

Additional Information Request - Energy costs

Anglian Water
October 2023

Additional Information Request – Energy Costs – October 2023

The information request table has been completed in nominal prices as requested in the line description.

In the information request table we have only included cost data for electricity, which represents over 86% of our total energy use. As such, the historic totals will not fully reconcile to the APR energy lines, and the forecasts do not fully reconcile to the PR24 post-RPE energy costs included in our submission, even when converted to the same price base.

Wholesale

Our forecasts in this table effectively represent the forward wholesale market rates for power, including forecast non-commodity costs, at the time we locked down our numbers prior to our audit and assurance process commencing. The wholesale forecasts came from the Lloyds forward market on 24 May 2023 and the non-commodity cost forecasts came from a Cornwall Insight forecast 'Water UK Initial Indicative Forecast' from November 2022. We fully expect these forward price forecasts to change prior to the Draft Determination and Final Determination and for the AMP8 allowances to be based on the fuller information available by then.

In the PR24 submission tables we used the forward market rates (i.e. ignoring the impact of any hedging activities) in calculating Real Price Effects in accordance with the SUP11 guidance (para 13.2) which states that the change above/below CPIH should be due to 'macro-economic factors outside the companies' direct control'. In contrast, the direction offered in the letter accompanying this request asks us to include the impact of hedging in our forecasts. However, as we only had a small proportion of expected AMP8 energy purchases hedged at that time (c.5%), this would have made only a minor impact on the submission.

At the time of writing, the forward price has reduced somewhat since our lockdown of numbers, and whilst it was therefore too late to reflect that reduction in our submission, our expectation has always been that the eventual allowance for energy would incorporate the latest information as we move towards a Final Determination. Our aim in this is simply to be funded a reasonable and fair amount for energy in the Determination, given the current market conditions we face.

We have also proposed an uncertainty mechanism, set around that reasonable and fair starting point, both to protect customers from large falls in the cost of energy and to protect companies from large increases in the cost post the rate set at Determination. The ONS indexes proposed in our uncertainty mechanism include the impact of hedging by companies across the UK, which seems a good way of adequately dealing with the impact of different hedging strategies and preserving regulatory incentives.

In the table we show both import and export prices, with the net position being the weighted average net position, the weighting based on the relevant volumes of energy imported/exported. The export price is typically, but not always, significantly lower than the import price which is a feature of the market. We show in 2022/23 that the export price achieved was actually higher than our hedged import price. Import and export prices in that year were both high but we were not exposed to the high import prices due to the forward purchases we had tied in via our hedging strategy.

Both the import prices and export prices were fixed for our table lockdown. In the same way the import prices have fallen since our lockdown, so too will the export prices. All of this said, because of the volumes involved, the export of energy has a relatively immaterial impact on the net nominal input price, typically being within 3% of the nominal import input price.

Retail

The energy cost we incur on Retail is a very low proportion of our total spend on energy and an immaterial part of the total Retail cost with much less than 0.1% incurred on energy.

The numbers in the retail ‘Nominal import input price – Energy’ line are the same as those in the wholesale line. This reflects the manner in which we secure import energy for the whole business, rather than for individual price controls.

Hedging policy and hedging ladder

Our hedging policy is detailed below and addresses the questions posed in the guidance. Effectively we build up our hedges over time, operating within high-low volume based percentage tramlines such that we are fully hedged prior to each season (half year periods) and ideally fully hedged prior to the start of each financial year. The tramlines are set out in the tables below. If we move outside of the tramlines we require specific approval from our Board. We sought and acquired this approval at the end of 2022/23, allowing us to stay below the minimum tramline for a short period into 2023/24.

How much of its energy consumption it hedges in advance, and if/how it operates a ‘hedging ladder’?

The energy policy is to purchase or “fix” the price for blocks of electricity and gas for future periods in steps, within specified parameters, thereby spreading the price risk across a longer period and avoiding single annual market purchases. A dynamic, or systematic, approach is taken to build up the minimum hedging levels on a monthly/quarterly basis in order to reduce the price volatility. The figures in the tables below show the proportion of our anticipated energy expenditure which we expect to have hedged at any point in time ahead of the start of a price control period and season.

Months ahead of start of AMP	60	48	36	24	12	6	0
Min % of AMP	0	0	5	10	15	20	25
Target % of AMP	0-5	5-10	10-15	15-25	25-35	35-50	50
Max % of AMP	20	30	40	50	75	100	100

To maintain protection against market volatility, if not already fully hedged, additional hedging is undertaken ahead of the season:

Months ahead of start of season	24	12	6	0
Min % of Season	0	25	50	100

In other words, we never enter a season without being 100% hedged against our expected usage.

How much (if any) of its consumption is effectively purchased at spot market prices?

No power is effectively purchased on the spot market. There is a tolerance with our energy supplier for settlement of small over and under purchases at the hedged price within a tolerance which we have never breached.

How much (if any) of its consumption is set under long-term offtake contracts?

9% of energy imports are fixed on long-term offtake contracts.

We do self-generate and use energy, with currently around 12% of total usage being delivered via Combined Heat and Power (CHP) engines. This is likely to reduce as a percentage of total use over time. This is partly because we have largely reached our capacity for generation and partly because energy usage is rising over time with factors such as growth and the Water Resources Management Plan. This results in us having to pump water further, from areas of surplus to areas of deficit, to meet both new demand and abstraction reductions on existing sources.