
Centre City Tower, 7 Hill Street, Birmingham B5 4UA
21 Bloomsbury Street, London WC1B 3HF

Peter Simpson
Chief Executive
Anglian Water Services Ltd
Lancaster House
Lancaster Way
Ermine Business Park
Huntingdon
Cambridgeshire
PE29 6XU

3 July 2019

Dear Peter

PR19 update

I wanted to provide you with an important update about our assessment of Anglian Water's revised business plan, submitted to us on 1 April.

We set out in our methodology that we expect water companies to make a step change in efficiency over the next five years so that customers get more of what matters. We are concerned that there is a substantial difference between our view of efficient and justified expenditure and the expenditure that was included in your revised business plan for base costs for both the wholesale water and wastewater control areas. We are providing this information early to give you the maximum amount of time available to ensure your cost submission for the final determination is efficient and well justified. At draft determination on 18 July, we will set out full information on our assessment of the efficient allowance for total expenditure across all price controls for base and enhancement costs.

Your September business plan proposed an increase in base costs from historical expenditure and, in our initial assessment of business plans, we assessed Anglian Water's plan as falling significantly short of demonstrating cost efficiency. However Anglian Water submitted base costs in its revised April 2019 plan that were largely unchanged from its September 2018 plan.

Customers expect water companies to deliver essential water and wastewater services in an efficient manner. The gap on base costs is particularly important because it reveals inefficiency, compared to other water companies, in the year on

year costs that a company incurs running its business. Efficient base costs are essential for a well-functioning company.

Our current assessment of your revised plan suggests that there will remain a significant gap between the base cost proposed in your plan and our view of the efficient level of base costs. The table below summarises the price controls that are driving the gap for base costs.

Key differences between Ofwat and company view of base costs

	April plan (£m)	Our current view (£m)	Gap (%)
Water	1,795.1	1,508.3	16.0%
Wastewater	2,546.9	2,140.2	16.0%

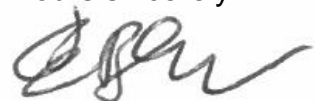
Wholesale expenditure expressed in 2017-18 CPIH deflated prices. Figures presented reflect updates to our approach to assessing costs since the initial assessment of plans. In water, base costs now include 'new development', 'new connections', and 'addressing low pressure', which were previously classified as enhancement. In wastewater, base costs now include 'new development and growth', 'growth at sewage treatment works', and 'reduce flooding risk for properties', which were previously classified as enhancement. Details of this will be set out in the draft determination

Our current assessment is still subject to change, although at this stage we do not expect any material changes to the size of the gap before the draft determination. We note that we have not necessarily been able to take full account of all late evidence, submitted after the 1 April business plan. While we will reflect on this information for the final determination, we consider that Anglian Water needs to take urgent action to address the efficiency challenge on base costs. Our emerging view of the most recent information we have received from Anglian Water is that it is not sufficient to explain the gap in base costs.

Given the material difference for Anglian Water, we want to give you as much time as possible to reflect on your plan for 2020-2025 and reconsider your proposals in responding to our draft determinations.

It is not our intention to discuss this further until we publish our draft determinations, but we expect this issue to form part of the consultation process after that date.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D Black', written in a cursive style.

David Black

Senior Director, Water 2020