



# Indicative scope for 2021-22 wholesale charges (August 2020)

## (a) Introduction

This statement of the indicative scope for 2021-22 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 2021-22 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 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.

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. 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-Industry-Act-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 2021-22 charging year we are proposing to delay the further phasing out of the water fixed charges, due to forecast increases in water charges arising from other factors. We expect to continue the phasing out of these charges from 2022-23.

### **New ammonia charge**

We intend to introduce 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 costs of treating their ammonia discharges, enabling them to respond to these price signals. This change will mean our charges will partly reflect the amount of ammonia discharged into the sewerage system and will translate into lower bills for customers with a low ammonia discharge, and higher bills for customers with a high ammonia discharge, making the bills 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 are engaging with our trade effluent customers on the change and we will confirm the tariff changes incorporating ammonia into our Mogden formula when we publish our indicative charges in October 2020.

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

### Inflation and price limits

Our 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 water charges, the combined impact of the K factors for the water resources and water network + price controls, assuming CPIH of 0.9%, is 1.3%. For our 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 wastewater reflects 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)). 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 quickly.

### Impact of performance in financial year 2019/20

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.

On an unconstrained basis, for our water service the impact of these adjustments could add a further ~5% to charges in 2021-22. For our wastewater service the impact of these adjustments could add a further ~2%.

### 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 2021/22, required by 14 January 2021 ("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 bills for all customers that 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.

As the unwinding of our accelerated customer reparations to our wastewater customers is the primary reason for the price increase, we are not minded to take any further mitigating action at this time. The overall profile for the AMP is consistent with the £123m of rebates agreed as part of our section19 undertaking, and absent this any increase would be below the 5% threshold.

The forecast increase in water charges is driven by our actual 2019-20 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%.