

9 June 2020

**Consultation on change of ownership for
Leep Networks (Water) Limited (formerly
SSE Water Limited)**

About this document

This document is a consultation on:

- a) the issues arising out of the 2019 change of control of Leep Networks (Water) Limited¹, (“**LN(W)L**”, previously named SSE Water Limited); and
- b) the proposal to transfer sites from Leep Water Networks Limited² (“**Leep Water Networks**”) to LN(W)L.

LN(W)L is a new “**NAV**” (which stands for ‘new appointment or variation’)³. NAVs are limited companies which provide a water and/or sewerage service to customers in an area which was previously served by the incumbent monopoly provider.

We are asking for views on our assessment of the change of control, the proposed modifications and area variation to the Instrument of Appointment (“**licence**”) of LN(W)L, the proposed licence revocation of Leep Water Networks and our assessment of the minimum financial security required by LN(W)L.

This document sets out:

- Our assessment of the impact of the change of ownership and control on LN(W)L and consideration of whether changes to that company’s licence are required to protect customers;
- Our assessment of the entities identified as Ultimate Controllers of LN(W)L;
- The proposed modifications to the conditions of the licence of LN(W)L following the change of control;
- Our assessment of LN(W)L’s financial security; and
- The transfer of sites from Leep Water Networks to LN(W)L by means of a revocation of the licence of Leep Water Networks and a variation of the licence of LN(W)L.

¹ Companies House number 06021063

² Companies House number 06680258

³ <https://www.ofwat.gov.uk/regulated-companies/markets/nav-market/>

Under section 13 of the Water Industry Act 1991 (“**WIA91**”), the Water Services Regulation Authority (‘Ofwat’) may modify the conditions of a water company’s⁴ licence if the company consents to the modifications. Before making modifications under section 13 of the WIA91, Ofwat must give notice in accordance with that section. In respect of the licence held by LN(W)L, this document (including the attached Appendix which outlines the licence changes) is a Notice under section 13 of the WIA91.

In addition, under section 8 of the WIA91, Ofwat must give notice before it varies the area of the regulated company that holds the licence (“**the Appointee**”). This document is notice under section 8 of the WIA91 that we propose revoking the licence of Leep Water Networks and varying the licence of LN(W)L so that the two sites currently served by Leep Water Networks, will instead be served by LN(W)L.

⁴ For the purpose of this document, a reference to a water company or company means a company holding an appointment as a water and/or sewerage undertaker under the Water Industry Act 1991.

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1. Introduction

Owners of water companies have an important role to play by, among other things, ensuring their actions are conducive to maintaining the company’s resilience in the long term and the delivery of a high quality service to customers. As a consequence, it is important that we assess changes in the ownership of the companies we regulate and, where appropriate, use our power to modify licence conditions if we believe that customers need additional protection.

The licence defines an “Ultimate Controller” as any person who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of Ofwat) in a position to control, or to exercise material influence over, the policy or affairs of the Appointee or of any holding company of the Appointee.

In the interests of customers and in accordance with our statutory duty to secure that water companies properly carry out their functions, we aim to ensure that any Ultimate Controller of a water company has the integrity, and the operational and financial capability to run such an essential public service as a water utility. Our aim is to take a proportionate approach when there is a change of ownership or control of an Appointee.

In this document, we set out the specific regulatory considerations arising from the change in control of LN(W)L following its acquisition by Leep Utilities Limited (“Leep”, company number 10742452) as well as Leep’s proposal to transfer sites currently supplied by Leep Water Networks to LN(W)L. The transfer would be executed by a variation to the licence of LN(W)L and a revocation of the licence of Leep Water Networks.

Figure 1.

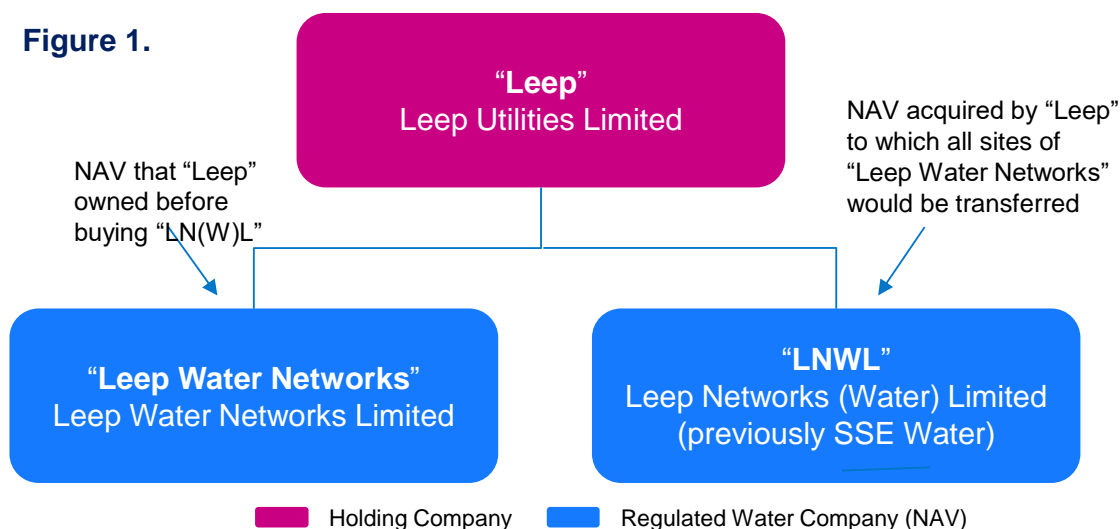


Figure 1 above highlights the companies discussed in this document and the proposed changes to their licences. A detailed corporate structure diagram is shown in figure 3 of section 2.1. If, as planned, sites are transferred to LN(W)L and the licence of Leep Water Networks is revoked, Leep Water Networks would no longer be an operational entity in the corporate structure shown in figure 3.

This document also sets out proposed modifications to LN(W)L's conditions of appointment. Some of the changes we propose here are consistent with those recently consulted on for the 17 largest water companies as part of our recent work on [strengthening the regulatory ring-fencing framework](#). Others are consistent with the work we have done to simplify and modernise licence conditions while maintaining current protections for customers and the balance of risk for companies, as set out in our conclusions on [licence simplification and modernisation](#). We take a proportionate approach to regulating NAVs and accordingly, some of the licence conditions that apply to the 17 largest companies are in the licence conditions of NAVs but have been suspended until we give notice of their application. Some of the conditions that are being proposed here, do not at this stage apply to other NAVs. We consider that they should apply to LN(W)L to bring its licence closer to the industry leading standard and we may in due course introduce some of these conditions to other NAV licences.

