



# **Statement of Board Assurance provided to the Water Services Regulation Authority 2017-18 Wholesale charges**

January 2017

## Contents

---

|  |    |
|--|----|
| Statement of Board Assurance provided to the Water Services Regulation Authority: 2017-18 Wholesale Charges..... | 3  |
| Annex to wholesale charges assurance statement - compliance with Ofwat's wholesale charging rules.....           | 4  |
| Statement regarding the Board's assessment of bill increases where they exceed 5%.....                           | 16 |
| Statement regarding changes in wholesale charges between the publication of indicative and final charges.....    | 18 |
| Statement summarising the restructure of wholesale charges for business customers.....                           | 21 |
| Summary log of Consultation with CC Water.....   | 24 |

## Statement of Board Assurance provided to the Water Services Regulation Authority – 2017-18 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 wholesale charges for the 2017-18 charging year. 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 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.

We provide information on our compliance with Ofwat's wholesale charging rules in the Annex to this assurance statement.



**Robert Jennings**  
Chairman

## 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).   | Compliant.<br>We have published our wholesale charges, including those subject to a special agreement, on our website by the prescribed deadline of 13 January 2017.<br>We have published the charges in two formats: our "Wholesale Statement of Principles and Charges" document, which includes wholesale charges for residential customers in accordance with Ofwat's Information Notice of 24 November 2016 (IN 16/11), and non-primary wholesale charges for retailers in accordance with Ofwat's wholesale charging rules; and<br>in the spreadsheet template developed by Ofwat to aid comparability of wholesale charges across the industry. |
| 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). | Compliant.<br>As rule 7.   |

| 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"> <li>(a) the replacement of lead service pipes;</li> <li>(b) the provision and maintenance of fire hydrants;</li> <li>(c) damage to apparatus;</li> <li>(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;</li> <li>(e) site inspections;</li> <li>(f) the provision and use of standpipes;</li> <li>(g) the testing of meters; and</li> <li>(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.</li> </ul> | <p>Compliant.</p> <p>We have expanded our “Wholesale Statement of Principles and Charges” document to include all Non-Primary charges that we will make to retailers in the new business retail market. This includes all the charge types listed in rule 9 ((a) to (h)).</p>                            |
| 10       | <p>Wholesale Charges must be published at least eleven weeks before the start of the period for which the charges will be imposed.</p>   | <p>Compliant.</p> <p>We have published our wholesale charges by the prescribed deadline of 13 January 2017.</p>  |
| 11       | <p>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.</p>   | <p>Compliant.</p> <p>As rule 7, we have published our “Wholesale Statement of Principles and Charges” document on our website. In addition, we have published our wholesale charges using the spreadsheet template developed by Ofwat to aid comparability of wholesale charges across the industry.</p> |
| 12       | <p>Wholesale Charges must be published with such additional information or explanation as is necessary to make clear what services are covered by each charge.</p>   | <p>Compliant.</p> <p>In addition to setting out the financial value of our wholesale charges for 2017-18, our “Wholesale Statement of Principles and Charges” document provides explanatory narrative for each area of charging.</p>   |

| Rule no.     | Wholesale charging rule  | Compliance statement   |
|--------------|--|--|
| <b>13</b>    | <b><i>General charging principles</i></b>  |  |
| 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"> <li>(a) fairness and affordability;</li> <li>(b) environmental protection;</li> <li>(c) stability and predictability; and</li> <li>(d) transparency and customer-focused service.</li> </ul> | <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> |
| <b>14-18</b> | <b><i>Principles for determining the amount of charges</i></b>   |  |
| 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>With the exception of a small number of properties that attract a fixed annual charge, our wholesale water supply revenue from customers not on our large user tariff is recovered by variable charges.</p> <p>The costs of providing surface water drainage and highway drainage are recovered by fixed annual charges.</p> <p>Otherwise, with the exception of a small number of properties that attract a fixed annual charge, our wholesale sewerage 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.</p> <p>The underlying position outlined above will be subject to a small change for the remaining three years of this price control period due to the implementation and subsequent phasing-out of a new wholesale fixed charge. See rule A1 (a).</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 industry.</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.<br>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.<br>We have separate charges for foul drainage, surface water drainage, highway drainage, and trade effluent.   |
| <b>19</b>    | <b><i>Unmetered charges</i></b>   |   |
| 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:<br>(a) which Rating Valuation List charges are fixed or determined by reference to; and<br>(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.<br>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. |
| <b>20-21</b> | <b><i>Wastewater charges</i></b>  |   |
| 20           | 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:<br>(a) foul water;<br>(b) trade effluent;<br>(c) surface water draining from Eligible Premises; and<br>(d) surface water draining from highways.                               | Compliant.<br>As rule 18.<br>We have separated sewerage charges in this way since April 2000.   |

