This section focuses on a number of key points raised in Anglian's SoC where Ofwat has brought forward new arguments or evidence as well as noting those which Ofwat does not address.

### A. The Response undermines the correct standard for redetermining the balance of risk and return

The Response is incorrect to assert that the WIA91 does not impose a hard requirement to ensure a price control is financeable. It claims that the WIA91 grants Ofwat *'regulatory judgment'* in *'performing'* the finance duty such that it is not a *'pass fail test'* (OF.OV¶¶A1.53-1.55). Balancing the WIA91 duties affords regulatory discretion *on how* to achieve financeability, but cannot permit a price control that may plausibly leave the notional company unable to finance its functions. To do so would ultimately harm the interests of existing and future customers by incentivising under-investment as well as infringing the resilience and growth duties. It would mean a price control which fails to provide investors with comfort that the notional company would, in principle, achieve a market return. The Response is also wrong to dismiss the relevance of investability on the grounds that the term does not appear in the WIA91 (OF.OV¶A1.55). This ignores that the duty's essence is to ensure that the sector can attract sufficient investment to finance its functions. Denying its relevance only highlights Ofwat's failure to examine it.

As explained in the Joint Reply, the Response also applies the wrong bar for the notional company, which distorts its assessment of risk and return. Throughout its assessment of the PR24 risk profile, financeability, and cost of equity, Ofwat depends on SVT, UU and, to a lesser degree, PNN to set the benchmark for the notional company. However, these companies are all expected to outperform their FD.[2] The notional company, in contrast, is a company expected to make the allowed return. Relying on SVT, UU, and PNN distorts the calibration of the price control. It is, thus, hardly surprising that nearly half of the sector by regulated capital has requested a redetermination.

Finally, Ofwat contests whether the CMA should consider information which has become available post-FD. However, ignoring relevant evidence would risk eroding faith in the predictability and rigor of the Redetermination and overall regulatory framework, at a time when companies need to raise unprecedented levels of new finance in the interests of customers. It is also contrary to the purpose of a redetermination, according to which the CMA reaches its own view as to an appropriate balance of risk and reward, based on the available evidence (CMA205¶3.5-3.12). Notably, contemporaneous information is likely to be particularly important for the CMA's assessment of debt financeability, given this is heavily underpinned by credit rating agencies' use of such information to determine their assessment of the sector.

### B. The Response fails to address the implications of the sector's long-term investability needs

Anglian's SoC explained that the FD's cost of equity did not address the implications of the changing investment proposition for the notional company, with negative or minimal net distributions to investors over a 25-year time horizon, the sector's changed risk profile post-PR19, and increased interest rates.[3] The Response largely fails to engage on this, maintaining the untenable line that PR24 is not materially different to PR19 (OF.RR¶1.34, also evident in the FD's treatment of beta: OF.RR¶5.117). This difference is at the heart of why Anglian sought a redetermination. The arguments raised in the Response do not challenge Anglian's fundamental point, that the FD failed to consider whether the cost of equity was sufficient to attract investment given the profile of returns in AMP8-12, and in any case do not hold for the following reasons.

Investors in the notional company will not receive adequate returns. The Response conflates the FD's assumed dividend yield with dividends net of equity injections (OF.RR¶9.41) to claim that a 4% dividend yield is sufficient to attract investment. However, such an assumption does not change the fact that Anglian's investors are still required to inject additional equity and, thus, wait until 2040 to receive net cash returns (on a notional basis). Beyond AMP10, investors then face further uncertainty over whether the level of returns will be commensurate with their investment. Ofwat implicitly assumes that investors are prepared to commit such levels of equity injections at the allowed return in the FD. But the Response fails to explain why such an assumption is appropriate or that Ofwat has considered the implications of the significantly different investment proposition on the cost of equity.

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2 Oxera, Annex 003; See public statements by SVT (here) and UU (here).

3 See also NAO, Regulating for investment and outcomes in the water sector (April 2025), paras 1.7-1.10 and Figure 1 (available here)

The assumption that dividend payments can be supported via equity injections also does not hold. The Response references SVT and National Grid as *'companies scaling equity injections'* to support *'ongoing payment of dividends'* (OF.RR¶9.41). But these examples do not evidence the notional company could support a stable dividend, particularly over the long run.[4] SVT is a particularly poor example, as it is expecting to outperform the regulatory contract and, considering its lower long-term expenditure growth demands (as evidenced in its LTDS) relative to Anglian's and the average company's in the sector, is expected to have a consistent net dividend after AMP8 (in contrast to the wider industry). The claim also does not address the fundamental challenge: is the cost of equity sufficient to attract equity in these circumstances?