Finally, we outline the process for bringing the sites of LN(W)L and those of Leep Water Networks Limited together such that they all operate under the LN(W)L licence from the effective date of the appointment variation.

2. LN(W)L – background and assessment of the new owners

In this section we set out an overview of the changes to the ownership of LN(W)L. We also assess the capacity of its new group of investors to be the owners of a regulated water company. To assess the new owners of LN(W)L we reviewed information that we received from Leep. In addition, we have separately carried out our own investigations on the new corporate structure using publicly available information.

2.1 Overview of changes in LN(W)L’s ownership structure

In April 2019 Leep, the owner and operator of a range of regulated electricity, water and district heating utility assets, entered into an agreement with SSE plc to acquire its water business which it operated as SSE Water. The transaction completed at the end of May 2019.

Leep is 90% owned by Ancala Partners LLP (“**Ancala**”) and 10% owned by Peel Group. Until March 2019 Peel Group owned 50% of Leep but sold 40% of Leep to co-owner Ancala two months prior to the acquisition of LN(W)L thereby increasing Ancala’s ownership from 50% to 90%.

Figure 2. Leep’s owners before and after March 2019

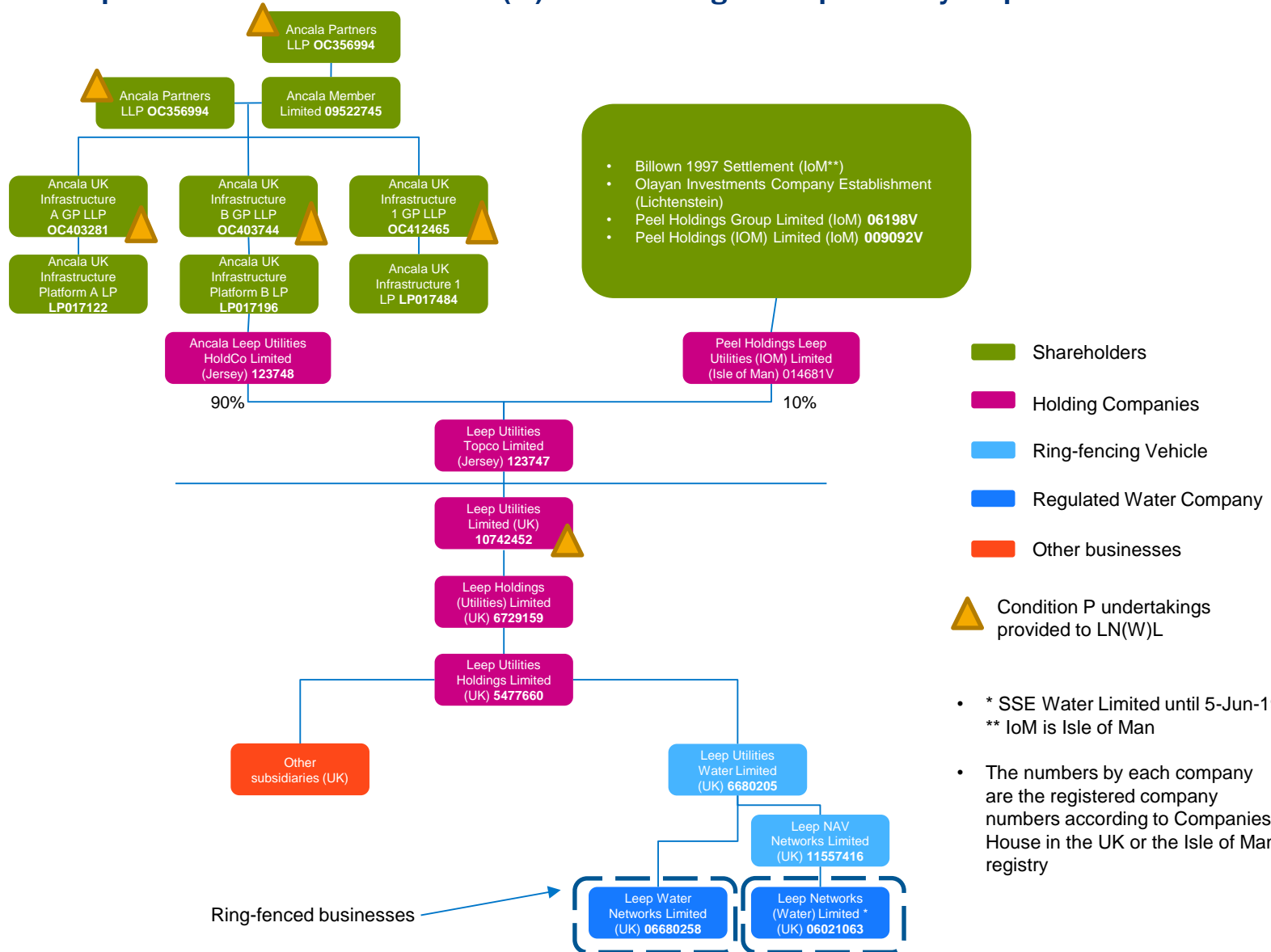
Before March 2019	Ancala, 50%	Peel Group, 50%
After March 2019	Ancala, 90%	Peel, 10%

Information provided to us by Leep shows that a series of three funds, structured as limited liability partnerships with a variety of third party investors and managed in each case by Ancala as general partner, ultimately owns 90% of LN(W)L. The funds are:

1. Ancala UK Infrastructure Platform A LP (with Ancala UK Infrastructure A GP LLP as its general partner);
2. Ancala UK Infrastructure Platform B LP (with Ancala UK Infrastructure B GP LLP as its general partner); and
3. Ancala UK Infrastructure 1 LP (with Ancala UK Infrastructure 1 GP LLP as its general partner).

The current corporate structure of Leep is shown in figure 3 below. The corporate structure diagram that Leep provided us with has been expanded by us to include more entities in the wider group using information obtained from Companies House and other public sources.

Figure 3. The corporate structure within which LN(W)L sits following the acquisition by Leep:



2.2 Assessment of owners and their capacity to own a regulated water company

When a change of ownership happens we look at how much relevant experience an owner has in delivering, managing or investing in the infrastructure sector. We do this to gain insight into a new owner's knowledge and capabilities in owning a regulated entity.

The capacity to be shareholders of appointed water companies

We also want to be satisfied that any change of ownership does not compromise the effective management of the Appointee. To help with this, we look at relevant information, in each particular case, to help satisfy us that a new owner has the integrity and the operational and financial capacity to assume the role of owning a water company. We also consider how the licence can be modified to ensure customers are better protected.