| Rule no.     | Wholesale charging rule  | Compliance statement  |
|--------------|--|---|
| 21           | 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.                         | Compliant.<br>We have provided customers with a rebate of the surface water drainage charge, upon successful application, since April 2000.<br>Where we make a rebate, we proactively apply the rebate to other properties in the immediate vicinity.<br>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. |
| <b>22</b>    | <b>Trade effluent</b>  |   |
| 22           | 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.  | Compliant.<br>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.   |
| <b>23-24</b> | <b>Concessionary drainage charges</b>  |   |
| 23           | The Wholesale Charges published by each sewerage undertaker must set out:<br>(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<br>(b) the reductions allowed. | N/A<br>We do not offer concessionary drainage charges, and this is explicitly stated in our "Wholesale Statement of Principles and Charges" document.<br>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.  |

| Rule no.  | Wholesale charging rule  | Compliance statement  |
|-----------|--|---|
| 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.<br/>As rule 23.</p>   |
| <b>25</b> | <b><i>Special agreements</i></b>   |   |
| 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.<br/>For each of our special agreements, the special agreement only relates to the wholesale element of the total charges; i.e., customers subject to a special agreement pay standard retail charges in addition to the wholesale charges.<br/>After the opening of the non-household retail market in April 2017, there will be no change to the way we calculate the wholesale charges that we pass on to retailers in respect of special agreements.<br/>This will allow the retailer to charge for those services at the same rate.</p> |
| <b>26</b> | <b><i>Small companies</i></b>  | <b>N/A</b>  |

| 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:  | Compliant.<br>We have submitted our assurance statement to Ofwat and published it at the same time we published our wholesale charges.   |
| (a)          | the company complies with its legal obligations relating to the Wholesale Charges it has published;   | Compliant.<br>Licence Condition B (compliance with price controls): Oxera Consulting LLP has provided assurance that our wholesale charges are compliant with the wholesale price controls.<br>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. Further to our discussions with Ofwat on 4 November 2016 and 20 December 2016, we confirm that the restructure of our wholesale charges for business customers, made in response to the request received from Business Stream, will be phased-out over the remaining three years of this price control period. Further information on the restructure and the associated consultation is provided with this Annex. |
| (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%; | Compliant.<br>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 Wholesale Charges is accurate; | Compliant.<br>Deloitte LLP has provided assurance on the appropriateness of our systems and processes.  |
| (d)      | the company has consulted with relevant stakeholders in a timely and effective manner on its Wholesale Charges; and  | Compliant.<br>We commenced engagement with CCWater on 2017-18 charges in July 2016.<br>The engagement has taken a number of forms. There has been an on-going exchange of emails with CCWater since July, including the provision of information to CCWater both proactively and in response to their queries.<br>There was an agenda item on 2017-18 charges at the quarterly meetings with CCWater held on 12 September 2016 and 13 December 2016, comprising a presentation made by us followed by a discussion and question and answer session. With regard to the restructure of our wholesale charges (see rule A1 (a) above), we held discussions with CCWater both before and after the period of consultation, and they provided a formal response to the consultation.<br>In their consultation response, CCWater raised concerns regarding the implications of the restructure on the cost-reflectivity of our wholesale charges. Our decision to make the restructure temporary by phasing it out over three years, took these concerns into account.<br>We received a letter from CCWater on 20 December 2016 confirming the engagement that had taken place and summarising the key matters arising from it.<br>A summary log of our consultation with CCW is provided with this Annex. |

