

Statement of Board Assurance provided to the Water Services Regulation Authority 2020-21 Indicative Wholesale Charges

11th October 2019



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Statement of Board Assurance provided to the Water Services Regulation Authority: 2020-21 Indicative Wholesale Charges

The Company, under the direction of the Board, has undertaken a thorough process of internal and external assurance with regard to the setting of indicative wholesale charges for the 2020-21 charging year.

The indicative wholesale charges as published are based on the draft determination published by Ofwat on 18 July 2019. They will be updated to reflect the final determination which will be published on 11 December 2019.

As a result of the assurances it has received, the Board has satisfied itself to the best of its ability that:

- a. the Company complies with its legal obligations relating to the indicative wholesale charges it has published;
- b. the Board has assessed the effects of the indicative charges on potential licensees (as a whole or in groups) who are retailing wholesale services to eligible customers, and to business end-users (as a whole or in groups), and approves the impact assessments and handling strategies developed in instances where bill increases for potential licensees (as a whole or in groups) who are retailing wholesale services to eligible customers and eligible business end-users (as a whole or in groups) exceed 5%;
- c. the Company has appropriate systems and processes in place (including up-to-date models and data) to make sure that the information published about its indicative wholesale charges is accurate; and
- d. The Company has consulted with relevant stakeholders in a timely and effective manner on its wholesale charges.



Ian McAulay
Chief Executive Officer



Keith Lough

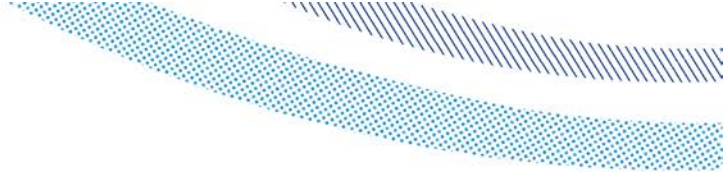
Annex to wholesale charges assurance statement - compliance with Ofwat's wholesale charging rules

Rule no.	Wholesale charging rule	Compliance statement
1-6	<i>Introduction and Interpretation</i>	N/A
7-12	<i>Publication</i>	
7	Each water undertaker must publish the Wholesale Charges payable by a water supply licensee for the supply of water to Eligible Premises that are connected to the undertaker's supply system. This includes the Eligible Premises to which a Special Agreement would otherwise apply (although nothing in these rules requires the publication of a customer's name or address).	N/A for indicative charges
8	Each sewerage undertaker whose area is wholly or mainly in England must publish the Wholesale Charges payable by a sewerage licensee in respect of the provision of sewerage services to Eligible Premises that are connected to the undertaker's sewerage system. This includes the Eligible Premises to which a Special Agreement would otherwise apply (although nothing in these rules requires the publication of a customer's name or address).	N/A for indicative charges

Rule no.	Wholesale charging rule	Compliance statement
9	<p>Each relevant undertaker must also, as a minimum, publish the Wholesale Charges (or the methodology for calculating such charges where the charges cannot be determined in advance) that would, where relevant, be payable by a water supply or sewerage licensee for:</p> <ul style="list-style-type: none"> (a) the replacement of lead service pipes; (b) the provision and maintenance of fire hydrants; (c) damage to apparatus; (d) the carrying out of inspections to ascertain whether any provision contained in or made or having effect under the Water Industry Act 1991 with respect to any water fittings or with respect to the waste or misuse of water is being or has been contravened; (e) site inspections; (f) the provision and use of standpipes; (g) the testing of meters; and (h) the disconnection of a service pipe (or for otherwise cutting off a supply of water) to any premises and the reconnection of such premises to a water main. 	N/A for indicative charges
10	Wholesale Charges must be published at least eleven weeks before the start of the period for which the charges will be imposed.	N/A for indicative charges
11	Wholesale Charges must be published on a relevant undertaker's website and in such other manner as the undertaker considers appropriate for the purpose of bringing it to the attention of persons likely to be affected by it.	N/A for indicative charges
12	Wholesale Charges must be published with such additional information or explanation as is necessary to make clear what services are covered by each charge.	N/A for indicative charges

