

WATER INDUSTRY ACT 1991, SECTION 13(1)
MODIFICATION OF THE CONDITIONS OF APPOINTMENT OF
ANGLIAN WATER SERVICES LIMITED

Made on November 2007
Coming into effect on 8 November 2007

Conditions F and P in the Appointment of Anglian Water Services Limited are deleted and replaced with the following:

Condition F : Accounts and accounting information

1.1 *Introduction*

The purposes of this Condition are to ensure that:

- (1) the financial affairs of the Appointed Business can be assessed and reported on separately from other businesses and activities of the Appointee, as if its sole business consisted of being a water undertaker and/or sewerage undertaker having its equity share capital listed on the International Stock Exchange of United Kingdom and Republic of Ireland Ltd;
- (2) information on revenues, costs, assets and liabilities attributable to specified activities of the Appointed Business can be provided and reported on;
- (3) transactions between the Appointed Business and any other business or activity of the Appointee or any Associated Company can be assessed and reported on;
- (4) there is no cross-subsidy between the Appointed Business and any other business of the Appointee or between the Appointed Business and any Associated Company;
- (4A) the transfer of assets (including the provision of financial support) to Associated Companies does not adversely affect the Appointee's ability to carry out its functions as a water and sewerage undertaker or to finance those activities;
- (5) the Water Services Regulation Authority is furnished with regular accounting and other information to enable it to compare the financial position and performance (including, without limitation, costs) of the Appointed Business and of so much of the respective businesses and activities of all other undertakers holding appointments made under Chapter I of Part II of the Water Industry Act 1991 as consists of the carrying out of the Regulated Activities; and
- (6) the Appointee has at its disposal sufficient financial and managerial resources to carry out the Regulated Activities (including the investment programme necessary to fulfil its obligation under the Appointment(s)).

2. *Interpretation and Construction*

2.1 In this Condition and for the purposes of this Condition:

references to "**the Appointed Business**" shall be construed as if the Appointed Business included the management and holding by the Appointee of any protected land;

"infrastructure assets" means

- (1) Network Assets, as defined in paragraph 1 of Condition L; and
- (2) all of the following:
 - (a) valves and hydrants forming part of the water and trunk main systems;
 - (b) impounding and pumped raw water storage reservoirs;
 - (c) dams;
 - (d) sludge pipe lines; and
 - (e) outfall pipes and other pipes for the conveyance of effluent from any sewage disposal works of the Appointee which discharge directly into the sea or coastal waters;

"infrastructure renewals expenditure" means expenditure on maintaining or restoring the original operating capability, qualitative performance and condition of infrastructure assets, other than expenditure which is capitalised and routine day to day maintenance expenditure which is charged as an operating cost to the profit and loss account;

"Principal Services" means

- (1) water supply; and
- (2) sewerage services

and references to a Principal Service are to either and each of water supply and sewerage services;

"sewerage services" includes sewage treatment and disposal and reception, treatment and disposal of trade effluent.

2.2 Except where otherwise expressly provided, references in this Condition to costs or liabilities shall be construed as including taxation, and references to any profit and loss account shall be construed accordingly.

2.3 For the purposes of this Condition:

- (1) all forms of property shall be assets, whether situated in the United Kingdom or not, including:
 - (a) options, debts and incorporeal property generally; and
 - (b) any currency including sterling;
- (2) references to the supply of a service include references to anything (including the services of any employee) being made available; and
- (3) references to a transfer of an asset or liability include references to 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.

3. *Accounting Records*

The Appointee shall keep proper accounting records in a form which enables the revenues, costs, assets and liabilities of, or reasonably attributable to, the respective businesses and activities of the Appointee described in this Condition and the other matters mentioned in this Condition to be separately identified, having regard to the terms of any guidelines notified from time to time by the Water Services Regulation Authority to the Appointee under paragraph 5, 6, 7, or 8.

4. *Accounting Statements*

4.1 The Appointee shall prepare on a consistent basis in respect of each financial year ending after the transfer date accounting statements which shall comprise, and show separately in respect of each of:

- (1) the Appointed Business;
- (2) on an aggregated basis, all businesses and activities of the Appointee other than the Appointed Business; and
- (3) on an aggregated basis, all businesses and activities of the Appointee including the Appointed Business

a profit and loss account, a statement of assets and liabilities and a statement of source and application of funds, together with notes thereto, setting out the revenues, costs (including depreciation, where charged), assets and liabilities thereof, or reasonably attributable thereto.

4.2 Accounting statements prepared under sub-paragraph 4.1 shall:

- (1) so far as reasonably practicable having regard to the purposes of this Condition, have the same content as the annual accounts of the Appointee prepared under the 1985 Act and be prepared in accordance with the formats and the accounting policies and principles which apply to those accounts; and
- (2) state the principal accounting policies applied.

5. *Segmental Information*

5.1 Accounting statements prepared under paragraph 4 shall show or disclose separately:

- (1) an analysis of total operating costs (excluding interest and taxation) of the Appointed Business showing separately for each Principal Service:
 - (a) manpower costs;
 - (b) other costs of employment;
 - (c) power;
 - (d) local authority rates;
 - (e) water charges (including abstraction charges and amounts payable for taking supplies of water in bulk);
 - (f) local authority sewerage agencies;
 - (g) materials and consumables;
 - (h) hired and contracted services;
 - (i) charges for bad and doubtful debts;
 - (j) depreciation and amortisation (where charged);
 - (k) intangible assets written off;
 - (l) infrastructure renewals expenditure;
 - (m) exceptional items; and
 - (n) on an aggregated basis, all other operating costs.