The new owners of LN(W)L

Ancala and its experience in the infrastructure sector

Ancala already has a stake in water assets regulated by Ofwat; we assessed the ability of Ancala to own a water company when they acquired Portsmouth Water Limited ("**Portsmouth Water**") in 2018. At the time, we received information on the assets and business of Ancala and we have taken this information into account in the context of the additional and updated information provided to us. Our 2018 change of control assessment did not find any issues with Ancala as the new owner of Portsmouth Water. Note that the Portsmouth Water acquisition did not meet the necessary criteria for referral to the Competition and Markets Authority (CMA).⁵

Founded in 2010, Ancala is an independent investment manager focused on mid-market investments in UK and European infrastructure assets. Ancala works closely with governments, local authorities and regulators, and considers that the practical

⁵ A specific water merger regime applies to transactions which result in any two or more 'water enterprises' – namely companies appointed under Section 6 of the Water Industry Act 1991 ("WIA") to be a 'water undertaker' and/or 'sewerage undertaker' – ceasing to be distinct. However, the CMA cannot refer such a transaction to a Phase II (in-depth) investigation unless the turnover of the water enterprises already owned and the water enterprise being acquired are each more than £10 million. At the time Portsmouth Water was acquired by Ancala, Leep Water Networks had turnover of less than £10 million. LN(W)L also had turnover of less than £10 million at the time of its acquisition.

knowledge gained through these relationships is enhanced by the involvement of Ancala's individual industry partners who have a track record in regulated sectors including water, energy and utility services.

Ancala's other significant portfolio companies besides Portsmouth Water include interests in International Energy Group, Scottish Area Gas Evacuation system (SAGE), Beryl Pipeline, Green Highland Renewables, Ancala Solar and Biogen. These are explained in some detail on page 7 of [Portsmouth Water's change of control consultation](#).

The Peel Group and its experience in the infrastructure sector

Founded in 1971, the Peel Group's diversified business includes holdings in energy and infrastructure, hospitality and leisure including retail and media, £2.3bn worth of land and property (real estate), £300m in airports and associated infrastructure including ports (transport) and 6.1 million square feet of logistics assets. Further detail on the Peel Group's investments is available on its [website](#).

Leep Water Networks (previously called Peel Water Networks Limited) was incorporated in August 2008 and granted a licence in February 2009. At that time it was 100% owned by the Peel Group. Peel Group held 100% until May 2017 when Ancala took a 50% stake in the business. In March 2019, prior to the acquisition of LN(W)L, Peel Group reduced its stake in the combined business further from 50% to 10%. Leep is Peel Group's key vehicle for investing in regulated energy and water.

Corporate governance and management of LN(W)L

Leep confirmed that the board of LN(W)L is comprised of:

- **David Glover** (Investor-appointed Chairman) – David is Operations Director at the Peel Group and is a Director across 17 entities within the group. His Directorship at Peel Land & Property Investments plc commenced in 2002;
- **Victoria Louise Manfredi** (Executive Director) – Louise has been Managing Director of Leep since May 2017 and previously spent 16 years at Peel Utilities: 8 years as Head of Utilities and 8 years as Director of Utilities;
- **Tim Power** (Investor-appointed Director) – currently a Director at Ancala Partners, Tim Power has worked in a variety of finance roles since 2006 including 6.5 years at Ernst and Young where he covered regulated and non-regulated utilities among other things; and
- **Lee Wallace** (Executive Director) – Lee has been CFO at Leep since 2018 and just prior to his current role was Group Financial Controller at Citation Professional Solutions for 4.5 years.

Leep believes that the experience of each of these individuals in managing Leep, POD53 (a non-household water retailer owned by Leep) and other regulated entities within Leep's group of companies (and across Ancala and the Peel Group's portfolios) means the board of LN(W)L will be well placed to ensure adherence to the relevant statutory and regulatory regime and to further best practice principles of strong governance and leadership as guided by Ofwat.

In addition, Leep told us that, some of LN(W)L's existing management team joined Leep as part of the transaction. This includes Bob Smith (Water Manager), who had worked for SSE plc since 2007 and previously spent nine years at Southern Water; and John Gibson (Licence and Compliance Manager), who was responsible for the June returns to Ofwat, managing SSE Water's licence conditions and its responsibilities under the WIA91. Leep has told us that they consider these managers to be well placed to respect, protect and enhance the interests of customers in LN(W)L's appointed areas.

Economic and financial standing

Leep, Ancala and the Peel Group have all confirmed that neither they nor any of their associated group companies are subject to any financial investigations by an accredited UK (or equivalent) regulator or have any legal or financial claims against them which might have a material impact on their financial standing. We have not independently verified these statements with other regulators, however, searches of public information have not turned up anything untoward.

Conflicts of interest

Ancala and Leep have said that they do not consider that any of the existing interests held by them are appropriately classified as "conflicts of interest". However, for the sake of completeness they outlined all of their existing interests in the water sector.

Leep confirmed that the Peel Group does not have any other water interests.

Ancala's other existing water interests include:

1. Ownership of 100% of the shares in Portsmouth Water via a series of funds structured as limited partnerships with a variety of third party investors and managed in each case by Ancala (as the general partner).
2. A 2.2% indirect interest in Southern Water Services Limited ("**SWSL**") held via Ancala European Infrastructure III LP's limited partnership interest in Hermes Infrastructure Spring III LP. Ancala told us that it does not have control of or

material influence over the performance or strategy of SWSL. Their interest in SWSL only provides them with a right to receive information regarding SWSL's financial performance (e.g. financial reports and valuations).

3. POD53 Limited (“**POD53**”), a water supply and sewerage licensee, eligible to supply non-household (i.e. commercial) premises.
4. An interest in Ancala Water Services (“**AWS**”) a 25 year public-private partnership contract in operation since 2003 to maintain and operate water and wastewater services for the UK Ministry of Defence.

Any relationship between Leep and other activities of Ancala or Peel Group has the potential to create a conflict of interest. We therefore expect Ancala, Peel Group and the board of LN(W)L to maintain an appropriate policy in relation to dealing with potential conflicts of interest and to act exclusively in the interests of the Appointee and have regard exclusively to the interests of the Appointee when making decisions that affect LN(W)L. In addition, where LN(W)L enters into arrangements with an associated company we expect such arrangements to comply with the ring-fencing conditions of its licence and to meet the transfer pricing requirements set out in the Regulatory Accounting Guidelines (RAGs). To mitigate the risk of conflicts of interest occurring, Leep confirmed that it has a Code of Conduct in place which includes a Conflict of Interest Policy.