Rule no.	Wholesale charging rule	Compliance statement
13	<i>General charging principles</i>	
13	<p>Relevant undertakers whose areas are wholly or mainly in England must determine what types of charges may or may not be imposed and the amount of any charges that may be imposed in accordance with the principle that Wholesale Charges should reflect:</p> <ul style="list-style-type: none"> (a) fairness and affordability; (b) environmental protection; (c) stability and predictability; and (d) transparency and customer-focused service. 	<p>Compliant.</p> <p>Our charges for the surface water drainage service use meter size as a proxy for surface area.</p> <p>We recognise that using actual surface area to set surface water drainage charges is more cost-reflective and has the potential to provide a stronger environmental price signal. However, implementing this basis of charge will create significant bill impacts, and for some classes of customer it may not be practicable or affordable for them to modify their surface water drainage arrangements in order to mitigate the charge.</p> <p>Based on our high-level assessment of costs and benefits, we currently don't see a compelling case for moving to area-based charges.</p>
14-18	<i>Principles for determining the amount of charges</i>	
14	<p>Consistent principles and methodologies must be applied to the calculation of charges for different classes of Eligible Premises, regardless of the services provided.</p>	<p>Compliant.</p> <p>We apply consistent principles and methodologies to the calculation of charges for different classes of Eligible Premises, regardless of the services provided.</p>

Rule no.	Wholesale charging rule	Compliance statement
15	Charging structures must reflect the long-run costs associated with providing the relevant service.	<p>Compliant.</p> <p>Charges based on volume best reflect the long-run costs associated with providing the service.</p> <p>We have removed our fixed NHH charges to become more cost reflective thus now all of our wholesale water supply revenue from customers not on our large user tariff is recovered by variable charges.</p> <p>Our water and sewerage large user tariffs comprise a lower volume charge and a fixed annual charge. The fixed annual charge is volume-related, and is set to ensure parity of the unit charge at the band threshold volumes.</p> <p>In the case of wholesale trade effluent revenue, the majority is recovered by variable charges based on the Mogden formula, with the costs of monitoring consents recovered by a fixed annual charge structure, which better reflects the risk presented by the discharge and the associated monitoring requirements.</p> <p>The costs of providing surface water drainage and highway drainage are recovered by fixed annual charges (see 13 above).</p>
16.	Differences between charges for services provided to Eligible Premises that are larger users of water and sewerage services and charges for services provided to Eligible Premises that are smaller users of water and sewerage services must only be based on cost differences associated with differential use of network assets, differential peaking characteristics, different service levels and/or different service measurement accuracy.	<p>Compliant.</p> <p>The difference in charges between our standard charges and large user charges are based on cost differences associated with differential use of network assets.</p> <p>The differences are supported by our cost model, and are broadly in line with the rest of the sector.</p>



Rule no.	Wholesale charging rule	Compliance statement
17	Where cost differences associated with differential peaking characteristics are used as a basis for differences between charges for services provided to Eligible Premises that are larger users of water and charges for services provided to Eligible Premises that are smaller users of water, the charges fixed on that basis must be structured on an appropriate peak demand basis.	N/A. We do not have charges associated with differential peaking characteristics.
18	Charges for sewerage services must take into account the different pollutant loads associated with foul water, trade effluent, surface water draining from Eligible Premises and surface water draining from highways.	Compliant. We have separate charges for foul drainage, surface water drainage, highway drainage, and trade effluent.
19	<i>Unmetered charges</i>	
19	No unmetered Wholesale Charges may be imposed unless the basis on which those charges are fixed or determined is clear and, in the case of Rateable Value Charges, it is clear: (a) which Rating Valuation List charges are fixed or determined by reference to; and (b) if the undertaker uses a different value or other amount to that specified in such a list, the methodology or other basis on which that different value or other amount is calculated.	Compliant. Our “Wholesale Statement of Principles and Charges” document specifies the Rating Valuation List that unmetered charges are fixed or determined by reference to. Additionally, the document sets out how we may apply a notional Rateable Value in certain circumstances.