Finally, the citation of anecdotal examples of equity raises does not illustrate the notional company's investability. The Response ignores that these form only £1.6 billion of the £12.6 billion equity investment Ofwat assumed in its FD for AMP8 and are a negligible part of the sector's total equity needs over AMP812. The examples cited do not support the genuine availability of new equity for the notional company consistently over a longer-term horizon. It is notable that Ofwat does not cite any examples of equity investment that would support its case.

### C. The Response does not engage with the basic building blocks on the cost of equity for PR24

The Response fails to engage with Anglian's challenge that the FD's cost of equity is not commensurate with the sector risk level. Claiming the FD *'adopted a rigorous assessment of the evidence'*, the Response alleges that Disputing Companies have '*been selective in their use of arguments'* in the context of risk and return such that there is an *'inevitable asymmetry of evidence'* (OF.RR¶1.45). The reverse is true: the Response continues to rely uncritically on the FD's CAPM (despite acknowledging its weaknesses) and flawed MARs analysis, whilst disregarding all evidence from Disputing Companies that points to a significantly higher cost of equity. Ofwat's risk analysis is equally weak. In particular:

The Response dismisses the reality of converging debt-equity spreads in the sector. It claims that Ofwat is *'unaware of any financial theory which posits the need for a minimum wedge between the cost of debt and equity'* (OF.RR¶5.148). But this ignores the central question: would rational investors commit to a 25-year investment for equity returns barely above, or below, the cost of debt? Anglian's point is simply the practical reality facing companies: there needs to be a sufficient wedge, otherwise investors will have no incentive to take the additional risk associated with equity. This is particularly important at PR24, given then significant new equity investment required over a long-term horizon. The Response's other argument, that only SVT and UU should be used to calculate the debt-equity spread because *'the other companies in the sample'* are a *'a poorer match for the characteristics of the notional company'*, only illustrates how Ofwat selectively and incorrectly defines the benchmark for the notional company as set out above (OF.RR¶5.149). Oxera's analysis excludes all outlier performers – good and bad – precisely to avoid skews by their relative performance vis-à-vis the median company.

Ofwat continues to downplay the significantly increased risk and reduced returns in the sector. This is most obviously illustrated in the Response's support for the FD beta, which implies that investment at PR24 is *less* risky than at PR19. The conclusion is in direct contradiction to the real-world evidence (AS¶646-657), highlighted by the decision by credit rating agencies to downgrade the sector (AS¶Annexes 004a, 037) and the NAO's recent report on the sector which highlight the greater level of risk in the sector.[5] The Response's TSR is, in this regard, wholly misleading. As explained in the Joint Reply, the TSR is mainly driven by high outturn inflation and is, thus, largely offset by totex underperformance (as Ofwat itself acknowledges in seeking to rebut the Cunliffe chart). RCV indexation may protect real returns from inflation, but it does not increase them. In a similar vein, Ofwat's assessment of the Cunliffe Review recognises that PR19's 'challenging' nature resulted in sectoral underperformance of 1.3% against the allowed return (OF.RR¶2.16), but largely attributes this to poor performance. This implies the sector is going backwards, ignoring PR19's mis-calibration and, more fundamentally, that irrespective of its cause, the consequence is a heightened investment risk associated with the sector.

The Response fails to engage with KPMG's risk analysis for a notional company operating in Anglian's region, including company-specific evidence and past performance data (AS¶Annex 004). Ofwat comments in general terms that company-specific risk drivers are not relevant to the notional company and, without evidence, attributes company-specific risk to poor performance (OF.OV¶¶A1.58-1.59; 3.3). Ofwat is wrong to dismiss company specific characteristics as key drivers of risk, as any notional operator would be exposed to the characteristics of Anglian's region and network, including external risks

4 Ofwat conveniently ignores that equity injections are dependent on the allowed cost of equity being set at the appropriate level and other price parameters enabling cost delivery, as flagged in Oxera, Investability at PR24 - Final Report for Water UK (August 2024), p. 34.

5 NAO, paras 11-17 and 3.24.

and factors outside of company control. Adopting a common approach which fails to take into account Anglian's company-specific characteristics compounds risk issues at the industry level.

The Response is also wrong that the notional company would be able to maintain a Baa1/BBB+ credit rating. The Joint Reply addresses the Response's main flaws in this regard.

**D. The Response fails to engage with Anglian's proposal that the price control set expectations for future price controls to provide investors with greater regulatory certainty**

The Response is wrong to dismiss Anglian's proposal that the CMA set an expectation on the cost of equity for future AMPs (AS¶708). It states this should not be in the Redetermination's scope as the allowed return in future AMPs *'must reflect prevailing market data and relevant features of the regulatory regime at the time a determination is set'*. Anglian agrees: it does not request that the CMA substitute Ofwat in future price reviews but rather provide reasonable certainty to investors over the investment horizon to incentivise investment at PR24. This is only achievable if the CMA confirms that the cost of equity is expected to increase over future AMPs, given the longer-run cost of debt.