| Rule no.     | Wholesale charging rule   | Compliance statement   |
|--------------|---|--|
| (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.                | Compliant.<br>We include below, as part of this assurance statement submission, a statement explaining why changes have occurred and why these changes were not anticipated and/or mitigated.  |
| <b>A2-A5</b> | <b><i>Indicative charging information</i></b>   |  |
| 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. | N/A for 2017-18 as the final version of the rules were issued after indicative charges were published.<br>We advised CCWater in July that we were not planning to make any significant changes to our primary Wholesale Charges in 2017-18.<br>Since then, we received a request from Business Stream to restructure our wholesale charges (see A1 (a) and (d) above). |
| 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).   | N/A for 2017-18 as the final version of the rules were issued after indicative charges were published.<br>We published indicative wholesale charges for 2017-18 on 30 September 2016, and notified 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: | N/A for 2017-18 as the final version of the rules were issued after indicative charges were published.<br>We received a request from Business Stream to restructure our wholesale charges.<br>Having taken legal advice on competition law, and discussed with Ofwat and CCW, we consulted with retailers (see A1 (a) and A2 above). |
| (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:  | N/A for 2017-18 as the final version of the rules were issued after indicative charges were published.<br>We published indicative wholesale charges for 2017-18, and the associated assurance statement, on 30 September 2016, and provided the assurance statement to Ofwat. |
| (a)      | the company complies with its legal obligations relating to the indicative Wholesale Charges it has published;  | See A1 (a) above.   |
| (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%; | See A1 (b) above.   |
| (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   | See A1 (c) above.   |
| (d)      | the company has consulted with relevant stakeholders in a timely and effective manner on its indicative Wholesale Charges.  | See A1 (d) above.   |

## Statement regarding the Board's assessment of bill increases where they exceed 5%

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.

The Board's assessment of bill increases for residential customers is discussed in a statement accompanying the assurance of our retail charges.

As confirmed in our Statement of Significant Changes and assurance statement, we are restructuring our wholesale charges for business customers. As a result of this restructure, these customers will experience offsetting movements in their wholesale and retail charges. This will ensure that, on 1 April 2017 when the business customer retail market opens and Business Stream take over our business customers, these customers will not experience a material change in their total charges (i.e., wholesale charges plus retail charges).

However, without intervention, due to the underlying upward pressures on wholesale water supply charges in 2017-18, customers who only take the water supply service from us would experience an increase in those charges that is over 5%. The Board has given this matter due consideration, and decided to defer the take-up £0.9m of water supply in order to ensure that no class of business customer experiences an increase in wholesale charges above 5%.

The assessment of bill increases for business customers presented below is based on the wholesale charges that would have been set for 2017-18 if the restructure of our wholesale charges had not taken place. This allows the underlying increase in wholesale charges to be presented.

Presenting the movement in wholesale charges based on the restructured charges would be potentially misleading, because under the restructure there are offsetting changes in wholesale and retail charges to ensure that business customers do not pay higher charges in total in 2017-18 as a result of the restructure.

In summary:

- Wholesale charges for dual-service customers will increase by less than 3%
- Wholesale charges for sewerage-only customers will increase by less than 2%
- Wholesale charges for water-only customers will increase by less than 5%

These impacts are illustrated in the table below.

| Volume m3/a >        | 50    | 100   | 500   | 1,000 | 5,000 | 12,000 | 20,000 | 60,000 | 100,000 | 150,000 |
|----------------------|-------|-------|-------|-------|-------|--------|--------|--------|---------|---------|
| <u>Dual Service</u>  |       |       |       |       |       |        |        |        |         |         |
| Change £             | 6     | 11    | 49    | 96    | 480   | 1,109  | 1,825  | 5,285  | 8,791   | 12,369  |
| Change %             | 2.82% | 2.82% | 2.81% | 2.81% | 2.82% | 2.78%  | 2.76%  | 2.72%  | 2.70%   | 2.74%   |
| <u>Sewerage Only</u> |       |       |       |       |       |        |        |        |         |         |
| Change £             | 3     | 4     | 18    | 34    | 170   | 407    | 675    | 2,015  | 3,401   | 4,629   |
| Change %             | 1.88% | 1.74% | 1.60% | 1.58% | 1.58% | 1.58%  | 1.57%  | 1.57%  | 1.57%   | 1.57%   |
| <u>Water Only</u>    |       |       |       |       |       |        |        |        |         |         |
| Change £             | 3     | 6     | 31    | 62    | 310   | 702    | 1,150  | 3,270  | 5,390   | 7,740   |
| Change %             | 4.96% | 4.96% | 4.96% | 4.96% | 4.96% | 4.97%  | 4.97%  | 4.98%  | 4.98%   | 4.99%   |

We note that for the c13,000 business customers that only take water supply services from us the increase in wholesale charges is only slightly below the 5% threshold in Ofwat's wholesale charging rules.