Rule no.	Wholesale charging rule	Compliance statement
20-21	<i>Wastewater charges</i>	
20	<p>Sewerage undertakers whose area is wholly or mainly in England must, in relation to each period beginning on or after 1 April 2020, separate Wholesale Charges for sewerage services provided to Eligible Premises into separate charges for the reception, treatment and disposal of:</p> <ul style="list-style-type: none"> (a) foul water; (b) trade effluent; (c) surface water draining from Eligible Premises; and (d) surface water draining from highways. 	<p>Compliant. As rule 18. We have separated sewerage charges in this way since April 2000.</p>
21	<p>Sewerage undertakers must provide for an appropriate reduction in the Wholesale Charges payable for the provision of sewerage services to any Eligible Premises where the sewerage undertaker knows, or should reasonably have known, that surface water does not drain to a public sewer from those premises.</p>	<p>Compliant. We have provided customers with a rebate of the surface water drainage charge, upon successful application, since April 2000. Where we make a rebate, we proactively apply the rebate to other properties in the immediate vicinity. Prior to 2015-16, we only backdated the rebate to the start of the charging year in which the claim was made. With effect from 2015-16, we make the rebate effective from 1 April 2015 or the customer's occupation date if this is later.</p>
22	<i>Trade effluent</i>	
22	<p>Charges to be paid in connection with the carrying out of a sewerage undertaker's trade effluent functions must be based on the Mogden Formula, a reasonable variant of the Mogden Formula or on a demonstrably more cost-reflective basis.</p>	<p>Compliant. Our trade effluent charges are based principally on the Mogden formula, supplemented by our fixed annual consent monitoring charge structure, which better reflects the risk presented by the discharge and the associated monitoring requirements.</p>

Rule no.	Wholesale charging rule	Compliance statement
23-24	<i>Concessionary drainage charges</i>	
23	<p>The Wholesale Charges published by each sewerage undertaker must set out:</p> <p>(a) the classes of community group (if any) in relation to which the undertaker allows reductions in the Wholesale Charges payable by a sewerage licensee in respect of surface water drainage from Eligible Premises; and</p> <p>(b) the reductions allowed.</p>	<p>N/A</p> <p>We do not offer concessionary drainage charges, and this is explicitly stated in our “Wholesale Statement of Principles and Charges” document.</p> <p>We note that these concessionary charges are principally offered by those water and sewerage companies that have implemented area-based charges for surface water drainage to mitigate the impacts of those charges on groups such as schools, churches, and community organisations.</p>
24	<p>Where a sewerage undertaker’s charges scheme under section 143 of the Water Industry Act 1991 includes a provision designed to reduce charges to community groups in respect of surface water drainage from their Eligible Premises, the amount of Wholesale Charges payable by a sewerage licensee in respect of the provision of sewerage services to Eligible Premises occupied by community groups must be determined in accordance with the principles that:</p> <p>(a) Wholesale Charges must be reduced in relation to the same classes of community group; and</p> <p>(b) the reductions in Wholesale Charges must be the same and apply for the same period.</p>	<p>N/A.</p> <p>As rule 23.</p>
25	<i>Special agreements</i>	
25	<p>Where a Special Agreement would apply to the provision of services to Eligible Premises if the undertaker continued to provide the services, a relevant undertaker must impose on a water supply licensee or, as the case may be, a sewerage licensee only such charges as would enable the licensee to charge for those services at the same rate or rates as would have applied if the Special Agreement had applied.</p>	<p>Compliant. For each of our special agreements, the special agreement only relates to the wholesale element of the total charges. Since the opening of the non-household retail market in April 2017, there has been no change to the way we set the wholesale charges that we pass on to retailers in respect of special agreements. This allows the retailer to charge for those services at the same rate.</p>