The Response's claims concerning regulatory predictability are also counterintuitive: it is Ofwat's failure to ensure that the FD take into account the longer term which Anglian is challenging. Failure to engage with the long term might be less problematic when investment is relatively low, such that it can be financed by retained earnings. That is, however, not the case for AMP8 and beyond. The Response cites the importance of regulatory predictability and yet has selectively applied the UKRN Guidance (e.g., on TMR); introduced halfway mitigations that fail to deliver meaningful risk reductions; ignored the implications of the higher interest rate environment; and omitted that credit rating agencies have downgraded the entire sector due to the weakening of the regulatory regime.

**E. Ofwat's focus on Anglian's DDR and the actual company avoids the main issues for redetermination**

The Response and Further Response argue that Anglian and the other Disputing Companies are asking for significantly more than their DDR (Further Response p. 4) and that the Redetermination is driven by actual company performance (OF.RR¶10.8-10.15).

Ofwat is, first, wrong to claim that Anglian's SoC is a significant change to its DDR. Ofwat ignores that Anglian's DDR raises the same core issues, namely that the DD (i) failed to address if the DD was 'investable'; (ii) exposed the efficient company to significant downside risk that undermines sector investability; and (iii) understated the cost of debt and cost of equity (which cross-checks indicate is too low) (DDR¶14.2-4). The DDR also noted that, whilst the notional company would be financeable under the DD provided it met its baseline targets (this has now changed, following revisions in credit rating agencies' metrics), it would not be financially resilient (DDR¶14.5).

Anglian's fundamental 'ask' has not changed. Anglian's DDR Summary explained that '*neither Anglian Water, nor our sector as a whole, will be able to attract the necessary equity to fund our business plan'*. To remedy this, Anglian proposed that Ofwat '[u]*pdate and incorporate the full suite of cross-regulatory evidence'* and '[r]*eflect the diminished spread between the cost of equity and cost of debt in setting the WaCC for the Final Determination*' (DDR Summary). Anglian makes the same basic ask in its SoC.

The Response also avoids the key questions for Redetermination, instead referring to Anglian's and the other Disputing Companies' actual financing structures. However, Anglian has sought the appropriate cost of capital for the notional company, in accordance with regulatory precedent (e.g. PR19¶9.1377). Anglian's actual position is irrelevant to setting the allowed return: a position which the Response makes repeatedly (e.g., OF.RR¶¶1.19, 2.39, 3.20, 10.1). As such, it is irrelevant for the purposes of the CMA's Redetermination.

In any event, the Response's characterisation of Anglian's dividend yields is misleading. The dividend yields chart emphasises that Anglian paid a dividend of £1.6 billion but omits to reference that the dividend was immediately repaid to remove an intra-company loan. This point was addressed in detail as part of the CMA's review in PR19.[6] It also ignores the obvious point in the Response's own charts: Anglian's dividend yield has remained suppressed for six years, well below Ofwat's dividend yield assumptions for the notional company.

[6] Anglian, Letter to the CMA titled 'Hearing follow-up' dated 12 August 2020.

## IV. Long-term Asset Health

The majority of Anglian's asset health reply is in the Joint Reply. This is a vital topic that must not be deprioritised as per page 1 above. In addition, Anglian notes the Response's claim that deviation from PR19 BP forecast gravity sewer renewal rates raises concerns around Anglian's historic delivery (OF.CAC¶4.14). This fails to recognise the operational realities that forecast BP intentions will unavoidably vary from actual delivery in light of: (i) operational realities of the AMP, where companies (as per the totex framework) will need to flex spend between assets classes to operational need and the FD obligations and incentives; and (ii) the level and conditions of actual FD funds awarded. Ofwat's approach risks repeating (and indeed validates Anglian's material concerns on) Ofwat's Mains Renewal approach (AS¶359-361) (despite the Response's position this may not be applied to other assets (OF.AAH ¶4.21)).

## V. Base costs

**On evolving base requests:** Ofwat mischaracterises Anglian's SoC as including additional base asks (OF.EACI¶2). This is incorrect. Anglian's UIOLI storage points and gravity sewers ask (having advocated for a general UIOLI base uplift at DD (AS¶301)) is *not a CAC* and is an *alternative not an addition* to its base cost asks (AS¶321(v)); its business rate/modelling request is simply to use the most recent data (per the PR19 redetermination) (AS¶321(vi)); while a 0.8% Frontier Shift is consistent with Anglian's initial BP and Anglian continued to advocate that 1% was unsupported throughout the PR24 process (AS¶286). (Please see the Joint Reply for further responses on the Frontier Shift).

