

Preliminary statement of significant changes to primary non-household wholesale charges (Published July 2018)

(a) Introduction

This preliminary statement of significant changes is made under Ofwat's wholesale charging rules (rule A2) <https://www.ofwat.gov.uk/wp-content/uploads/2018/03/Wholesale-charging-rules-issued-by-the-Water-Services-Regulation-Authority-under-sections-66E-and-117I-of-the-Water-Industry-Act-1991-1.pdf>. It sets out potential significant changes that we are considering regarding our primary non-household wholesale charges for the 2019-20 charging year.

Our primary non-household wholesale charges are set out in Section 3 of our Wholesale Statement of Principles and Charges document which can be found on our website (<https://www.southernwater.co.uk/information-leafletscharges>). They are the charges that we make under sections 66E and 117I of the Water Industry Act 1991, to water and sewerage licensees with a retail authorisation or a restricted retail authorisation. The charges relate to the supply of water and sewerage services, both on an enduring or temporary basis, and including:

- (i) fixed and volumetric charges and allowances;
- (ii) any other charges set out in Section 3 of our Wholesale Statement of Principles and Charges document in relation to specific circumstances or events.

(b) Significant changes in charging policy from the previous year

Application of fixed charges for large user tariff sites comprising more than one SPID

We are proposing to change the way we apply fixed charges for large user tariff sites that comprise more than one SPID.

Currently, the level of fixed charge applied to each SPID comprising a large user tariff site is determined by reference to the total annual volume of water supplied to and/or wastewater collected from the site.

In some instances, this results in an individual SPID attracting wholesale charges that are higher than they would be if the standard tariff were applied. Typically, this situation arises where the annual volume of water supplied and/or wastewater collected in relation to the SPID is low compared to the total annual volume for the site as a whole.

Following retailer representation, we propose to remedy this position with effect from 1 April 2019. To do this we propose to apply fixed charges at SPID level rather than site level; that is, the fixed charge for each SPID comprising a site will be determined by the volume of water supplied and/or wastewater collected in respect of each SPID rather than for by the volume for the site as a whole.

Taken in isolation from other factors driving changes in wholesale charges, no retailer will experience a year-on-year increase in wholesale charges in respect of any given large user tariff site as a result of this proposed change.

At the time of writing this statement, we are not planning any other material changes to the methodology used to calculate wholesale charges.

Restructure of primary non-household wholesale charges

Following consultation with retailers and other stakeholders in 2016, we implemented a new structure of fixed non-household wholesale charges with effect from 1 April 2017, with a corresponding reduction in wholesale variable charges.

In accordance with our published consultation decision document (<https://www.southernwater.co.uk/media/default/PDFs/wholesale-charges-decision.pdf>) we are committed to phasing-out of these charges.

A consequence of phasing-out the new fixed wholesale charge structure will be that the wholesale charges to retailers in respect of some classes of business customer will increase by more than the overall average increase in wholesale charges.

Our Board decided not to commence this phasing-out process in 2018-19 because, in a significant number of instances, it would have resulted in retailers experiencing a year-on-year increase in wholesale charges significantly in excess of the 5% threshold referenced in rules A1 and A5 of Ofwat's wholesale charging rules. The principal driver of the increase in 2018-19 wholesale charges was RPI at 3.9%.

With RPI forecast to remain above 3% (see section (c) below), in considering whether to commence the phasing-out in 2019-20 our Board will again consider the potential impact on retailers. As an alternative to commencing the phasing-out process in 2019-20, our Board may consider delaying this to 2020-21, the first year of the new price control period. We are anticipating that our charges in general will fall in 2020-21, and this would create headroom in which to phase-out the fixed charge structure implemented in 2017-18. We welcome views from retailers on this matter, and will consult with them before determining what to do.

(c) Increase in primary non-household wholesale charges

Under Ofwat's wholesale charging rules (rules A1 and A5), our Board are required to provide assurance to Ofwat that they have assessed the effects of the new charges on water supply and

sewerage licensees, and that they approve the impact assessments and handling strategies developed in instances where bill increases for licensees exceed 5%.

At the time of publishing this statement, we forecast that primary non-household wholesale charges will remain broadly flat for the water supply service, and that the increase will be below 4% for the wastewater service. This is based on our current forecast of the November 2018 retail price index (RPI), which is 3.1%. When we set 2019-20 charges, the actual level of year-on-year change will also be influenced by our forecast of billed properties and billed volumes of water and sewage for the 2019-20 charging year.

In accordance with Ofwat's wholesale charging rules (rule A3), we are required to publish indicative primary non-household wholesale charges for 2019-20 in October 2018.