As stated above, the Board has given careful consideration to the potential impacts for this class of customer. In this context the Board would note that c16% of these customers take sewerage services from Thames Water, and we have been informed that their sewerage charges are falling in 2017-18. This would reduce the combined wholesale charges for these customers further below the 5% threshold.

For the remaining water-only customers the Board considers that the financial value of the bill increases are reasonable when compared with increases in other utility charges faced by businesses. We would note that for over 80% of these customers, who use less than 500 m3/a, the increase in water supply wholesale charges will equate to less than £1 per week.

## Statement regarding changes in wholesale charges between the publication of indicative and final charges

In summary, between the publication of indicative and final charges:

- water supply charges have changed by 0.08%, and
- sewerage charges have changed by (0.18%).

### Restructure of wholesale charges for business customers

Following discussion with Ofwat, and after consulting CCWater and retailers participating in the business retail customer market, we are restructuring our wholesale charges for business customers in 2017-18.

A new structure of fixed wholesale charges will be implemented with effect from 1 April 2017, with a corresponding reduction in wholesale variable charges.

At the time we published our indicative wholesale charges, on 30 September 2016, we were aware that Business Stream were considering the structure of the retail (end-customer) charges they wanted to make to the business customers transferring from us to them with effect from 1 April 2017. However, at this time Business Stream had not made a formal request to us to restructure our wholesale charges.

In the absence of both a formal request from Business Stream and the detail of the restructure they required, and ahead of any opportunity for engagement with retailers, we therefore felt we had no option but to set our indicative wholesale charges for business customers on the basis of the structure prevailing at that time.

Further information regarding this restructure can be found in the Annex to our Board assurance statement on wholesale charges, and on our website <https://www.southernwater.co.uk/retailer-consultation>.

An analysis of the movements in wholesale charges between publication of indicative and final charges is set out in the tables below.

## Water supply

| Drivers of change in charges                                 | Indicative charges (Sep 16) | Final charges (Jan 17) | Change       | Comment on change  |
|--|-----------------------------|------------------------|--------------|--|
| K  | 1.01%                       | 1.01%                  | 0.00%        |  |
| RPI  | 1.66%                       | 2.19%                  | 0.53%        | Our internal forecast of the November 2016 RPI in September 2016 for indicative charges was 0.53% below the actual value published by ONS in December 2016.  |
| AMP5 RCM blind-year adjustment                               | 0.00%                       | 0.00%                  | 0.00%        | We confirm that in setting final charges we have used the RCM Adjustments as published by Ofwat on 8 December 2016 <a href="http://www.ofwat.gov.uk/wp-content/uploads/2016/12/Revenue-correction-mechanism-2010-15-final-reconciliation.pdf">http://www.ofwat.gov.uk/wp-content/uploads/2016/12/Revenue-correction-mechanism-2010-15-final-reconciliation.pdf</a> . |
| True-up re: 2015-16 actual revenue against allowed revenue   | 1.72%                       | 1.72%                  | 0.00%        |  |
| Impact of 2017-18 forecasts of billed properties and volumes | 0.50%                       | 0.53%                  | 0.03%        | This small movement reflects the on-going data cleansing work we performed in preparation for the opening of the business customer retail market.  |
| Impact of revenue deferral                                   | 0.00%                       | (0.48%)                | (0.48%)      | In accordance with our statement regarding the Board's assessment of bill increases where they exceed 5%, the Board has decided to defer revenue of £0.9m to ensure no class of customer experienced an increase in wholesale charges above 5%.  |
| <b>Total proposed increase in wholesale charges</b>          | <b>4.89%</b>                | <b>4.97%</b>           | <b>0.08%</b> |  |

At 0.08%, the change in water supply charges between the publication of indicative and final charges is principally due to two factors. Firstly, our internal forecast of RPI made in September 2016 was 0.53% lower than the actual value, reflecting the unforeseen increase in inflation that occurred after the publication of indicative charges. Secondly, the Board's decision to defer £0.9m (equivalent to 0.48%) to ensure no class of customer experienced an increase in wholesale charges above 5%.

