

**WSX09 -  
Annexes - Base  
cost adjustment  
claims**

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submission



**Wessex Water**  
YTL GROUP

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# CAC6 – Energy costs

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*This supporting document is part of Wessex Water's business plan for 2025-2030.*

*More information can be found at [wessexwater.co.uk](http://wessexwater.co.uk)*

# A1 Energy costs

## A1-1. Introduction to the claim

### A1-1.1. Overview of the claim

This early cost adjustment claim submission relates to the additional costs that we expect to incur in AMP8 in order to deliver our services given the increase in energy costs over and above the levels that we consider will be implicitly funded through Ofwat's PR24 econometric models.

This document is to be read alongside the completed cost adjustment claim template. This document provides supporting information in line with Ofwat's assessment criteria for cost adjustment claims as set out in Appendix 9 of the PR24 final methodology. This section is structured in line with Ofwat's assessment criteria for cost adjustment claims.

### A1-1.2. Scope of costs covered by this claim

This claim covers the costs of energy prices from 2022/23, where these are above the historical average of energy costs reported within base expenditure that form part of modelled base costs.

We will review the scope of the claim for final submission, for example to consider chemical and other costs also, which have been experiencing similar unprecedented increases in prices. We note the interaction between energy and chemical costs which needs careful consideration so as not to double count any adjustment proposed in this area.

### A1-1.3. Summary of claim value (provisional)

The net values of the claim are summarised in the table below. We will confirm the final value of the claim as part of our PR24 business plan.

Table 1 Summary of the claim value (provisional)

Water Network +

	2025/26	2026/27	2027/28	2028/29	2029/30
Gross value of the claim (£m)	£18.0	£18.0	£18.0	£18.0	£18.0
Implicit allowance (£m)	£11.8	£11.8	£11.8	£11.8	£11.8
Net value of the claim (£m)	£6.3	£6.3	£6.3	£6.3	£6.3

*Wastewater Network +*

	2025/26	2026/27	2027/28	2028/29	2029/30
Gross value of the claim (£m)	£42.2	£42.2	£42.2	£42.2	£42.2
Implicit allowance (£m)	£27.6	£27.6	£27.6	£27.6	£27.6
Net value of the claim (£m)	£14.7	£14.7	£14.7	£14.7	£14.7

### **A1-1.4. We are not proposing a symmetrical cost adjustment**

We are not proposing that Ofwat make a symmetrical cost adjustment across the industry as part of this claim. This is an industry-wide issue, given the step change in energy market costs relative to the levels implicitly funded by Ofwat's April 2023 models.

## **A1-2. The need for a cost adjustment**

This section sets out our response to Ofwat's "need for a cost adjustment" criterion. We first set out some contextual information on the need for a cost adjustment. We then address each question that Ofwat has listed under this criterion.

### **A1-2.1. Context for the cost adjustment claim**

This section sets out some background information on the step change in energy costs and why a cost adjustment outside Ofwat's econometric models is needed.

#### **A1-2.1.1. Historical energy prices**

The unit price of energy in 2022/23 incurred is a marked step change compared to the historical average as shown in the chart below.

Figure 1 Historical energy prices



### A1-2.1.2. The need for a cost adjustment

Ofwat's base econometric models implicitly fund power at average unit cost observed over time period of modelling. Most important to the time period of modelling is the time period over which the efficiency score is modelled (i.e. last five years). If models were to be run today, the corresponding APR data available would be 2017-18 to 2021-22 for calculation of allowances. The below table summarises on a unit cost basis the shortfall in efficient allowances with reference to historical unit costs we have incurred.

Table 1 – Comparison of 22/23 energy prices to historical energy prices

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
p/kWh (inc. Fixed), 22/23 prices	██████	██████	██████	██████	██████	██████
Historical average p/kWh (prior to energy price hike)	██████	██████	██████	██████	██████	
22/23 p/kWh above historical average						██████

The above illustrates that the efficient allowance for energy costs needs to be higher than the level of modelled costs implied by the base expenditure econometric models. We consider a cost adjustment claim is appropriate to upward adjust the efficient level of modelled costs to align what the model would allow as efficient expenditure for energy with what that allowance could actually buy today in the energy market. An RPE in PR24 can then be used to capture increases or decreases in energy prices relative to CPIH.

### A1-2.2. Unique circumstances

Ofwat lists the following questions in relation to this area:

- Is there compelling evidence that the company has unique circumstances that warrant a separate cost adjustment?*
- Is there compelling evidence that the company faces higher efficient costs in the round compared to its peers (considering, where relevant, circumstances that drive higher costs for other companies that the company does not face)?*
- Is there compelling evidence of alternative options being considered, where relevant?*

This claim for a cost adjustment is *not* based on a view that Wessex Water has unique circumstances that warrant an adjustment to allowances based on Ofwat's April 2023 econometric models, or that it faces higher efficient costs in the round than its peers. Indeed, the circumstances that justify this claim potentially applies more widely across the industry.

Energy is a business-critical input that cannot readily be substituted.

As such, we do not believe that the "unique circumstances" criterion is relevant to this claim.

### **A1-2.3. Management control**

In relation to the "management control" area, Ofwat lists the following questions:

- d) *Is the investment driven by factors outside of management control?*
- e) *Have steps been taken to control costs and have potential cost savings (eg spend to save) been accounted for?*

In the short term we can and do hedge energy prices to secure the future unit cost of energy. The primary purpose of this is to provide price stability, not necessarily to out-perform the market.

In the current climate of energy price hikes, market hedging cannot provide indefinite protection to the sharp rise in prices. Whilst we have used hedging to secure a relatively good unit price for 22/23, this cannot be sustained and we are expected to experience the full impact and exposure in 23/24 and through to 24/25 based on current information. We note the market is fast changing.