**On Mains Renewal:** On the mains renewal PCD's status (OF.EACI¶2.258-2.259), Anglian welcomes Ofwat's preparedness to resolve issues between the interaction with Anglian's query response and the PCD. However, Anglian's more general concern about the prescription of conditions grade to inform asset renewal PCDs remains and will not be resolved by that process (Anglian explains that using condition grade to inform asset replacement is contrary to the guidance informing conditions grade assessment in AS¶590-593). (Please see the Joint Reply for further responses on mains renewal).

**On Leakage:** The Response states that PR19 conclusions '*are no longer relevant'* as *'the empirical evidence has improved'* (OF.CAC, page 8). To be clear: (i) Anglian's CAC uses the latest empirical evidence; and (ii) the operational realities rendering frontier performance more costly (per AS¶232 and recognised at PR19 FD¶8.51, 8.59)) remain.

The Response states that "*the key question [...] is whether the allowance from the base cost models provide sufficient allowances to allow leading leakage performing companies to maintain low leakage levels*" (OF.CAC¶2.13). Anglian agrees this is the key point. However, the models do not sufficiently fund Anglian.

Ofwat assumes that Anglian's base leakage is funded through an Implicit Allowance ("**IA**") within the base models. However, on the basis of the PR24 leakage IA, Anglian is materially underfunded. Indeed, Anglian forecasts both overspending its base leakage funds by £158m and being the only company penalised for missing its PR24 leakage PCLs (except UU, for whom Anglian anticipates a minimal £0.5m penalty). This underfunding of Anglian's leakage position reflects PR19 where, even post-CMA intervention, Anglian had to overspend its leakage totex by £100m yet still incurred a £32m penalty despite its frontier performance (and must return totex funds to customers via the PR19 clawback mechanism (AS¶435)). For the CMA's information, Anglian's PR24 IA is c. £12m lower than PR19.[7]

A cause of this underfunding appears to lie in flawed conclusions by Ofwat, based on a poorly evidenced IA method (which diverges from the PR24 FM).[8] Anglian and Oxera submitted detailed evidence that the PR24 IA fell short of the level needed to maintain leading leakage performance (see AS¶249-257 and Annex 007). The Response does not address this, and indeed fails to engage with Oxera's analysis in Annex 007. Ofwat's IA calculation details have been newly provided following a request outside the Response and FD (*documents provided by email from Ofwat to Linklaters on 13/05/2025 and 16/05/2025, copied to the CMA*), and Anglian addresses below the IA in light of this insight on Ofwat's calculation.

While PR24 FM states there is no single correct IA approach, it recognises reaching a "*robust*" IA may make it appropriate "*to use a range of approaches*" and that examples of PR19 methods included removing expenditure categories or explanatory variables from models, or assessing average unit costs (PR24 FM¶30-31). However, in contrast to its PR24 FM reflections,

7 All figures quoted are in 2022/23 Price Base.

8 Ofwat, Final Methodology, Appendix 9, Setting expenditure allowances (December 2022) (see here)

Ofwat uses only one method, and a flawed and highly unusual one: regressing historical leakage costs on TWD base model variables (OF.CAC¶2.20).

By contrast, Oxera (AS¶254, Annex 007¶15-16, 19-21, footnote 28) gives three methods that utilise example approaches cited in PR24 FM (including one cross-check). These are: (i) removing leakage spend from models; (ii) analysing upper quartile ("**UQ**") historical leakage performance; and (iii) assessing median company leakage performance. Approach (i) is recommended, as it logically starts from Ofwat's base allowance post catch-up efficiency challenge (per PR24 FM) and then reconducts the modelling assessment by deducting leakage maintenance costs. This enables calculation of the difference between the two modelled outcomes, thereby naturally identifying the leakage IA (a conceptual approach effectively used at PR19, recommended in PR24 FM, and fully endorsed by Ofwat at PR24 DD).[9] Each is more robust than Ofwat's IA method (supported by each producing very similar estimates to each other). Each shows that Anglian is materially underfunded.

Regardless, Ofwat's IA calculation is not robust and is inconsistent with its base allowance methodology:[10]

- Ofwat's model to calculate the IA uses *total* rather than *base* leakage cost, but the former includes enhancement.[11]
- Ofwat applies the incorrect-catch-up efficiency challenge (using the UQ level from its FD base-cost modelling (0.99) rather than from the leakage model (0.81)). Correcting this alone would show that Anglian is underfunded by £70m.[12]
- Conceptually, a standalone leakage regression using TWD variables fails to consider important base cost drivers, as: (a) by only using TWD models[13] it ignores leakage impact on the wholesale water base models that account for 50% of the overall base assessment; and (b) it doesn't triangulate the regressed TWD model output with the wider base models (water resource plus, wholesale water) to identify the appropriately benchmarked UQ to derive the IA.