## Sewerage

| Drivers of change in charges                                 | Indicative charges (Sep 16) | Final charges (Jan 17) | Change         | Comment on change   |
|--|-----------------------------|------------------------|----------------|---|
| K  | 0.85%                       | 0.85%                  | 0.00%          |   |
| RPI  | 1.66%                       | 2.19%                  | 0.53%          | Our internal forecast of the November 2016 RPI in September 2016 for indicative charges was 0.53% below the actual value published by ONS in December 2016.   |
| AMP5 RCM blind-year adjustment                               | (0.19%)                     | (0.93%)                | (0.74%)        | At the time we set indicative charges in September 2016 we did not know the final value of the AMP5 RCM Adjustment. When the final value of the adjustment was notified by Ofwat, we found that we had under-estimated the value of the adjustment. When we set indicative charges, we were minded to make the full adjustment in 2017-18. However, when the actual value of the adjustment was published by Ofwat we revised this approach and have made 50% of the adjustment in 2017-18. We confirm that this approach is consistent with the RCM Adjustments as published by Ofwat on 8 December 2016 <a href="http://www.ofwat.gov.uk/wp-content/uploads/2016/12/Revenue-correction-mechanism-2010-15-final-reconciliation.pdf">http://www.ofwat.gov.uk/wp-content/uploads/2016/12/Revenue-correction-mechanism-2010-15-final-reconciliation.pdf</a> . |
| True-up re: 2015-16 actual revenue against allowed revenue   | (1.22%)                     | (1.22%)                | 0.00%          |   |
| Impact of 2017-18 forecasts of billed properties and volumes | 0.64%                       | 0.67%                  | 0.03%          | This small movement reflects the on-going data cleansing work we performed in preparation for the opening of the business customer retail market.   |
| <b>Total proposed increase in wholesale charges</b>          | <b>1.74%</b>                | <b>1.56%</b>           | <b>(0.18%)</b> |   |

At (0.18%), the change in sewerage charges between the publication of indicative and final charges is principally due to two factors. Firstly, our internal forecast of RPI made in September 2016 was 0.53% lower than the actual value, reflecting the unforeseen increase in inflation that occurred after the publication of indicative charges. Secondly, the impact of the AMP5 RCM blind year adjustment fell by 0.74% due to under-estimating the value of the adjustment at the time we set indicative charges.

# Statement summarising the restructure of wholesale charges for business customers

## About this document

This document sets out our decisions in respect of the restructuring of Southern Water's wholesale charges to retailers in the non-household retail market. It also summarises the responses we received to our consultation and responds to the issues and evidence raised by stakeholders, which we have taken into account in setting our wholesale charges.

This document is also published on our website <https://www.southernwater.co.uk/retailer-consultation>.

## Background

In November 2016, Southern Water consulted on proposed changes to the non-household wholesale charges which will be applicable to retailers for wholesale services from 1 April 2017. The proposal would result in a potential change to the indicative charges, published on 30 September 2016.

In June 2016, Southern Water announced that it will sell its existing non-household retail business to Business Stream when the competitive market opens in April 2017. As part of the orderly transfer of non-household customers from Southern Water, Business Stream has asked Southern Water to consider making a change to the way in which it sets its wholesale charges, to ensure that while the market adjusts to the new competitive environment, Southern Water's non-household customers transferring to Business Stream are not significantly affected by such transfer. Business Stream's concern is that the current tariff structure is not reflective of the costs that will be incurred by retailers in the competitive market. Business Stream has therefore asked us to consider an amendment to the wholesale charging structure which in their view would ensure that customers' bills are not subject to significant changes overall.

Currently, Southern Water's retail margins (the difference between the final tariff paid by customers and the wholesale tariff) for supply to business customers take the form of a fixed annual charge, based on a banded structure. The tariff bands are based on the volume of water supplied and/or the volume of sewage returned to the sewerage system. Within a given tariff band, all customers pay the same level of retail charge, regardless of their volume.

Business Stream has told us that it is concerned that these fixed charges do not accurately reflect the costs that will be incurred by retailers in the competitive market from 2017, some of which vary with volume, such as working capital and bad debt. Accordingly, Business Stream have suggested that part of these costs should be included in a variable element of the retail margin.

The proposed changes would amend the wholesale charging structure, by introducing a new fixed element to our wholesale charges and an appropriate reduction to the volumetric element. This structure is similar to the structure of wholesale tariffs of other water and wastewater companies and it would not result in Southern Water collecting any additional revenues. Similarly, this would not involve any cross-subsidy between Southern Water and Business Stream. The purpose of the amendment is to prevent incidence effects for customers who will transfer at market opening.