Rule no.	Wholesale charging rule	Compliance statement
26	<i>Small companies</i>	<i>N/A</i>
27	Subject to paragraphs 28, 29 and 30, relevant undertakers whose areas are wholly or mainly in England must set and publish their Wholesale Connection Charges as if: (a) those charges related to services in respect of household premises rather than non-household premises, and (b) the Charging Rules for New Connection Services (English Undertakers) applied to them.	N/A for indicative charges
28	The obligation in paragraph 27 excludes the rules in paragraphs 44 to 46 of the Charging Rules for New Connection Services (English Undertakers).	N/A for indicative charges
29	Relevant undertakers must publish their initial Wholesale Connection Charges in their Charging Arrangements by 1 June 2018.	N/A for indicative charges
30	Thereafter, relevant undertakers must consult on their Wholesale Connection Charges at the same time as their charges under the Charging Rules for New Connection Services (English Undertakers), and must publish them in their Charging Arrangements.	N/A for indicative charges
31	The provisions for Small Companies in paragraph 17 of the Charging Rules for New Connections Services (English Undertakers) apply in relation to Wholesale Connection Charges as they apply in relation to the charges covered by those rules.	<i>N/A</i>

Rule no.	Wholesale charging rule	Compliance statement
<i>Annex</i>	<i>Information requirements</i>	
<i>A1</i>	<i>Assurance statements</i>	
A1	Each undertaker should provide to the Water Services Regulation Authority an assurance statement from its Board of Directors and publish its statement no later than the time of publication of its final Wholesale Charges confirming that:	N/A for indicative charges
(a)	the company complies with its legal obligations relating to the Wholesale Charges it has published;	
(b)	the Board has assessed the effects of the new charges on water supply and sewerage licensees (as a whole or in groups) who are retailing wholesale services and on customers occupying Eligible Premises (as a whole or in groups) and approves the impact assessments and handling strategies developed in instances where bill increases for licensees (as a whole or in groups) who are retailing wholesale services and on customers occupying Eligible Premises (as a whole or in groups) exceed 5%;	
(c)	the company has appropriate systems and processes in place (including up-to-date models and data) to make sure that the information published about its Wholesale Charges is accurate;	
(d)	the company has consulted with relevant stakeholders in a timely and effective manner on its Wholesale Charges; and	
(e)	where final Wholesale Charges are significantly different from the indicative Wholesale Charges published for the same period, the Board has considered the reasons why those changes occurred and has issued a statement explaining why those changes were not anticipated and/or mitigated. For these purposes, “indicative Wholesale Charges” means the information referred to in A3 below and charges are “significantly different” if a reasonable person would consider the changes to be material.	

Rule no.	Wholesale charging rule	Compliance statement
A2-A5	<i>Indicative charging information</i>	
A2	No later than six months before publishing its final Wholesale Charges, each undertaker (other than a small company), should if considering making any significant changes to its primary Wholesale Charges publish information that, at a minimum, informs stakeholders of the scope of its proposed changes. For these purposes, changes will be “significant” if a reasonable person would consider them to be material. The information provided does need not be as detailed as that referred to in A3 and A4 below.	Compliant. We published a preliminary Statement of Significant Changes on our website in July 2019.
A3	No later than three months before publishing its final Wholesale Charges, each undertaker (other than a small company) should provide to the Water Services Regulation Authority and publish indicative Wholesale Charges. For these purposes, “indicative Wholesale Charges” are the primary Wholesale Charges that the undertaker reasonably expects to fix for the following period (based on the information available to it at that time).	Compliant. We will publish indicative wholesale charges for 2020-21 on our website in October 2019, and notify Ofwat accordingly.

Rule no.	Wholesale charging rule	Compliance statement
A4	No later than three months before publishing its final Wholesale Charges, each undertaker (other than a small company) should, if it intends to make any significant changes to its primary Wholesale Charges, provide to the Water Services Regulation Authority and publish a statement of significant changes. For these purposes:	Compliant. We will publish an updated Statement of Significant Changes on our website in October 2019, and notify Ofwat accordingly.
(a)	changes to the level of primary Wholesale Charges, or to the methodology for calculating them, will be significant if a reasonable person would consider them to be material; and	
(b)	a statement of significant changes should include:	
(i)	what changes are expected;	
(ii)	how water supply and sewerage licensees (as a whole or in groups) and customers occupying Eligible Premises (as a whole or in groups) are likely to be affected; and	
(iii)	the handling strategies that may be adopted by the undertaker or why the undertaker considers that no handling strategies are required.	