The answer to the Response's 'key question' is therefore no; the models do not sufficiently fund Anglian to maintain its frontier position.

As to the root-cause, the Response has new charts (Figures 1 and 2 OF.CAC¶2.18) purporting to show there is no compelling evidence of higher frontier leakage costs as some poor-performers have high spend. Anglian's main response to this proposition is in AS ¶241-248 and Annex 007, but it responds here to Figures 1 and 2.

In this evidence assessment, it must be remembered that Ofwat also ranks the four frontier leakage performers as the 'least efficient' in the TWD models (a material (c.30%) proportion of which capture leakage) while those at/beyond the UQ of efficiency in these models are substantially poorer performers than Anglian (AS¶247, Figure 18, Annex 007¶4-6). The TWD models capture all leakage spend (without the potential cost-allocation issues that Ofwat references in OF.CAC¶footnote 6). Regardless, Anglian's analysis (which uses Ofwat's dataset but is more granular than Figures 1 and 2 by assessing company-level trends and yearly changes) shows clearly that maintaining leakage costs all companies at/near the frontier more as leakage reduces (AS Annex 007, Figure 2.1 with AS Figure 17 showing increased costs for Anglian to maintain lower levels since 06/07).

Replicating Figures 1-2 with *funds granted* shows a strong positive correlation with leakage levels (as shown in Figure A below). This clearly evidences that companies are funded more as outcomes decline (shown by AS Annex 007 Tables 1.2, 1.3 and Figure 1.3 across both base and enhancement). The Response does not address the rationale for giving higher funding

9 Specifically when used by Bristol in its IA for its Canal & River Trust CAC. South West Water and Bristol Water, PR24 CAC, Initial submission (June 2023), page 25. (See here) section 3.4.4; Ofwat, Base CAC feeder model – Bristol Water (July 2024) (Tab BRLCAC1, Cell D23) (See here).

10 By contrast, Oxera's recommended model (i) above (a) isolates base spend; (b) uses two distinct UQ levels - one from the modelling suite with leakage spend and one without - to capture genuine differences in the estimated efficiency levels across the two scenarios; and (b) uses the entire modelling suite, enabling the determination of base allowances consistent with the FD.

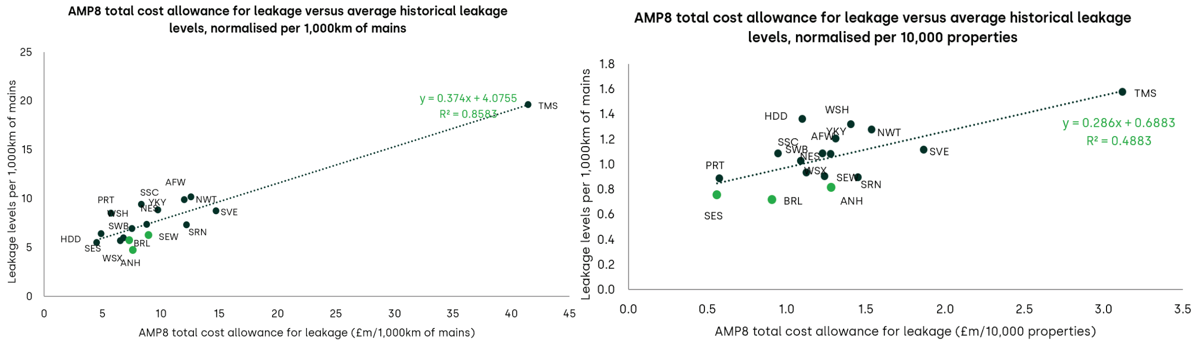
11 See OF, Leakage CAC supporting analysis excel, table 'Predicted leakage costs', Columns F and AJ,

12 Oxera analysis based on OF, Leakage CAC supporting analysis excel and Ofwat, PR24 Base Cost Water Model (see here).

13 More precisely, it uses a reduced form of TWD models that focus exclusively on the portion of TWD costs attributable to leakage costs.

to poorer performers, particularly given their more lenient PCLs, compared to less funding and more stringent PCLs at the frontier.

**Figures A: Leakage AMP8 total allowance vs. average historical levels, normalised by properties/km**[14]




Anglian notes that Ofwat questions whether its performance stems more from 'exogenous factors' than effort (OF.CAC¶2.21), citing an illustrative example from Anglian's initial 2023 CAC. CACs had to show that needs arose from factors outside management control, and Anglian therefore explained that regional traits impact leakage (including highlighting traits that render maintaining leakage challenging in Anglian's region). However, this does not alter Anglian's SoC case: that despite the critical importance of leakage control in its region, it has been materially underfunded (the Responses' '*key question*'; as shown by robust IA methodologies and by its PR19 / PR24 forecast overspend and penalty positions), and that it costs more to maintain leakage at the frontier (shown by data and from operational experience). In any event, while regional factors may have impacts, this does not diminish the significant effort needed to maintain frontier leakage. Per its SoC, leakage is critical to Anglian's region and it invests substantially to maintain low levels with many companies seeking its advice on leakage (AS¶234, 241-243, 258).