Conclusion

Our change of control assessment has not found any issues associated with the new investors in LN(W)L, based on the information we have received to date.

Nonetheless, we consider that some modifications are needed to strengthen the ring fencing conditions in LN(W)L's licence and to include a requirement for LN(W)L to comply with a direction from Ofwat to enforce the legal undertakings it has procured under Condition P, and information requirements arising from a potential change of ownership or control. We set out our views on this in section 4 below.

Questions:

- Do you agree with our assessment of the new owners of LN(W)L?
- What are your views on the ability of the new owners to own a regulated water utility?
- Do you have any concerns with the new owners that might affect the ability of LN(W)L to fulfil its statutory duties and obligations under its licence?
- Do you have any specific views on the potential conflicts of interest?

3. LN(W)L – identification of Ultimate Controllers

In this section we discuss and seek views on, the identification of the providers of Condition P undertakings to LN(W)L under the new ownership structure.

All appointees need the active co-operation of their owners in carrying out their functions. LN(W)L has a licence obligation requiring it to obtain legally enforceable undertakings from its Ultimate Controller(s). The licence further states that where the Ultimate Controller is not the UK holding company, an undertaking also needs to be provided by the UK holding company. Based on the current group structure of LN(W)L, the ultimate UK holding company is Leep Utilities Limited (“**Leep**”). The entities giving the undertakings are currently required to, among other things, provide the Appointee with any information it needs to comply with its licence and to refrain from any action that may cause the Appointee to breach any of its obligations under the WIA91 or its licence (see Condition P4 in the appendix for detail).

In the information submitted to Ofwat by Leep they identified and proposed procuring undertakings from the following entities:

- Ancala Partners LLP;
- Leep Utilities Limited (as the ultimate UK holding company of Leep group);
- The general partners (on behalf of the limited partners) of the relevant Ancala funds: (1) Ancala UK Infrastructure A GP LLP; (2) Ancala UK Infrastructure B GP LLP and (3) Ancala UK Infrastructure 1 GP LLP.

Having assessed the corporate structure using Companies House data, we agree with the entities identified as Ultimate Controllers of LN(W)L; we also agree that undertakings are needed from Leep Utilities Limited. We do not consider that undertakings need to be provided to LN(W)L by additional entities. The position of each entity is identified by a triangle in figure 3. As the Peel Group now only holds a 10% stake in Leep and do not have specific other rights or powers, we do not consider that LN(W)L needs to procure an undertaking from them.

We were given copies of the undertakings that the above entities provided to LN(W)L in May 2019 and expect to receive re-executed copies aligned with the modified Condition P4 (as shown in the Appendix).

Questions:

- What are your views on the identification of the Ultimate Controllers?

4. Proposed licence modifications

Given the change in control of LN(W)L, we are taking this opportunity to update the licence to ensure it reflects the current industry leading standard of protection for the regulated company and its customers. This section sets out the licence modifications we propose to best achieve this goal.

We discuss the proposed modifications in general terms below and set out the specific drafting changes to the current licence of LN(W)L in the Appendix to this document. LN(W)L has agreed in principle to the proposed modifications.

Proposed licence modifications

Structure of the regulatory ring-fence licence conditions

We are taking this opportunity to propose strengthening the ring-fencing conditions in LN(W)L's licence to bring them closer to the industry leading standard and we are also proposing to vary the licence of LN(W)L to include sites previously supplied by Leep Water Networks. The area variation is covered in more detail in section 6.

We propose taking the ring-fencing provisions and definitions from the current Conditions I and K and moving them to an updated Condition P and Condition A, as well as inserting some new provisions and definitions to the updated conditions. This move will consolidate the updated ring-fencing provisions into the updated Condition P, which will be titled 'Regulatory ring-fence'.

The combined effect of these changes will result in the removal of all provisions in the current Condition K and Condition I.

New definitions

We propose adding definitions to Condition A of the licence of LN(W)L for "the Consumer Prices Index (H)", "Holding Company", "Subsidiary" and "United Kingdom Holding Company".

We also propose adding a new definition for "Ring-fencing Certificate", which will relate to the updated requirement for a ring fencing certificate in the updated Condition P. The ring-fencing certificate will replace some of the current reporting requirements in LN(W)L's licence, specifically the Certificate of adequacy in Condition I and the statement on sufficient rights and assets (other than financial resources) in Condition K. In addition to these existing reporting requirements, the

new definition for Ring-fencing Certificate means that LN(W)L will also be required to report on the adequacy of its systems of planning and internal control.

Enforcement of Condition P undertakings

We propose introducing wording to LN(W)L's licence to require the Appointee to comply with a direction from Ofwat to enforce the legal undertakings it has procured under Condition P. We consider this provides an important protection for LN(W)L and its customers in the event that LN(W)L's owners fail to comply with their undertakings, or behave in a manner which may or will lead to the Appointee breaching its licence.

The purpose of this regulatory direction is to shield the Appointee from influence exerted by its owners to act in breach of its licence and provides a route for the Appointee to ensure that the actions of its owners do not themselves lead to a breach (for example by an owner failing to provide information or amending group finance arrangements in a way that breaches the regulatory ring-fence). This in turn protects customers' interests by preserving the integrity of the licence obligations. We consider that, just as the undertaking itself strengthens the ability of the Appointee to comply with its licence, this proposed regulatory direction will strengthen the "shield" from the influence of Ultimate Controller(s) which may prejudice licence compliance.

Change of control notification requirements

We propose introducing a provision that requires the Appointee to inform us when it becomes aware of a change, or an upcoming likely change, that could lead to a change of control. This would include informing us of a submission for merger clearance to the Competition and Markets Authority and/or the European Commission.

Ofwat has a duty to act in a way which we consider is best calculated to secure that the functions of regulated companies are properly carried out. We consider this proposed notification requirement important in enabling us to carry out this duty, as we need to ensure that we can identify and address any regulatory issues arising from a change of control in a company. This is equally important regardless of the size of the regulated company.

Assets, rights and resources

We propose introducing a requirement for the Appointee to act in a manner which is best calculated to ensure it has adequate systems of planning and internal control.

This requirement will be in addition to the existing requirements in LN(W)L's licence, which relate to the adequacy of financial resources and facilities, and management resources to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil its obligations). In light of the increase in LN(W)L's size following the variation of its licence, we consider the addition of the reporting requirement relating to systems of planning and internal control to be proportionate.

Reporting material issues

We propose introducing a provision in LN(W)L's licence requiring the Board of the Appointee to inform Ofwat as soon as possible when they become aware of any circumstance that may materially affect the Appointee's ability to carry out its regulated activities. The provision to report material issues to Ofwat is designed to make us aware of significant issues to help us better discharge our regulatory responsibilities.

