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www.ofwat.gov.uk

Louise Manfredi
Managing Director
Leep Utilities Limited
The Greenhouse
MediaCity
Salford
M50 2EQ

19 August 2020

Dear Louise,

Re. Determination pursuant to Condition P3.4

1 Introduction

- 1.1 Leep Networks (Water) Limited (“**LN(W)L**”) is the holder of an instrument of appointment granted under section 6 of the Water Industry Act 1991 (the “**Appointment**”). Words and expressions defined in the Appointment shall have the same meaning in this letter unless the context otherwise requires.
- 1.2 LN(W)L is a new appointee or “**NAV**” (which stands for ‘new appointment or variation’)¹. NAVs are limited companies which provide a water and/or sewerage service to customers in an area which previously fell within the area of appointment of the incumbent monopoly provider.
- 1.3 On 1 October 2020 a new **Condition P** becomes effective in LN(W)L’s Appointment. Condition P2 of the Appointment provides that LN(W)L must ensure that, at all times, there is an undertaking in place which is given by the Ultimate Controller of the Appointee in favour of the Appointee. Conditions P3 and P3.4 of the Appointment provide that LN(W)L must ensure that the person giving the undertaking must at all times make available to the Appointee such money as Ofwat determines in writing is necessary to enable LN(W)L to comply with its obligations under the Act or the conditions of the Appointment.

¹ <https://www.ofwat.gov.uk/regulated-companies/markets/nav-market/>

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1.4 The purpose of this letter is to record Ofwat's determination under Condition P3.4 of the Appointment (the "**Determination**") and to set out the conditions of that Determination.

1.5 The Determination provided in section 2 of this letter is made on the basis of the information provided by LN(W)L to Ofwat following its acquisition and Ofwat's assessment of the specific circumstances of LN(W)L as at the date of this letter. Accordingly, the Determination should not be taken to be a statement of Ofwat's policy in relation to any determination for other appointees.

2 Ofwat's Determination

2.1 Ofwat's current [standard policy for NAVs](#) requires a NAV to obtain 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)" (the "**Standard Calculation**"). The Standard Calculation 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 as the NAV's number of connections increase.

2.2 For the purposes of Condition P3.4 of the Appointment and subject to the conditions set out in paragraph 2.4 below, Ofwat determines that the person giving the undertaking must at all times make available to the Appointee the minimum level of financial security according to the formula set out in paragraph 2.3 below. Having considered all the information available to us we have agreed an alternative approach to the Standard Calculation with LN(W)L.

2.3 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 accounts². Financial security provided by LN(W)L to any incumbent

² Our understanding is that revenues are recognised by LN(W)L according to International Financial Reporting Standard 15 (IFRS15).

water company, i.e. a wholesaler, that provides it with a bulk supply of water or bulk sewerage services will be recognised³.

2.4 The Determination is subject to the following conditions:

2.4.1 That LN(W)L submit 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;

2.4.2 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.

2.4.3 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 the circumstances set out in this letter that, in the opinion of either LN(W)L or Ofwat, warrants a further Determination.

3 Reasons for Determination

3.1 LN(W)L told Ofwat that given its large number of sites and level of revenue, there is a strong likelihood that in the case of an adverse event, only a subset of 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

³ 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. So far 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.

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and Leep Water Networks including projections of the statement of financial position and the statement of profit and loss.

3.2 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.

3.3 On this basis, Ofwat considers that the Determination set out in section 2 is consistent with its statutory duties.

Yours sincerely,

Aileen Armstrong