

Preliminary statement of significant changes to primary non-household wholesale charges (Published July 2019)

(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 2020-21 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 (southernwater.co.uk/wholesale-charges). 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

Transition into AMP7 and creation of new price controls

In September 2018 we submitted our business plan for the period 2020-25 to Ofwat. Following Ofwat feedback we updated the plan in April 2019. Our business plan included significant service improvements along with substantial efficiency savings and a reduction in the forecast cost of capital.

This translates to a significant reduction in our wastewater bill for our customers in 2020-21. Our water bill will reduce by much less due to significant investments to maintain resilience and security of supply of water. At the time of publishing this statement we forecast our wastewater bill will fall by 7-8% and our water bill between 0-1% for an average customer.

In addition, as part of the Ofwat price review our wholesale business will now be separated by four price controls. Therefore our wholesales charges will be split between:

- Bioresources
- Wastewater Network Plus
- Water Network Plus
- Water Resources

We will limit the impact on our tariffs from the price control separation, while ensuring that each tariff is appropriately cost reflective within each price control.

Impact from Ofwat's investigations and penalty on our wastewater business

On the 25th June 2019 Ofwat published a notice of its intention to impose a penalty on our company in respect of failings related to the management, operation and performance of our wastewater treatment works. We are deeply sorry for the past failures outlined in Ofwat's notice. We are fully committed to continuing to improve our business to deliver the standards our customers deserve.

We've agreed to recompense wastewater customers £123 million through bill rebates over five years (2017–18 prices). As part of the price review process Ofwat will confirm the impact this will have for the 2020-21 charging year. All else being equal the estimated impact of the rebate in 2020-21 is to reduce wastewater bills by a further 6%-7%. Our current expectation is that we will apply this rebate through a reduced volumetric sewerage charge.

Removal of non-household fixed charges

In 2017-18, we introduced a new transitional fixed charge for non-household customers. This was intended to help smooth the transition to the opening of the non-household retail market and reduce the risk of bill increases for larger customers. When we introduced these fixed charges, we made it clear that they were temporary and would be phased out over time. We are proposing to remove these fixed charges in 2020-21 and revert to fully volumetric wholesale charges.

The impact of removing the fixed charge on the largest customers will be mitigated by reductions in the overall bill arising from the PR19 process and the impact of our financial penalty from Ofwat. We will carry out an impact assessment to ensure that no class of customer will experience significant bill increases as a result of the change.

Further changes we are exploring for our wholesale charges

We are exploring the feasibility of including a separate charge for ammonia within the Mogden formula that is used to determine trade effluent charges. This will provide more clarity for businesses on the amount of charge they incur for their ammonia discharges, enabling them to respond to these price signals. To enable this change we need to fully understand the direct impact and cost to the business of ammonia, in order to ensure the tariff will be appropriately cost reflective. We will be engaging with our trade effluent customers on the proposed change over the coming months and we will confirm whether we are incorporating ammonia into our Mogden formula when we publish our indicative charges in October 2019.