Rule no.	Wholesale charging rule	Compliance statement
A5	Each undertaker (other than a small company) should provide to the Water Services Regulation Authority an assurance statement from its Board of Directors and publish its statement no later than the time of publication of its indicative Wholesale Charges confirming, using the best available information available at that time, that:	Compliant. We will submit our assurance statement to Ofwat and publish it at the same time we publish our indicative wholesale charges.
(a)	the company complies with its legal obligations relating to the indicative Wholesale Charges it has published;	Compliant. Licence Condition B (compliance with price controls): Oxera Consulting LLP has provided assurance that our wholesale charges are compliant with the wholesale price controls. Licence Condition E (undue discrimination and undue preference): In some areas our cost allocation is necessarily based on assumption as opposed to actual data. Where assumptions have been used these have been verified by subject matter experts within the Company. Compliance in this area is subjective, and therefore cannot be stated absolutely.
(b)	the Board has assessed the effects of the new charges on water supply and sewerage licensees (as a whole or in groups) who are retailing wholesale services and on customers occupying Eligible Premises (as a whole or in groups) and approves the impact assessments and handling strategies developed in instances where bill increases for licensees (as a whole or in groups) who are retailing wholesale services to eligible customers and on customers occupying Eligible Premises (as a whole or in groups) exceed 5%;	Compliant. We include below, as part of this assurance statement submission, a statement explaining the Board's assessment of bill increases.

Rule no.	Wholesale charging rule	Compliance statement
(c)	the company has appropriate systems and processes in place (including up-to-date models and data) to make sure that the information published about its indicative Wholesale Charges is accurate; and	<p>Oxera Consulting LLP have assured our 2020-21 indicative charges. As part of their work, Oxera performed checks on the base data used for forecasting the number of billed properties and volumes of water and wastewater. For the ten most material charges in terms of revenue yield, Oxera checked the base data used for forecasting purposes back to source systems.</p> <p>Deloitte audited our 2018-19 statutory and regulatory accounts. While they were unable to adopt a control reliance strategy for their audit, due to IT issues, they undertook substantive testing and made the following comment in their report to our Audit Committee: “Based on the work performed, we concluded satisfactorily in regards to management override of controls risk.”</p> <p>The revenue analysis and wholesale control reconciliation published for March 2019 in table 2I of the APR showed a variance of 0.2%R between allowed wholesale revenues and actual revenues for 2018-19. The data in this table was assured by Deloitte and the variance was within acceptable tolerance levels.</p> <p>In addition there were no material issues raised in Deloitte’s audit report, and they issued an unmodified audit statement on our financial statements.</p>

Rule no.	Wholesale charging rule	Compliance statement
(d)	the company has consulted with relevant stakeholders in a timely and effective manner on its indicative Wholesale Charges.	<p>Compliant.</p> <p>We commenced engagement with CCWater on 2020-21 charges in July 2019.</p> <p>The engagement to date has comprised an on-going exchange of emails, including the provision of information to CCWater both proactively and in response to their queries.</p> <p>In addition to publishing our preliminary Statement of Significant Changes on our website in July 2019, our Wholesale Services Team proactively contacted retailers to make them aware of the Statement and to offer them the opportunity to provide feedback and seek clarification.</p>



Statement regarding the Board's assessment of bill increases

In accordance with Ofwat's wholesale charging rules, the scope of this statement is restricted to the wholesale charges made to retailers participating in the business customer retail market.

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 reduce c.5% for the water supply service, and will reduce by c.15% for the wastewater service (excluding the impact of any rebates resulting the penalty notice published by Ofwat on 25 June 2019). This is based on our current forecast of the November 2019 consumer price index (CPI), which is 1.4%, and reflects all the other drivers of change in wholesale charges, including our forecast of billed properties and billed volumes of water and sewage for the 2020-21 charging year. Application of rebates arising from Ofwat's penalty notice could reduce wastewater charges by a further 6-7%, if applied to current customer charges.

This means that the increase in wholesale charges experienced by retailers will be below 5%.

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 removing these charges from 2020-21. A consequence of the removal of the fixed wholesale charges 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. However, based on our current view, none of these customers will experience an increase of greater than 5%.