Financial security

We propose to amend the requirement for those persons providing the Ultimate Controller undertaking to pay to the Appointee on demand such money (up to a maximum aggregate liability of £4 million) as may be necessary to enable the Appointee to comply with its obligations under the Act or the Appointment (currently in Condition P, paragraph 1(d)). Instead we propose that Condition P will provide that the Ultimate Controller will "at all times make available to the Appointee such money as Ofwat determines in writing is necessary to enable the Appointee to comply with its obligations under the Act or the conditions of the Appointments" (proposed P4.4). The updated financial security provision will ensure customers remain adequately protected as LN(W)L's business continues to grow. This is discussed in more detail in the next section.

Questions:

- What are your views on the proposed modifications to LN(W)L's licence?

5. Assessment of LN(W)L's financial security

The variation to LN(W)L's licence to add existing sites of Leep Water Networks to it as well as the change in control requires us to consider whether the financial security currently in place is still adequate.

The licence of LN(W)L currently includes an obligation for the company to maintain £4m of financial security in place at all times (Condition P1(2)(d)). Total annual operating costs at the time the obligation was put into the licence in October 2007 were less than £0.2m, however, the business expected its activities to grow rapidly. Financial security was therefore set at a high enough level to accommodate significant growth before a re-assessment was required.

Our [standard policy for NAVs](#) requires a minimum level of financial security equal to "one year's annual operating costs required to supply the number of connections the business is projected to have in two years' time (as included in granted applications and proposed and current applications)" ("**Standard Calculation**"). Our policy states that, as their business develops, NAVs are responsible for continually monitoring the minimum level of financial security needed to ensure they meet our requirements. The level of financial security required may increase over time if the NAV's number of connections increases.

Our Standard Calculation allows us to consider alternative mechanisms for providing financial security based on the applicant's specific circumstances and the application in question. To approve an alternative mechanism the NAV needs to explain how its proposed approach provides an appropriate level of financial security. We also need to consider the business model adopted, along with any use of associated companies to provide services.

In considering an appropriate alternative mechanism for the financial security that LN(W)L needs to maintain, we considered the following factors:

- The number and diversity of LN(W)L's sites;
- The development stage of the portfolio of sites, i.e. the proportion of sites that were in development versus fully operational;
- LN(W)L's demonstrated track record of financing its operations over time;
- Ancala's stated commitment to continue to invest in and support the business.

LN(W)L told us that given its large number of sites and level of revenue, there was a strong likelihood that in the case of an adverse event, only a subset of their sites would be affected. As a result, it would continue to generate some income and would

like this to be accounted for within the financial security mechanism. As part of their request, Leep sent us the management accounts of both LN(W)L and Leep Water Networks including projections of the statement of financial position and the statement of profit and loss.

Following our assessment, Ofwat concluded that an alternative mechanism can provide sufficient protection for customers given the circumstances specific to LN(W)L. We consider an alternative mechanism is appropriate for LN(W)L because their portfolio of 35 sites includes a large number of relatively mature sites that have been operational and generating revenue for several years. We believe that, in this specific case, the level of audited revenues secured by the diverse portfolio will allow that under most shock events a portion of the portfolio would continue to generate some income to support the delivery of services to customers thereby offsetting or reducing the company's need to hold the full level of financial security outlined by Ofwat's Standard Calculation. We also note that Leep has told us that their owners are committed to financially supporting the growth of the business.

We therefore propose the following formula to calculate the minimum level of financial security required for LN(W)L going forward: LN(W)L's minimum level of financial security is **equal** to that calculated from Ofwat's [Standard Calculation](#) and as updated from time to time **less** 50% of earned revenues in the last financial year as reported in LN(W)L's audited financial accounts⁶. Financial security provided by LN(W)L to any incumbent water company, i.e. a wholesaler, that provides it with a bulk supply of water or bulk sewerage services, will be recognised⁷.

Our determination on financial security will be set out in a letter to LN(W)L and published on the Ofwat website. It is the responsibility of LN(W)L to ensure that it maintains the necessary financial security in line with the formula outlined in the determination letter. We propose that our determination is subject to the following conditions:

⁶ Our understanding is that revenues are recognised by LN(W)L according to International Financial Reporting Standard 15 (IFRS15).

⁷ Just as Ofwat requires NAVs to maintain financial security, some incumbent water companies that supply the NAV with services require them to provide financial security such as letters of credit from an independent third party institution. So that we are not double counting security, we have agreed with LN(W)L that we will recognise any such letters of credit that they have provided to incumbents as part of the financial security package as long as they send Ofwat a copy of this security and we agree that it is appropriate. LN(W)L has provided us with a copy of the letter of credit that they have procured on behalf of Thames Water Utilities Limited.

1. That LN(W)L submits to Ofwat along with their annual return:
 - a. a statement disclosing the amount of financial security that LN(W)L has in place alongside an explanation of how this amount has been calculated in accordance with Ofwat's determination;
 - b. any relevant documents that accompany that statement and updated copies whenever changes are made; and
 - c. a copy of any financial security given to incumbents and updated copies whenever changes are made;
2. That LN(W)L notifies Ofwat at the same time as it sends a notice to any provider of financial security that they need to call on that financial security. This notification requirement is important as it would alert us to potential cash flow problems at an early stage.
3. That LN(W)L obtains Ofwat's further determination:
 - a. if the Standard Calculation is amended; or
 - b. if there is a material change to circumstances that, in the opinion of either LN(W)L or Ofwat, warrants a further determination.

Questions:

- What are your views on the proposed modifications to LN(W)L's financial security requirement?
- What are your views on the financial security formula and the associated conditions?

6. Variation of the area of appointment of LN(W)L and revocation of the licence of Leep Water Networks

The purpose of this section is to consult on our proposal to vary the appointment of LN(W)L to allow it to supply water and sewerage services to MediaCityUK and Liverpool International Business Park, the two Sites currently served by Leep Water Networks, and to revoke the licence of Leep Water Networks.

6.1 Background to LN(W)L

As set out in section 2 above, in May 2019 Leep acquired LN(W)L, formerly SSE Water. At the time of acquisition, Leep owned a NAV company, Leep Water Networks which currently supplies water and sewerage services to MediaCityUK and Liverpool International Business Park (the “**Sites**”).

The outcome of the acquisition is that Leep now owns two NAV companies: its original holding, Leep Water Networks and LN(W)L. Since May 2019, Leep has been running the two businesses separately but intends to consolidate both companies into LN(W)L so that all sites are operated and managed under one legal entity.