## Summary of consultation responses and key issues

Southern Water is committed to the creation of a level playing field and contributing to the success of a competitive non-household market. Accordingly, before making any decision on the proposed change to its wholesale tariffs, Southern Water consulted with stakeholders to seek the views of all potentially affected retailers and interested parties.

In particular, Southern Water wished to understand stakeholders views on:

- i. whether such a change to Southern Water's wholesale charges should occur; and
- ii. if so, the level at which the fixed element should be set or the methodology to arrive at that level;
- iii. whether this change should be temporary and phased out over time, or kept under review.

Southern Water received six responses to the consultation. Below we set out a summary of the responses to the key issues:

### 1. Proposal to modify the wholesale charges to include both a fixed and variable element

All of the retailers that responded to the consultation were either broadly supportive or fully supportive of the proposal to modify the wholesale charges. There was a general consensus that the wholesale charges should be amended to contain both a fixed and variable element. The change was supported as it was generally accepted that a proportion of the retail cost to serve is inherently variable, such as costs for working capital and bad debt, and that the previous charging structure did not appropriately allocate these variable costs across the tariff bands.

One retailer did raise a concern regarding retail incidence effects, stating that there were limitations to the percentage that retail margins could change.

### 2. The level of the fixed element of the charge

We received differing views on the level of the fixed charge. One retailer supported the proposal in principle, but had a concern that the fixed charge in the example provided, would be an insufficient retail margin at the low end of the illustrative tariff band. Another retailer stated that their modelling indicated that the variable element of the retail margin should be between 40% and 70%, depending on the tariff band. A further retailer stated that the fixed charge should be such that the retail margin was 50% of the variable charge.

We also received a view from a stakeholder that wholesalers should be mindful of the need to ensure their charges comply with Ofwat's charging rules and are both cost reflective and seek to avoid any significant bill impacts for customers.

### 3. Timing of the fixed wholesale charge

Several of the retailers believed that the fixed element of the wholesale charges should not be phased out over time. It was argued that consistency of charging structures across wholesalers is important and that phasing out the fixed charge could lead to customer bill impacts.

However, views from regulatory and consumer organisations were very clear, stating the need for wholesale charges to be compliant with Ofwat's charging rules. These allow for temporary adjustments to offset any significant bill impacts but also require charges to be cost reflective. One stakeholder stated that they were concerned that the proposal would not be appropriate or sustainable if the changes resulted in charges becoming less cost reflective with consequences or impacts on customers over time that were unfair.

## Evaluation and Decisions

### Decision 1

Given the broad support we received from retailers, we intend to introduce a fixed element to the wholesale charge. We believe this is supported by retailers to ensure appropriate charge structures and, as the incumbent water company, we believe that we have a responsibility to ensure that our customers are looked after and that their bills remain stable following our proposed exit from the market.

With regards to the response concerning retail incidence effects, we have an obligation to ensure that our charges are compliant with Ofwat's charging principles on predictability and stability for customers, including for the retail margin.

### Decision 2

The level of fixed wholesale charge will be in the range suggested in the responses received from retailers. This will be reflective of the variable retail margin in order to achieve the purpose of the amendment which is to prevent incidence effects for customers who will transfer at market opening.

### Decision 3

Whilst several respondents felt that the introduction of the fixed element of the wholesale charge should remain in place permanently, we had strong views expressed from regulatory and consumer organisations that any adjustments for incidence effects should be temporary and that charges need to comply with Ofwat's charging rules in relation to cost reflectivity in the long term. Given that the fixed charge is not driven by a specific cost, it is our intention to phase out the new fixed wholesale charge over time. Therefore, the wholesale charges will be a temporary restructuring to avoid immediate incidence effects and ensure that customers transferring to Business Stream as a result of Southern Water's exit are not adversely affected.

## Next Steps

Following this consultation and decision document, we will be publishing our new wholesale charges on 13 January, 2017 in line with the decisions in this document.

## Appendix 1 - List of Respondents

Anglian Water Business

Clear Business Water

Consumer Council for Water

Three Sixty

Business Stream

Regent Water

Other stakeholders expressed an interest in the consultation but did not submit a response.