Finally, the Response cites Ofgem's ED2 to justify not reflecting performance impacts on costs (OF.CAC ¶2.22). However, as above, AS¶259, Annex 007¶4,12 show a fundamental FD issue, where poor performers are funded more and challenged less. This cannot be dismissed by broad-brush comparisons with other regulatory regimes, not least given the evidence of higher efficient frontier costs (and Ofwat's broader position that allowance levels are inextricably linked to expected service levels (AS¶239)).

**On Boundary Boxes**: The Response misunderstands the nature of Anglian's BB replacements in AMP8 and past periods. It suggests Anglian proposes a proactive programme ('*there is no assurance that the company needs to have a proactive ... replacement programme*', OF.CAC¶3.9). It does not. Replacements are reactive to address customer risks, initiated by, eg. customer-reported issues like leaks or stop-tap failures (see AS¶274). This has always been Anglian's approach.

While Anglian welcomes that the Response does not dispute its BB assets' unique status, it does compare Anglian to SW (OF.CAC¶3.17). Anglian's need is very different. Anglian notes CMA Anglian_RFI_01 on this topic, and will provide further detail in that response.

The Response also incorrectly conflates Anglian's smart-metering and BB activities, claiming efficiency overlap. Smart-metering can occasionally uncover BB issues (so, contrary to OF.CAC ¶3.11 and ¶3.12, the initial assessment of a BB issue can occur if an Anglian technician discovers it while onsite for other functions: AS¶274, footnote 125). However, they're fundamentally distinct works, eg.in terms of nature, cost and scale (AS¶273), and unlike Anglian's smart meter roll-out, that targets specific areas, BB replacements occur unpredictably across region in response to individual failures. The works cannot be meaningfully or efficiently combined.

Appreciating the differences between BB and smart-meter work is essential for adequate funding. On the claim that Anglian's SoC does not consider meter-funding (OF.CAC¶3.14), Anglian's SoC to the contrary explained that its meter CAC and smart meter enhancement funding must fund c. 1,000 daily meter replacements (AS¶279). Importantly, fixing a BB alone does not satisfy the related PCD terms attached to these allowances, which penalise companies for each smart-meter undelivered -

[14] Oxera analysis using Figures 1 and 2 parameters. The same relationship holds when only looking at maintain leakage spend and/or using 23/24 leakage levels instead of historical averages.

and Anglian has forecast that only 1.7% of smart-meter replacements are expected to also entail a BB replacement (AS¶275). Further, Anglian's forecast BB spend is a material part of its base funds: being worth 19% of its AMP8 Water capital maintenance IA, and (as indeed was set out in its SoC) 60% of its combined meter CAC and smart meter enhancement allowances (which cover the above distinct activities (AS¶279)). Between BBs and mains renewal, the Response hypothecates a large proportion of Anglian's CM allowance for just two (albeit very important) asset types.

Finally, on the intended Asset Health Roadmap data collection, Anglian's broader concerns on this workstream (e.g., AS¶356 and Joint Reply) apply, not least given BBs are currently a non-sector wide issue, BBs are not in the initial priority list despite immediate needs, (OF.AAH¶4.13) and as Ofwat's view is that Anglian does not need distinct AMP8 funds despite its submissions.

**On Business Rates and Base/Retail Models:** As per page 1 above, Anglian disagrees with any suggestion that the CMA should close its mind to relevant evidence, including by deprioritising or subjecting these topics to data cut-offs (OF.OV¶5.4, 5.7, 5.18 and OF.AS, page 25). Changes in rates/data significantly affect funding, and thus quality and outcome deliverability (CMA205¶3.14), and decisions at PR24 should therefore reflect up to date and relevant data, per the CMA's approach at PR19 (AS¶307). Anglian notes that for Business Rates, a majority recovery in AMP9 does not resolve concerns, not least given the scale of AMP8 activity and cost-stretch, and as Anglian's proposal is a clear way to reduce the scale of corrections that may largely be borne by AMP9 future customers.

On Residential Retail, the Response incorrectly suggests that Anglian did not update forecast revenue and household numbers at DD (OF.AS, page 25). Both were updated. AMP8 Household Revenue forecasts can be sourced via BP Table RR27 or derived from Anglian's Financial Model using measured and unmeasured percentage changes from Table RR27. Ofwat appears to have used RR27 (in Ofwat's Residential Retail models one and two) but household numbers were reported in SUP1A and updated in Ofwat's Residential Retail model two. Anglian did not update RR27 at DD as: (i) Ofwat stated it was unnecessary,[15] and (ii) the data could be computed per the above. However, Ofwat failed to update Anglian's Residential Revenues in Residential Retail models one and two, leading to errors in Anglian's Retail costs in Residential Retail model three.