Accordingly, LN(W)L has applied to Ofwat for a variation of its areas of appointment to include the Sites. If the variation is granted it will mean the consequential revocation of the licence of Leep Water Networks. The variation and revocation are being done with the consent of both parties.

LN(W)L has extensive experience in the provision of water and sewerage services. In October 2007, LN(W)L (then SSE Water) obtained its first appointment as a water and sewerage undertaker for a housing development at the Old Sarum site in Wessex Water’s area. Since then Ofwat has agreed to vary its areas of appointment so that it serves a further 34 sites for water and/or sewerage services.⁸

In addition to this application, we have just approved an application from LN(W)L to provide services at a further site called Chatham Waters.

⁸ The register of new appointments and variations is published on the Ofwat website: <https://www.ofwat.gov.uk/publication/register-of-new-appointments-and-variations-granted-to-date/>

6.2 Background to MediaCityUK and Liverpool International Business Park

MediaCityUK is the site of the original appointment granted to Leep Water Networks in February 2009 (formerly Peel Water Networks Limited). It is located in Salford Quays and is a 200-acre mixed-use site.

On 25 October 2018, we granted a variation of Leep Water Networks' area of appointment to enable it to provide water and sewerage services to the Liverpool International Business Park. This site is a large established industrial park occupied by a range of companies. It is on about 157 acres and has been developed over 20 years. It now comprises some large warehouses and a number of smaller separate buildings. The application was based on the large user criterion as the site comprises one customer, the owner of the business park, Leep Utilities Services Limited. The customer is responsible for supplying water and sewerage services to individual customers on the business park.

Both Sites are supplied by way of bulk supply and discharge agreements between Leep Water Networks and the previous incumbent, United Utilities. LN(W)L proposes to provide services to the Sites using these existing bulk supply and bulk discharge agreements. United Utilities has confirmed its agreement to the existing arrangements continuing.

6.3 Our approach to the assessment of this application

The new appointment and variation mechanism, set out in primary legislation,⁹ provides an opportunity for entry and expansion into the water and sewerage sectors by allowing one company to replace the existing Appointee as the provider of water or sewerage services for a specific area. This mechanism can be used by new companies to enter the market; by existing Appointees to expand their businesses; and by two companies merging their businesses.

When considering applications for new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our statutory duty to protect consumers. When assessing applications for new appointments and

⁹ The legal framework for new appointments is set out in the WIA91. Section 7 of the WIA91 sets out the criteria by which an appointment or variation may be made. Section 8 of the WIA91 sets out the procedure for making that appointment or variation.

variations, the two key policy principles we apply are that:

- customers, or future customers, should be no worse off than if the site had been supplied by the existing Appointee (in this case Peel Water Services); and
- Ofwat must be satisfied that an applicant will be able to finance the proper carrying out of its functions as a water and/or sewerage company.

The relevant policy documents are available [here](#).

6.4 The legal basis for this variation and revocation

As there can only be one undertaker for every area in England and Wales, when we grant a variation to one company, we must vary the appointment of the incumbent to exclude that area. In circumstances where all sites served by an incumbent are being transferred, the licence of the incumbent must be revoked. This is the case in this instance. As all of Leep Water Networks' sites are being transferred to LN(W)L, the appointment of Leep Water Networks is being revoked with its consent.

The circumstances in which a new appointment or the variation of an appointment may be made, are set out in section 7(4) of the WIA91. We can grant an application for a NAV if there are no premises on the site, or if the premises on the site are unserved by the incumbent company (the "unserved" criterion). We can grant an application for a NAV if each of the premises on the site uses more than 50 megalitres of water in a 12 month period (the "large user" criterion) and if the customer consents. We can also grant an application for a NAV where the existing Appointee consents to transfer a site or sites to another Appointee (the "consent" criterion).

In this case, LN(W)L is applying for a variation to supply the Sites based on the consent criterion set out in section 7(4) (b) of the WIA91. This provision allows for variations if the existing incumbent consents to the variation. We have a letter from Leep Water Networks confirming that it consents to LN(W)L taking over both Sites.

6.5 Customer protection

Customer charges

In its application, LN(W)L has confirmed that it will be applying the same customer charges for the Sites as those made by Leep Water Networks. We are therefore satisfied that customers will be no worse off as a result of the proposed variation.

Customer service levels

Having considered all aspects relating to customer service and service levels provided to customers by Leep Water Networks, we consider that customers on both Sites will be no worse off in respect of the service being provided by LN(W)L than they would have been had they continued to be served by Leep Water Networks. This is because LN(W)L has set its service levels to either match or exceed those of Leep Water Networks.

Operational readiness

In its application, LW(N)L set out the organisational changes that have taken place or will take place in order to enable it to provide services to its existing customers as well as to the new customers on the Sites.

It has retained the previous SSE Water Operations Team, including the Head of Water. It has also expanded its Customer Services Team and taken over the billing system used by the SSE Water customer services team. Ofwat has reviewed the new arrangements and is satisfied that appropriate steps have been taken to ensure a smooth transition and the continuation of services.

6.6 Financial assessment

As indicated above, we are satisfied that with the revised financial security arrangements proposed, LN(W)L will be able to continue to finance its functions if the Sites are added to its area. The sites are already operational so it will receive revenue from the Sites from the outset, and the addition of the Sites is unlikely to have a detrimental impact on LN(W)L's ability to finance its functions; operating costs will only increase by around 7% as a result. In addition the Sites are already fully developed and self-sufficient, generating revenues in excess of operating costs.

6.7 Environment Agency (EA) and Drinking Water Inspectorate (DWI)

We take the views of these organisations into account before progressing to formal consultation on an application for a variation. Both the EA and DWI informed us that they are content for us to consult on the variation application.

Question:

- What are your views on the proposed variation of LN(W)L's area of appointment to include the two Sites currently owned and operated by Leep Water Networks?

7. Responding to this consultation and next steps

We would welcome any comments on this document. Please send your responses to OfwatPandO@ofwat.gov.uk.

Due to the closure of the Ofwat offices as a result of covid-19, we are currently unable to accept responses by post.

The closing date for this consultation is 8 July 2020. We will publish responses to this consultation on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Regulation 2016, the Data Protection Act 2018 and the Environmental Information Regulations 2004.

If you would like the information that you have provided to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons that the contents of those written responses remain confidential.

Consultation questions

We welcome responses to the following questions.

