



Updated statement of significant changes to primary non-household wholesale charges

(Published October 2019)

(a) Introduction

This statement of significant changes is an update to the statement we published in July, 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 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 (<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 non-household wholesale charges for 2020-21, in accordance with Ofwat's wholesale charging rules (rule A3).

These charges reflect the draft determination published by Ofwat on 18 July 2019. Charges will be updated for the impact of Ofwat's final decision to impose a financial penalty published on 10th October and Ofwat's final determination which is due to be published on 11 December 2019.

(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. Our business plan included significant service improvements along with substantial efficiency savings and a reduction in the forecast cost of capital. On 18 July 2019 Ofwat published its draft determination. This draft determination forms the basis of our published indicative charges. Our final charges will reflect Ofwat's final determination.

Ofwat's draft determination incorporates significant reductions in wastewater bills for our customers in 2020-21. Our water bills will also reduce but by a smaller amount, 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 c.15% and our water bill by c.5% for an average customer. This excludes the impact of any rebates resulting from Ofwat's penalty notice (see below).

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 25 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 pay compensation to wastewater customers totalling £123 million (2017–18 prices) over the period 2020-2025. As part of the price review process Ofwat will confirm the impact this will have for the 2020-21 charging year. If the rebate is applied wholly to current customer charges, the effect would be to reduce wastewater bills by a further 6%-7% in 2020-21. We will apply any rebate through reduced volumetric wastewater charges. The indicative charges published alongside his statement include the forecast impact of these rebates.

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 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 the reductions in overall bill reductions arising from the PR19 process and the impact of our financial penalty from Ofwat. No customer should experience bill increases >5% as a result of the change.

Further changes we are exploring for our wholesale charges

In our preliminary statement we said that we were exploring the feasibility of including a separate charge for ammonia within the Mogden formula that is used to determine trade effluent charges. This was to provide more clarity for businesses on the amount of charge they incur for their ammonia discharges, enabling them to respond to these price signals.

We do not intend to introduce this charge in 2020-21, but will work with affected customers to provide them with illustrative charges information ahead of its full introduction in 2021-22. This will enable customers to understand the likely impact of the new charge and, where appropriate, make changes to mitigate its impact.