## Summary log of Consultation with CC Water

| Date              | CCWater  | Southern Water   |
|-------------------|--|--|
| 6 April 2016      | Requested forecast consumption and customer numbers so they could understand the impact that price controls based on revenue have had on customer charges.   |  |
| 12 April 2016     |  | Response sent.   |
| 8 July 2016       |  | With reference to Ofwat's IN 16/02, advised CCWater that we were not anticipating any significant changes to our wholesale charging structure.<br>Requested that CCWater advise us of any charging-related matters they wanted us to consider for 2017-18.   |
| 11 July 2016      | Submitted clarification questions arising from our communication of 8 July 2016: <ul style="list-style-type: none"> <li>• Value of K factors</li> <li>• Proposed changes to tariffs</li> <li>• Forecast consumption and billed properties for 2016-17 compared to 2015-16 actuals</li> <li>• Mitigation of any impacts arising from the above movement.</li> </ul> | Initial response provided.   |
| 23 August 2016    |  | Substantive response provided.   |
|                   | Follow-up questions raised in respect of our substantive response.   |  |
| 24 August 2016    |  | Follow-up questions addressed.<br>Offer made to include an item on 2017-18 charges in the agenda for the September 2016 quarterly meeting.   |
| 12 September 2016 |  | September 2016 quarterly meeting.<br>Presentation made, including: <ul style="list-style-type: none"> <li>• Overview of proposed indicative wholesale charges.</li> <li>• Components of increase in indicative wholesale charges.</li> <li>• Wholesale charge impacts for residential and business customers.</li> </ul> We also advised CCW that Business Stream were currently reviewing the structure of retail (end-customer) charges for business customers.<br>There followed a general discussion and question and answer session.<br>The actions arising were: <ol style="list-style-type: none"> <li>SW to provide an update on the Business Stream review at the December quarterly meeting.</li> <li>SW to provide CCW with the final indicative charges as soon as possible prior to publication.</li> </ol> |
| 26 September 2016 |  | Action ii. completed.  |
| 8 November 2016   | Requested that the December quarterly meeting included an agenda item on 2017-18 charges to serve as the formal consultation   | Update provided on the Business Stream review of retail (end-customer) charges for business customers, and the proposed consultation process.  |
| 18 November 2016  |  | Provided draft of consultation document and further update on the consultation process.  |

| Date             | CCWater   | Southern Water  |
|------------------|---|---|
| 25 November 2016 |   | Formal invite to CCW to respond to the consultation.  |
| 28 November 2016 |   | Request to discuss self-funded social tariffs.  |
| 29 November 2016 | Offer to discuss self-funded social tariffs after December quarterly meeting.   |   |
| 8 December 2016  | Requested any relevant material to review in advance of the December quarterly meeting and for latest drafts of charges schemes.      | Advised CCW of proposed changes to charges schemes as provided marked-up draft documents for review and comment.  |
| 9 December 2016  | Responded to consultation on restructure of wholesale charges for business customers.   |   |
| 13 December 2016 |   | <p>December 2016 quarterly meeting. Presentation made, including:</p> <ul style="list-style-type: none"> <li>• Update on wholesale charges.</li> <li>• Update on components of increase in wholesale charges.</li> <li>• Outline of options under consideration for increasing wholesale charges.</li> <li>• Bill impacts for residential customers, including impact of retail charges.</li> <li>• Forecast average household bills.</li> <li>• Wholesale charge impacts for business customers, including explicit reference to water-only customers experiencing an increase slightly above 5%<sup>1</sup>.</li> </ul> <p>We updated CCW on the consultation on the restructure of wholesale charges for business customers. There followed a general discussion and question and answer session. Finally, we outlined our plans to implement a self-funded social tariff, and sought CCW feedback on design principles. We will be incorporating CCW's views in the final design.</p> <p>Copy of slide pack emailed to CCW attendees and actions arising from the meeting confirmed:</p> <ol style="list-style-type: none"> <li>i. Provide CCW with a profile of the number of customers to accompany the bill impact tables in the slide deck.</li> <li>ii. Advise CCW of the outcome of our discussion with Ofwat regarding the recovery profile for the RCM adjustment.</li> <li>iii. Advise CCW of the outcome of our consultation on the structure wholesale charges.</li> </ol> |
| 15 December 2016 |   | Action i. completed.  |
| 20 December 2016 | Wrote confirming the consultation process we had been through, and highlighting a number of the main matters that had been discussed. | Requested feedback on how we could improve the consultation process for 2018-19 charges.  |

<sup>1</sup> The December quarterly meeting pre-dated the Board's decision to ensure that wholesale charges did not increase by more than 5% for any class of customer