- 1) Do you agree with our assessment of the new owners of LN(W)L?
- 2) What are your views on the ability of the new owners to own a regulated water utility?
- 3) Do you have any concerns with the new owners that might affect the ability of LN(W)L to fulfil its statutory duties and obligations under its licence?
- 4) Do you have any specific views on the potential conflicts of interest?
- 5) What are your views on the identification of the Ultimate Controllers?
- 6) What are your views on the proposed modifications to LN(W)L's licence?
- 7) What are your views on the proposed modifications to LN(W)L's financial security requirement?
- 8) What are your views on the financial security formula and the associated conditions?
- 9) What are your views on the proposed variation of LN(W)L's area of appointment to include the two Sites currently owned and operated by Leep Water Networks?

Appendix – Proposed modifications to LN(W)L’s licence

We have colour coded the draft proposal to highlight those definitions or provisions that are new in red (such as the provision relating to reporting material issues) and those provisions that already exist in the current licence in some form but will be updated in orange (such as those provisions relating to the ultimate controller undertaking and provisions relating to the ring-fencing certificate, which replaces the current certificate of adequacy).

Provisions and definitions that appear in the current licence, but have simply been re-numbered or moved to Condition A, have been left in black.

We propose to make the following modifications to LN(W)L’s licence:

1. Paragraph 2 of **Condition A** is amended by:

- a. deleting ‘and’ from the end of subsection (1);
- b. replacing ‘.’ with ‘;’ at the end of subsection (2); and
- c. inserting the following new subsections:

(3) references to a liability shall be taken to include the creation of any mortgage, charge, pledge, lien or other form of security or encumbrance, the making of a loan and the taking on of a debt;

(4) references to a loan shall be taken to include the transfer or lending, by any means, of any sum of money or rights in respect of such sum; and

(5) references to a transfer of any asset or liability includes a part transfer of an asset or liability and, without limitation, there is a part transfer of an asset where an interest or right in or over the asset is created.

2. Paragraph 3 of Condition A is amended by inserting the following definitions in the appropriate place determined alphabetically:

“the Consumer Prices Index (H)” means the all items Consumer Prices Index including owner occupiers' housing costs published by the Statistics Board;

“Cross-Default Obligation” means a term of any agreement or arrangement whereby the Appointee's liability to pay or repay any debt or other sum arises or is increased or accelerated by reason of a default of any person other than the Appointee;

“Holding Company” has the meaning set out in section 1159 of the Companies Act 2006;

“Ring-fencing Certificate” means a certificate, submitted to Ofwat by the Appointee, which states that, in the opinion of the Board of the Appointee:

(a) the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out the Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted;

(b) the Appointee will have available to it sufficient management resources and systems of planning and internal control to enable it to carry out the Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted;

(c) the Appointee has available to it sufficient rights and resources other than financial resources, as required by paragraph P12; and

(d) all contracts entered into between the Appointee and any Associated Company include the necessary provisions and requirements in respect of the standard of service to be supplied to the Appointee, to ensure that it is able to carry out the Regulated Activities;

“subsidiary” has the meaning set out in section 1159 of the Companies Act 2006;

“Ultimate Controller” means any person which, whether alone or jointly and whether directly or indirectly, is, in the reasonable determination of Ofwat, in a position to control or in a position to materially influence the policy or affairs of the Appointee or any Holding Company of the Appointee;

“United Kingdom Holding Company” means a Holding Company which is registered in the United Kingdom and which is not a subsidiary of any company registered in the United Kingdom;

3. **Condition I** is deleted in its entirety.
4. **Condition K** is deleted in its entirety.
5. **Condition P** is deleted in its entirety and replaced with the following new condition:

Condition P: Regulatory ring-fence

Conduct of the Appointed Business

P1 The Appointee shall, at all times, conduct the Appointed Business as if it were

substantially the Appointee's sole business and the Appointee were a separate public limited company. The Appointee should have particular regard to the following in the application of this Condition:

P1.1 the composition of the Board of the Appointee should be such that the directors, acting as such, act independently of the parent company or controlling shareholder and exclusively in the interests of the Appointee;

P1.2 the Appointee must ensure that each of its directors must disclose, to the Appointee and Ofwat, conflicts between duties of the directors as directors of the Appointee and other duties;

P1.3 where potential conflicts exist between the interests of the Appointee as a water and a sewerage undertaker and those of other Group Companies, the Appointee and its directors must ensure that, in acting as directors of the Appointee, they should have regard exclusively to the interests of the Appointee as a water and a sewerage undertaker;

P1.4 no director of the Appointee should vote on any contract or arrangement or any other proposal in which he has an interest by virtue of other directorships. This arrangement should be reflected in the articles of association of the Appointee;

P1.5 the Appointee should inform Ofwat without delay when:

P1.5.1 a new director is appointed;

P1.5.2 the resignation or removal of a director takes effect; or

P1.5.3 any important change in the functions or executive responsibilities of a director occurs.

The Appointee should notify Ofwat of the effective date of the change and, in the case of an appointment, whether the position is executive or non-executive and the nature of any specific function or responsibility;

P1.6 the dividend policy adopted by the Appointee and the implications of paragraph P21; and

P1.7 the Principles of Good Governance and Code of Best Practice (or any successor document having a similar purpose and content) as may from time to time be incorporated into or approved for the purposes of the Listing Rules of the Financial Conduct Authority.

The Role of the company's Ultimate Controller and United Kingdom Holding Company

P2 The Appointee must ensure that, at all times:

P2.1 there is an undertaking in place which is given by the Ultimate Controller of the Appointee in favour of the Appointee; and

P2.2 where the United Kingdom Holding Company of the Appointee is not the Ultimate Controller of the Appointee, there is an undertaking in place which is given by the United Kingdom Holding Company of the Appointee in favour of the Appointee.

P3 The Appointee must ensure that any undertaking given pursuant to paragraph P2 provides that the person giving the undertaking must:

P3.1 provide, and procure that each of its subsidiaries other than the Appointee and its subsidiaries provide to the Appointee such information as is necessary to enable the Appointee to comply with its obligations under the Water Industry Act 1991 or under these Conditions;

P3.2 not take any action, and procure that each of its subsidiaries other than the Appointee and its subsidiaries do not take any action which may cause the Appointee to breach any of its obligations under the Water Industry Act 1991 or under these Conditions.

P3.3 ensure that at all times after Ofwat has given notice to the Appointee that it considers it appropriate the Board of the Appointee contains not less than two independent non-executive directors, who shall be persons of standing with relevant experience and who shall collectively have connections with and knowledge of the areas within which the Appointee holds the Appointments and an understanding of the interests of the customers of the Appointee and how these can be respected and protected; and

P3.4 at all times make available to the Appointee such money as Ofwat determines in writing is necessary to enable the Appointee to comply with its obligations under the Act or the conditions of the Appointments.

