



Statement of significant changes to primary wholesale charges

(Published October 2020)

(a) Introduction

This statement of significant changes is an update to the statement we published in August, and is made under Ofwat's wholesale charging rules (rule A4) <https://www.ofwat.gov.uk/regulated-companies/company-obligations/ofwat-regulating-the-industry-compliance-requirements-charging/>. It sets out potential significant changes that we are considering regarding our primary wholesale charges for the 2021-22 charging year.

Our primary 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/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.

This updated statement of significant changes is published alongside our indicative primary wholesale charges for 2021-22, in accordance with Ofwat's wholesale charging rules (rule A3).

Note that the level of uncertainty associated with the forecasts of developer activity, property numbers and consumption which underpin these wholesale charges is unusually high as a result of the impact of the Covid-19 pandemic. We will ensure that when final wholesale charges are set in January 2021, these reflect the latest available data. This may result in significant changes in forecast wholesale charges compared to these indicative charges.

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

Removal of non-household fixed charges

In 2017-18, we introduced a new transitional fixed wholesale 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 wholesale charges, we made clear that they were temporary and that they would be phased out over time.

We removed the fixed wholesale charge for our wastewater charges in 2020-21 and reverted to fully volumetric charges. We intend to phase out and remove our water fixed wholesale 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 2021-22 charging year we are proposing to delay the further phasing out of the water fixed wholesale charges, due to forecast increases in water charges arising from other factors. We expect to continue the phasing out of these wholesale charges from 2022-23.

New ammonia charge

We intend to introduce a separate wholesale charge for ammonia within the Mogden formula that is used to determine trade effluent charges. This will provide more clarity for businesses on the costs of treating their ammonia discharges, enabling them to respond to these price signals. This change will mean our wholesale charges will partly reflect the amount of ammonia discharged into the sewerage system and will translate into lower wholesale charges for customers with a low ammonia discharge, and higher wholesale charges for customers with a high ammonia discharge, making the wholesale charges more cost-reflective. We set out a shadow charge in 2020-21 to ensure our customers could prepare for the charge being introduced in the following charging year. We have engaged with our trade effluent customers and have decided to phase in the charge in order to limit the bill increases for customers next year.

(c) Factors affecting the level of our charges for 2021-22

Inflation and price limits

Our wholesale charges for 2021-22 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 2020 CPIH, the latest forecast for which is 0.9%.

For our wholesale water charges, the combined impact of the K factors for the water resources and water network + price controls, assuming CPIH of 0.9%, is 1.6%. For our wholesale wastewater charges the impact of the K factor for the wastewater network + price control is 3.2%. The price control for Bioresources is a total amount of revenue set as out in the Final Determination, modified to reflect the latest forecast sludge production for the charging year.

The higher increase for wholesale wastewater reflects the level of rebate built in to our charges in respect of our customer reparations following Ofwat's assessment of our historic failings related to the management, operation and performance of our wastewater treatment works. (For more information see www.southernwater.co.uk/making-amends). The charges rebate agreed with Ofwat for 2020-21 was higher than in subsequent years resulting in a year on year increase in charges in 2021-22. This profile was chosen to accelerate rebates to our customers.

Impact of Covid-19

In setting wholesale 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. For the indicative wholesale charges we have forecast lower consumption from business customers as a result of a higher level of vacant properties and lower assumed consumption of the remaining customer base. This is offset by a forecast increase in the level of household consumption. The forecast level of revenue from developers is also lower than that assumed by Ofwat in the final determination.

The level of wholesale charges is sensitive to changes in these assumptions. We will ensure that when final wholesale charges are set in January 2021, these reflect the latest data. This may result in significant changes in forecast wholesale charges compared to these indicative charges.

Impact of performance in financial year 2019-20

In addition to the Covid-19 overlay above, the price controls set by Ofwat at the 2019 Final Determination reflected a forecast of the impact of our performance in 2019-20 (the so-called 'blind year'). Charges in 2021-22 will be based on our actual 2019-20 performance and not the forecast included within our Final Determination.

As required by Ofwat, these indicative wholesale charges incorporate the impact of 2019-20 Outcome Delivery Incentives. The impact is to reduce our wholesale wastewater charges by around 1%. There is no impact for water charges.

Ofwat has provided flexibility over the timing of adjustments associated with other aspects of our performance in the blind year. In aggregate, these would increase wholesale charges for both water and wastewater. Other than to correct an error in Ofwat's calculation of the financial penalty described above, we have decided not to reflect any of these other blind year adjustments in our indicative wholesale charges as this would result in further upward pressure on customer bills in 2021-22.

Overall level of expected bill increases

With the exception of a small group of trade effluent customers who are impacted by the introduction of a new ammonia charge, the published wholesale indicative charges do not result in bill increases exceeding 5% for any group of customers.

These proposals 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 2021-22, required by 14 January 2021 ("Final Charges"). The level of Final Charges may vary from those of the Indicative Charges.