



Statement of significant changes to primary wholesale charges

(Published October 2022)

(a) Introduction

This statement sets out potential significant changes to our primary wholesale charges for the 2023-24 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 statement of significant changes is published alongside our indicative primary wholesale charges for 2023-24, in accordance with Ofwat's wholesale charging rules (rule A3).

(b) Overall level of expected bill increases

Taken together, the impact of the factors referenced within this document are expected to result in an increase in household and non-household bills for both dual service and wastewater only customers that is broadly in line with inflation (as measured by CPIH)¹. For the small number of household and non-household customers that receive only a water service from Southern Water, it is expected that the average household bill increase would be almost 1% higher than forecast CPIH, at 9.6%. As required by Ofwat, the Board has considered customer impacts and handling strategies where customer bills are increasing by greater than 5%.

We will be consulting further with our stakeholders, including customers, retailers and customer representatives, about the scope for changes to our 2023-24 charges.

Our 2023-24 charges will be available for final publication, once they have been reviewed and approved The Board of Southern Water Services Ltd., no later than 13 January 2023 ("Final Charges"). The level of Final Charges may vary from those of the Indicative Charges.

(c) Factors affecting the level of our wholesale charges for 2023-24

Under Ofwat's regulatory formula, each year we can increase our charges by inflation, as measured by CPIH, plus or minus a percentage determined by Ofwat – known as the K factor. The K factor reflects Ofwat's assessment of the efficient costs of running our business as determined at the 2019 price review.

In addition, charges reflect any penalties or rewards associated with performance against our Ofwat targets (ODI payments) in previous years, adjustments in relation to under or over-recovery of revenues in previous years.

Inflation

Our charges for 2023-24 will reflect inflation, as measured by the November 2022 CPIH figure published by the Office for National Statistics. The latest forecast for November CPIH inflation is 8.7%. We do not expect inflation to be materially lower than this.

K factor

In its final determination, Ofwat's assessment of price limits, Ofwat set a K factor of (1.8%) for wholesale water and (1.2%) for wholesale wastewater.

¹ These % changes include ODI impacts that are based on our own view of in-period adjustments, which may differ from Ofwat's final determination of these adjustments. The final charges will take account of Ofwat's final decisions on in-period adjustments.

Impact of performance in previous financial years

Actual revenue recovered in both 2019-20 and 2020-21 was lower than what was allowed by Ofwat in the Final Determination. 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.

Wholesale water

For wholesale water, the impact of adjustments relating to prior year variances increases revenue by 2.7%. The overall net increase to charges is 9.3%.

Wholesale wastewater

For wholesale wastewater the impact of an over-recovery of 2021-22 revenues further reduces revenue in addition to the ODI penalties incurred. As a result, the overall net increase to wholesale wastewater is 7.3% which is well below forecast inflation.

Uncertainties

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. As we emerge from the Covid-19 pandemic, there are uncertainties around the extent to which the significant changes in water consumption of both households and businesses seen during the pandemic will endure. Furthermore, increases in energy prices and the wider cost of living challenges, and the likelihood of an economic downturn over the next 18 months, may result in changes to customer behaviour, as they seek to economise on their water and energy usage.

Before publishing our final charges in January 2023, we will take account of the latest information around consumption behaviour. This may result in significant changes to the charges published here.

(d) Significant changes in charging policy

Social Tariff: 'Essentials' tariff

In 2021-22, we amended the eligibility criteria for our social tariff so that we could engage with more customers in need of financial support. Now with the current cost-of-living crisis our customers are facing, we want to increase the discount offered and to reach even more customers who are most in need. More specifically, we are planning to offer a higher percentage discount in 2023-24 to those customers already eligible for our social tariff, called 'Essentials', and also to reach more customers so that we can ensure everyone who is in need of our support receives it.

Surface water drainage fixed charge

Our existing tariff structure reflects a fixed annual charge to recover the costs of surface water drainage for all customers. The charge is linked to meter-pipe-size of a customer and the vast majority of both household and non-household customers incur the lowest charge of £21.

We are currently investigating the potential benefits and customer-impact of moving to site-area-based-charges. Such a basis of charge could more accurately reflect the costs associated with the drainage of surface water into our network and apportion the burden of charge more equitably. It could also serve as a catalyst to encourage the use of more sustainable drainage systems across our area, and we are keen to work with our customers to support such enhancements.

Statement of significant changes to primary non-household wholesale charges (Published October 2022)

While we will not reflect any change to the existing basis of charge in 2023-24, we may provide indicative “shadow charges” for those customers with very large site areas draining to our network. We hope that such shadow charges will help us to assess customer impact and to identify benefits and potential next steps for this project.

To reflect our better understanding of overall the costs of surface water drainage services, within our 2023-24 Wholesale Charges we have adjusted the balance of revenue recovered via surface water drainage charges versus foul water treated (without altering the total revenue recovered).

New ammonia charge for trade effluent

We introduced a separate trade effluent charge for ammonia within the Mogden formula for the first time in our 2021-22 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 2023-24 charges to appropriately balance the competing objectives of stable bills and cost reflectivity.

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 wastewater charges in 2020-21 and reverted to fully volumetric charges. We intend to phase out and remove our water fixed charges but are committed to doing so in a way that does not lead to significant bill changes for customers. We will consider the impact of a further phasing out of these charges in 2023-24, in light of increases in water charges arising from other factors.