P4 In the circumstances set out in P5, the Appointee may only enter into any new contract or arrangement with a person who is required to give an undertaking under paragraph P2 or the subsidiaries of such a person other than subsidiaries of the Appointee, with the prior written approval of Ofwat.

P5 The circumstances referred to in P4 are:

P6.1 where an undertaking required to be given by a person in accordance with paragraph P2 is not in place; or

P6.2 where there has been a breach of the terms of such an undertaking by the person that gave it and that breach has not been remedied.

P6 The Appointee must provide to Ofwat such certified copies of any undertaking given pursuant to paragraph P2 as are requested by Ofwat.

P7 The Appointee must immediately inform Ofwat in writing if the Appointee becomes aware that:

P7.1 an undertaking given by a person pursuant to paragraph P3 has ceased to be legally enforceable; or

P7.2 there has been a breach of the terms of such an undertaking by the person that gave it.

P8 The Appointee shall inform Ofwat as soon as reasonably practicable if the Appointee becomes aware that:

P8.1 arrangements are in progress or in contemplation which, if carried into effect, may lead to a change to the Ultimate Controller(s) of the Appointee; or

P8.2 arrangements have been put into effect which might be considered to have led to a change to the Ultimate Controller(s) of the Appointee; or

P8.3 any person intends to submit a merger control filing to the Competition and Markets Authority or the European Commission with respect to an actual or potential change of control of the Appointee.

P9 The Appointee must comply with any direction given by Ofwat to the Appointee to enforce the terms of an undertaking given to it pursuant to paragraph P2.

Assets, rights and resources

P10 To enable it to carry out the Regulated Activities the Appointee must, at all times, act in a manner which is best calculated to ensure that it has in place adequate:

P10.1 financial resources and facilities;

P10.2 management resources to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil its obligations under the Appointment(s)); and

P10.3 systems of planning and internal control.

P11 The Appointee must ensure that, as far as reasonably practicable, it has available to it sufficient rights and resources other than financial resources so that if, at any time, a special administration order were to be made in relation to it, the special administrator would be able to manage the affairs, business and property of the Appointee in accordance with the purposes of the special administration order.

P12 For the purposes of paragraph P11, the Appointee is not required to amend the terms of any legal obligation which has been transferred to it in accordance with a scheme made under Schedule 2 to the Water Industry Act 1991.

P13 Where rights and resources which are required to be made available pursuant to paragraph P11 are made available by a Group Company, the Appointee must ensure that if, at any time, a special administration order were to be made in relation to it, the rights and resources would be available to the special administrator for the purpose set out in paragraph P11.

Transfer pricing and Cross-Default Obligation

P14 In accordance with Regulatory Accounting Guideline 5 (Transfer Pricing in the Water and Sewerage Industry) published by Ofwat and revised from time to time, the Appointee must ensure that:

P14.1 every transaction between the Appointed Business and any Associated Company is at arm's length, so that neither the Appointed Business nor the Associated Company gives a cross-subsidy to the other; and

P14.2 the Appointed Business neither gives nor receives any cross-subsidy from any other business or activity of the Appointee.

P15 The Appointee must provide Ofwat with any information about the costs of an Associated Company which provides services to the Appointee which Ofwat reasonably requires.

P16 The Appointee must not, without the prior approval of Ofwat:

P16.1 give a guarantee in relation to any liability of an Associated Company;

P16.2 make a loan to an Associated Company; or

P16.3 enter into an agreement or other legal instrument incorporating a Cross-Default Obligation.

P17 The Appointee must not continue or permit to remain in effect an agreement or other legal instrument incorporating a Cross-Default Obligation unless:

P17.1 prior approval has been given by Ofwat; or

P17.2 the Cross-Default Obligation would only arise on a default by a subsidiary of the Appointee and the Appointee ensures that:

P17.2.1 the period for which the Cross-Default Obligation is in effect is not extended;

P17.2.2 liability under the Cross-Default Obligation is not increased; and

P17.2.3 no change is made to the circumstances in which liability under the Cross-Default Obligation may arise.

P18 The Appointee must not, without the consent of Ofwat, transfer to any Associated Company any right or asset to which paragraph P11 applies.

P19 In giving consent under P18, Ofwat may also give a direction to the Appointee on the valuation of the asset and the treatment of the consideration in respect of that asset in the Appointee's accounts.

Dividend policy

P20 The Appointee shall declare or pay dividends only in accordance with a dividend policy which has been approved by the Board of the Appointee and which complies with the following principles:

P20.1 the dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and

P20.2 under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk.

Ring-fencing statement and certificate

P21 No later than the date on which the Appointee is required to deliver to Ofwat a copy of each set of regulatory accounting statements prepared under Condition F, the Appointee must submit a Ring-fencing Certificate to Ofwat.

P22 Where the Board of the Appointee becomes aware of any activity of the Appointee or any Group Company which does not form part of the Regulated Activities, and which may be material in relation to the Appointee's ability to finance the Regulated Activities, the Appointee must:

P22.1 inform Ofwat; and

P22.2 within fourteen days of becoming aware of the activity, submit a new Ring-fencing Certificate to Ofwat.

P23 Where the Board of the Appointee becomes aware of any circumstances which would change its opinion such that it would not give the opinion contained in the Ring-fencing Certificate, the Appointee must inform Ofwat of this in writing.

P24 Whenever the Appointee submits a Ring-fencing Certificate to Ofwat, the Appointee must submit a statement of the main factors which the Board of the Appointee has taken into account in giving its opinion for the Ring-fencing Certificate.

P25 A Ring-fencing Certificate must be:

P25.1 signed by all directors of the Appointee on the date of submission; or

P25.2 approved at a meeting of the Board of the Appointee, convened in accordance with the Appointee's articles of association, in which case the Ring-fencing Certificate must:

P25.2.1 be signed by a director of the Appointee or the Appointee's company secretary; and

P25.2.2 have appended to it a certified copy of the minutes of the approval.

P26 Each Ring-fencing Certificate shall be accompanied by a report prepared by the Appointee's Auditors and addressed to Ofwat, stating whether they are aware of any inconsistencies between that Ring-fencing Certificate and either the statements referred to in condition F6.1 or any information which the Auditors obtained in the course of their work as the Appointee's Auditors and, if so, what they are.

Reporting of Material Issues

P27 Where the Board of the Appointee becomes aware of any circumstance that may materially affect the Appointee's ability to carry out the Regulated Activities the Appointee must inform Ofwat as soon as possible.

Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

June 2020

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