### **A1-2.4. Materiality**

Our business plan totex for AMP8 is still under development, so we do not have figures to apply Ofwat's materiality thresholds. Nonetheless, on current evidence:

- Our claim exceeds, by a considerable margin, Ofwat's materiality thresholds in respect of the water network plus and wastewater network plus price controls.
- The claim does not meet Ofwat's materiality thresholds for the water resources and bioresources price controls

### **A1-2.5. Adjustment to allowances (including implicit allowance)**

In relation to the adjustment to allowances, Ofwat lists the following questions:

- f) *Is there compelling evidence that the cost claim is not included in our modelled baseline (or, if the models are not known, would be unlikely to be included)? Is there compelling evidence that the factor is not covered by one or more cost drivers included in the cost models?*
- g) *Is the claim material after deduction of an implicit allowance? Has the company considered a range of estimates for the implicit allowance?*
- h) *Has the company accounted for cost savings and/or benefits from offsetting circumstances, where relevant?*
- i) *Is it clear the cost allowances would, in the round, be insufficient to accommodate the factor without a claim?*
- j) *Has the company taken a long-term view of the allowance and balanced expenditure requirements between multiple regulatory periods? Has the company considered whether our long-term allowance provides sufficient funding?*
- k) *If an alternative explanatory variable is used to calculate the cost adjustment, why is it superior to the explanatory variables in our cost models?*

We now set out the rationale for our proposed adjustment to allowances, which also addresses Ofwat's questions.

### **A1-2.5.1. The treatment of energy costs within Ofwat's April 2023 models**

Ofwat's models use outturn costs incurred by incumbents, expressed in real terms (for PR24 this will be in 22/23 prices). These outturn costs have embedded in them the impact of input price costs and efficiencies.

Models run on current historical data will not capture the impact of step change in energy prices seen since 22/23 as set out above.

We have taken a proportionate approach to recognise the above principle in this early submission. We however recognise that there may be alternative ways to consider the required adjustment level, for example to take account of later data to be available for inclusion in the econometric models by the time of Final Determination.

### **A1-2.5.2. The gross value of the claim (provisional)**

For the purposes of this early submission, we have calculated the gross value of the claim to be the product of:

- Forecast energy prices for PR24. We have assumed the current energy market price (22/23) for now (see table above), given market uncertainties and the reality that this will have changed for our final plan
- Forecast energy consumption for PR24. We have assumed this equal to energy consumed in 21/22 (as the latest APR reported values at the time of preparing this claim – see table below), given we are yet to finalise our forecast energy consumption requirements for PR24

Table 2 – Energy consumption, 2021-22 (Source: APR)

	2021-22
Energy consumption - water network +, MWh	83756
Energy consumption - wastewater network +, MWh	196024

The gross value of the claim is summarised in the table below.

Table 3 – Gross valuation of claim, £m 22/23 prices

Gross valuation of claim, £m 22/23 prices	2025/26	2026/27	2027/28	2028/29	2029/30
Water network +	£18.0	£18.0	£18.0	£18.0	£18.0
Wastewater network +	£42.2	£42.2	£42.2	£42.2	£42.2

### **A1-2.5.3. Estimated implicit allowance**

Ofwat's base econometric models implicitly fund power at average unit cost observed over time period of modelling. Most important to the time period of modelling is the time period over which the efficiency score is modelled (i.e. last five years).

We have estimated the delta between the current market price (22/23) to last five years of modelling data (17/18 to 21/22). We summarise the implicit allowance in the table below.

Table 4 – Implicit allowance of claim, £m 22/23 prices

Implicit allowance, £m 22/23 prices	2025/26	2026/27	2027/28	2028/29	2029/30
Water network +	£11.8	£11.8	£11.8	£11.8	£11.8
Wastewater network +	£27.6	£27.6	£27.6	£27.6	£27.6

#### A1-2.5.4. The net value of the claim (provisional)

The net value of the cost adjustment claim is estimated by subtracting the implicit allowance from the gross value of the claim. The table below summarises the net value of the claim.

Table 5 – Net valuation of claim, £m 22/23 prices

Net valuation of claim, £m 22/23 prices	2025/26	2026/27	2027/28	2028/29	2029/30
Water network +	£6.3	£6.3	£6.3	£6.3	£6.3
Wastewater network +	£14.7	£14.7	£14.7	£14.7	£14.7

## A1-3. Cost efficiency

In relation to cost efficiency, Ofwat lists the following questions in its guidance:

- Is there compelling evidence that the cost estimates are efficient (for example similar scheme outturn data, industry and/or external cost benchmarking, testing a range of cost models)?*
- Does the company clearly explain how it arrived at the cost estimate? Can the analysis be replicated? Is there supporting evidence for any key statements or assumptions?*
- Does the company provide third party assurance for the robustness of the cost estimates?*

The previous section explains how we have estimated the gross and net values of the cost adjustment claim for energy costs. Cost estimates are based on actual market prices paid by Wessex Water using a methodology easily replicable.

We have a dedicated team at Wessex Water who look to secure the best energy prices given market conditions, whilst balancing cost efficiency with price stability over applicable time horizons.

We will confirm our unit cost forecast and provide the necessary supporting evidence as part of our PR24 business plan submission.

## A1-4. Need for investment

We have not considered this test applicable to this claim.



## **A1-5. Best option for customers**

We have not considered this test applicable to this claim.

## **A1-6. Customer protection**

Customers are protected against variance in expenditure through the existing totex reconciliation and can further be protected by the appropriate use of forward looking RPEs. This strikes the correct balance of risk, still giving customers protection against price changes that are different to those expected whilst still retaining incentives for companies to manage their consumption and power purchase strategies efficiently.