



# Indicative scope for 2022-23 wholesale charges (July 2021)

## (a) Introduction

This statement of the indicative scope for 2022-23 wholesale charges is made under Ofwat's wholesale charging rules (rule A2)<sup>1</sup>. It sets out potential significant changes to our primary non-household wholesale charges for the 2022-23 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 ([www.southernwater.co.uk/wholesale-charges](http://www.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 business customer retailers. 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.

Ofwat's wholesale charging rules require that our Board evaluates whether year-on-year bill increases for water supply and sewerage licensees (as a whole or in groups) and/or customers occupying eligible premises (as a whole or in groups) will exceed five per cent. Where they are expected to do so, the Board must also assess any handling strategies developed to address significant bill increases.

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<sup>1</sup> <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-IndustryAct-1991-1.pdf>

## **(b) Significant changes in charging policy**

### **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 clear that they were temporary and that they would be phased out over time.

We removed the fixed charge for our wastewater charges in 2020-21 and reverted to fully volumetric charges. We intend to phase out and remove our water fixed charges over the current five-year price control period, but are committed to doing so in a way that does not lead to significant bill changes for customers. For the 2022-23 charging year we propose the continued delay to phasing out of the water fixed charges, due to increases in water charges arising from other factors. We expect to continue the phasing out of these charges in 2023-24.

### **New ammonia charge**

We introduced a separate charge for ammonia within the Mogden formula for the first time in our 21-22 charges. The decision was made to introduce this charge in a phased way, to minimise the impact on affected customers whose bills could have increased by more than 5%. This means that full cost-reflectivity for this charge will be achieved over a number of years. We will continue with this phased approach in 22-23 charges to appropriately balance the competing objectives of stable bills and cost reflectivity.

## **(c) Factors affecting the level of our wholesale charges for 2022-23**

### **Inflation and price limits**

Our charges for 2022-23 will reflect the K factors set by Ofwat as part of the 2019 price review. They will also be uplifted for inflation, as measured by November 2021 CPIH, the latest forecast for which is 2.5%.

For our water charges, the combined impact of the K factors for the water resources and water network+ price controls, along with CPIH at 2.5%, is 3.1%. For our wastewater charges the impact of the K factor for the wastewater network+ price control, and CPIH, is 2.8%. The price control for Bioresources is a total amount of revenue set out in the Final Determination, modified to reflect the latest forecast sludge production for the charging year.

The increase for wastewater continues to reflect the level of rebate built in to our charges in respect of our customer reparations following Ofwat's assessment of our failings related to the management, operation and performance of our wastewater treatment works. (For more information see [www.southernwater.co.uk/making-amends](http://www.southernwater.co.uk/making-amends)).

## **Impact of performance in financial years 2019-20 and 2020-21**

The price controls set by Ofwat at the 2019 Final Determination (FD) reflected a forecast of the impact of our performance in 2019-20 (the so-called 'blind year'). Actual revenue recovered for that year was lower than forecast. Due to exceptional factors, in particular the impact of the Covid-19 pandemic on customer consumption patterns, we deferred the recovery of this revenue in 2021-22.

As per the approved 2020-21 accounts, actual water revenue recovered was again below the allowed revenues per the FD. There was also a wholesale wastewater under-recovery in 2020-21. Under Ofwat's charging rules, this shortfall is recoverable in 2022-23 charges.

These are offset to some degree by underperformance payments incurred in respect of our 2020-21 Outcome Delivery Incentives (ODI), which would reduce the 2022-23 allowed revenues.

For wastewater the impact of the under-recovery of 2020-21 revenues is completely offset by the ODI penalties incurred, resulting in no overall impact on bills. Without intervention, for our water service the impact of these adjustments could materially increase our charges in 2022-23.

## **Impact of Covid-19**

In setting charges we need to forecast the number of properties and consumption for the year ahead, to ensure that our charges recover our allowed revenues from the price control. The Covid-19 pandemic has led to significant changes in the water consumption of both households and businesses. Forecasting the ongoing impact of these changes will be very difficult. Given the evolving nature of the situation it is important that we reflect the latest available information in our forecasts. This may mean that there is a greater level of movement between the indicative outlook, and draft and final charges than in previous years.

## **Overall level of expected bill increases**

These proposals (and the Indicative Charges) are subject to review and approval by the Board of Southern Water Services Limited of the charges for final publication in our Wholesale Charges Schedule for 2022-23, required by 13 January 2022 ("Final Charges"). The level of Final Charges may vary from those of the Indicative Charges.

Taken together, the impact of the above is expected to result in an increase in wastewater bills that broadly reflect the increase in CPIH plus the K factor. However, water bills for all customers would exceed the 5% level at which, under Ofwat's charging rules, it is expected that the Board will consider the appropriate handling strategies to address this impact.

The forecast increase in water charges is driven by our actual 2019-20 and 2020-21 performance. Companies have a choice in respect of the profiling of these adjustments. The board will therefore consider the profiling, customer impact, and handling strategies where customer bills are increasing by greater than 5%.

The £90 million fine Southern Water received from the courts in relation to illegal sewage spill incidents in the period 2010-2015, will not impact customers' bills. Our shareholders are bearing the cost.