## VI. Enhancement

**Comparison to initial BP:** Ofwat compares Anglian's FD funding with its revised request and original BP (OF.EACI¶1.11). Like all companies, Anglian updated its original BP to reflect regulatory requirement changes and new information emerging between its original (September 23) and final (November 24) BPs. The original BP would not account for the additional requirements which are now known. Therefore, comparing FD allowances with original BPs is not meaningful.

The Response later states: '*This was around £800 million more than Anglian Water's original business plan, after the company increased requests in several areas to move closer to our cost benchmarks*'. This misrepresents the full range of reasons for this increase in enhancement totex post the initial BP, as previously discussed with Ofwat in the Company's DDR meeting. The Table below summarises the totex increase drivers between the original BP and FD. Where costs were increased, in most cases this was to reflect new statutory requirements, updated regulatory guidance, emerging cost data from recent delivery activities, and alignment with cost benchmarks set out in Ofwat's DD.

| Enhancement area | Reason |
|---|---|
| **Cost changes made independent of Ofwat's DD cost benchmarks** | |
| Strategic Regional Options | Updated view on two reservoirs' delivery costs (increase agreed with Ofwat). |
| Microbiological treatment; storm overflows; IED; PFAS, cyber, monitoring | Scope updates to meet changed statutory requirements and updated associated guidance. Includes negative adjustments for cyber and continuous river monitoring. |
| P-removal; Interconnectors | Emerging cost data from 23-24 delivery. P-removal costs highlighted to Ofwat pre-DD. Interconnectors detailed in response to query OFW-REP-ANH-018. |

[15] OF, 240408 Summary Table, Summary Table Tab, Row 44. Also see Residential Retail Model One, Two and Three and Anglian Financial Model.

| Enhancement area | Reason |
|---|---|
| Growth at Sewage Treatment Works | Updated growth schemes: no change in underlying cost assumptions. |
| Mablethorpe desalination | Inclusion of development costs of scheme agreed with RAPID. |
| **Cost changes made in response to Ofwat's DD cost benchmarks** | |
| Net changes from acceptance of Ofwat's DD (increased costs) | Updating the plan to align with Ofwat's DD where additional costs were supported by Ofwat (such as P-removal) and where additional costs were not supported by Ofwat (e.g. Resilience, greenhouse gas reduction). |
| Increased pressures from base allowance shortfall | Transfer of costs from enhancement to base (no net change to totex). |

At DD, Ofwat considered Anglian efficient in its proposed enhancement allowances requested in its BP. Anglian's revised enhancement allowances were also accepted by Ofwat, as they were still found to be more efficient than Ofwat's cost benchmarks (OF.AS¶6.16 and ¶6.21). Whilst, following these adjustments, Anglian accepted the enhancement allowance in the FD in the round, delivering this investment continues to represent a significant step change in the scale and complexity of enhancement capital programmes, which inevitably introduces considerable risk that is not recognised by the broader FD settlement.

**VII. Outcomes**

**Leakage**: Anglian welcomes Ofwat's acknowledgment that, in the context of the PR19 claw-back mechanism, if the CMA intervenes, Ofwat recommends that the CMA use the actual 2024-25 outturn position to update the baseline and profile of the PR24 PCL for leakage (OF.AS¶7.58). This would also result in updates to the PCL model and enhancement models allowances, in line with the changes derived from the updated baseline. For the reasons set out in the SoC (AS¶420–450), Anglian asks the CMA to action this adjustment to ensure the PR24 determinations are grounded in actual performance data. This is critical to ensure appropriate performance targets and cost allowances.

**Total pollution incidents**: Ofwat indicates that it would *consider* the impacts of any change in the EPA following the stakeholder consultation by the EA and NRW and suggests deprioritising POL, leaving this to Ofwat's planned change control process (OF.AS¶7.64 and ¶8.2). Ofwat's change control process fails to detail how reporting changes (e.g., category 4 inclusion) will affect the overall incentives and balance of risk faced by companies in AMP8. Concerns around normalisation relate to the overall balance of risk companies face as part of the calibration of the PR24 determination. Deferring the process of revising PCs to an external consultation fails to engage with Anglian's principal concern with the calibration of the FD which it asks the CMA to address as part of its Redetermination. In particular, Ofwat briefly suggests deploying sensors may reduce pollution incidents at pumping stations and treatment works - this demonstrates that these assets are important drivers of the costs of avoiding pollutions. While sensors improve visibility and support improvements, they are not a standalone solution. Anglian's proposed remedy (AS¶478) directly addresses shortcomings in the existing normalisation approach, offering a pragmatic adjustment to Anglian's PCL. This change is practical, can be implemented at the start of AMP8, and remains valid regardless of any future EA/NRW changes to normalisation for EPA purposes. A broader review of normalisation for POL will be necessary at PR29 and the CMA can take steps now, by adjusting Anglian's PCL to reflect all potentially-polluting assets.

Ofwat contends that adjusting PCLs for regional factors would be double counting, as they are already accounted for in its cost models. This characterisation is incorrect. Anglian's concern relates to the inadequacy of normalising pollution incidents solely by sewer length, given over half of such incidents arise from other assets (AS, Figure 38, AS¶472–477). Anglian's proposed adjustment is a pragmatic measure for AMP8, allowing time to develop a more comprehensive normalisation approach at PR29. Ofwat's double counting concern assumes regional factors influence only costs, not performance. However, data on sources of pollution incidents clearly demonstrate that differences in assets, such as pumping station numbers, impact both cost and performance (AS, Figure 38). Additionally, Ofwat itself employs sewer length as a parameter in both its cost models and normalisation methodology, which calls into question the validity of its double-counting claim.

**External sewer flooding**: AS¶141–143 identifies concerns with Ofwat's external sewer flooding model. Notably, Ofwat's proposed PCL for Anglian for AMP8 is more challenging than most other companies', despite Ofwat's PR24 FM (Appendix 9, table 4.1) supporting a common PCL. Ofwat has argued that uniform PCLs would disadvantage Hafren Dyfrdwy and Thames Water because they lacked financial incentives in AMP7; however, their circumstances do not justify the proposed Anglian PCL, which penalises it for better past performance. Fairness concerns could instead be managed through company-specific exceptions, as Ofwat does for internal sewer flooding. More broadly, the Response suggests that the targets aim to 'push' performance to past levels (regardless of whether those have only been achieved on a one-off basis). This approach misunderstands the role of PCLs, which are baselines for financial incentives that should ensure a 'fair bet' for efficient firms rather than acting as performance floors.

**Water supply interruptions:** Anglian identified concerns with the PCLs for water supply (AS¶100). Ofwat acknowledges these PCLs for the start of AMP8 are not based on recent performance, with only 24% of companies meeting the PCL in 2023/24. Instead, Ofwat justifies the targets on what it believes companies should achieve, citing customer priorities, departing from the FD, which relied on selective historical data. Base cost allowances, tied to historical performance, do not appear to fund these PCLs, and without enhancement funding, they do not represent a 'fair bet'. Anglian's SoC proposal offers a pragmatic alternative, reflecting industry data and consistent with Ofwat's approach to Internal Sewer Flooding, while achieving a 43% improvement by 2029–30.

AS footnote 252 cited concerns with Ofwat's approach to the FD for Serious Pollution Incidents, Biodiversity and Water Quality Contacts. However, Anglian proposed deprioritising these in the Redetermination, suggesting that the CMA focus instead on Anglian's main priorities: changes to four PCs and the OAM deadband, which Anglian identified as its most material concerns. Ofwat disagreed that these ODIs should be deprioritised. While not Anglian's focus, Anglian believes broader issues remain with ODI calibration, contributing to risk asymmetry. Similar concerns have been raised earlier and by other companies. Anglian welcomes the CMA's consideration of these areas and can provide further detail if needed.

## VIII. PCDs

While Anglian supports PCDs as a back-stop for total non-delivery, as per Anglian's SoC (AS G.2¶¶596–605), PCDs create unmitigated risks, with time-incentive PCDs proving rigid and hindering long-term efficiency (AS G.2¶¶576–584), prescriptive PCDs restricting operations (AS G.2¶¶585–595), and reporting obligations imposing undue burdens (AS G.2¶¶619–625). Ofwat has not meaningfully addressed the asymmetric risk PCDs introduce in its risk analysis, nor its implications for Anglian's risk profile and need for a WACC reflecting these risks.

## IX. Concluding remarks

In its Response, Ofwat omits to reflect the compounding effect on the balance of risk and return of the lack of sufficient base allowances and compromise of asset health and the penalty exposure associated with the imposition of inflexible PCDs and miscalibrated ODIs. These factors, combined with the broader systemic and macroeconomic risk in the sector, make AMP8 (and future AMPs) a totally different investment proposition, compromising the notional company's long-term resilience and ability to service current and future customers. This is a key driver of Anglian's Redetermination. However, it is entirely discounted by the Response, which instead deploys a selective read of Anglian's SoC and new arguments to support its claim that the FD package was balanced. The reality is that the lack of rewards in the FD will have a material impact on the sector's attractiveness to investors, given the increased risk profile and uncertainty, to the detriment of customers in AMP8 and beyond.