The analysis shall include the details reasonably necessary to reconcile the operating costs shown in it with the total operating costs (excluding interest and taxation) of the Appointee shown in the accounting statements prepared under paragraph 4 in respect of the same period;

- (2) an analysis of total turnover of the Appointed Business showing separately turnover attributable to:
 - (a) water supply and, separately on an aggregated basis, sewerage and sewage treatment and disposal (excluding reception, treatment and disposal of trade effluent), distinguishing in each case between the provision of those services on a measured and unmeasured basis respectively;

- (b) on an aggregated basis, reception, treatment and disposal of trade effluent;
 - (c) grants; and
 - (d) on an aggregated basis, all other sources;
- (3) an analysis of total tangible fixed assets attributable to the Appointed Business showing separately:
- (a) for each of the items included in the annual accounts of the Appointee prepared under the 1985 Act required to be disclosed under Section B of Part I of Schedule 4 to the 1985 Act; or
 - (b) for each of the items included in such other analysis of tangible fixed assets by asset type as is disclosed in those annual accounts; and
 - (c) if not separately disclosed in those annual accounts, for infrastructure assets

amounts attributable to each Principal Service, and, as a separate category, on an aggregated basis tangible fixed assets which are not attributable to either Principal Service.

The analysis shall include:

- (i) the details reasonably necessary to reconcile the tangible fixed assets shown in it with the tangible fixed assets shown in the analysis prepared under this sub-paragraph 5.1(3) in respect of the immediately preceding financial year (including details of grants);
 - (ii) a statement of any assets which have been re-classified as current assets during the relevant financial year; and
 - (iii) to the extent that information is required to be given in respect of any of the items included in the annual accounts of the Appointee prepared under the 1985 Act referred to in this sub-paragraph 5.1(3) by virtue of Part III of Schedule 4 to the 1985 Act, the same information in respect of those items. In the case of the first analysis prepared under this sub-paragraph 5.1(3) the reconciliation required to be included under (i) above shall be with the analysis prepared by the Water Authority in respect of the financial year ended last before the transfer date; and
- (4) details necessary to reconcile expenditure made or incurred in relation to infrastructure assets with the expenditure made or incurred in relation to Network Assets during the same financial year as shown in the statement required to be delivered to the Water Services Regulation Authority under sub-paragraph 5.3 of Condition L.

5.2 Accounting statements prepared under paragraph 4 shall show separately for each item relating to sewerage services included in the analyses under sub-paragraphs 5.1(1) (operating costs) and 5.1(3) (tangible fixed assets) an analysis between amounts which are attributable to sewerage (including reception of trade effluent) and sewage treatment and disposal (including treatment and disposal of trade effluent).

5.3 The Water Services Regulation Authority may, after consulting with such bodies as are reasonably representative of undertakers holding appointments made under Chapter 1 of Part II of the Water Industry Act 1991 or, if none, the Appointee, from time to time by reasonable notice to the Appointee specify in such guidelines as are reasonable and appropriate for the purpose set out in sub-paragraph 1.1(5), variations of:

- (1) the matters required to be shown or disclosed under sub-paragraph 5.1(1) (but not so as to require separate analyses of matters comprised within any of the items listed in that sub-paragraph); and
- (2) the items in respect of which the analysis of total fixed assets is to be prepared under sub-paragraph 5.1(3)

and thereafter the Appointee shall show or disclose information under sub-paragraph 5.1(1) in respect of those matters or, as the case may be, shall prepare the analysis under sub-paragraph 5.1(3) in respect of those items, in each case as so varied from time to time.

6. *Transactions entered into by the Appointee or the Appointed Business with or for the benefit of Associated Companies or other businesses or activities of the Appointee*

6.1 The Appointee shall ensure that every transaction between the Appointed Business and any Associated Company (or between the Appointed Business and any other business or activity of the Appointee) is at arm's length, so that neither gives to nor receives from the other any cross-subsidy.

6.2 Subject to sub-paragraphs 6.3 to 6.7, accounting statements prepared under paragraph 4 shall disclose in relation to each transaction of a description specified in the first column of the Appendix to this Condition which took place during the financial year to which those statements relate, the company or, as the case may be, the business or activity which was party to the transaction with the Appointee or, as the case may be, the Appointed Business or which otherwise benefited from the transaction and the information in relation to that transaction specified in the second column of that Appendix.

6.3 Subject to sub-paragraph 6.4, any amount required to be disclosed in relation to a transaction specified in paragraph 3, 4, 5, or 6 of the Appendix may be aggregated with any amount relating to any other transaction falling within the same paragraph with the same company or other business or activity of the Appointee.

6.4 Subject to sub-paragraph 6.7, if the amount to be disclosed under sub-paragraph 6.2 in respect of any single transaction between the Appointee and any Associated Company (or between the Appointed Business and any other

business or activity of the Appointee) exceeds 0.5% of the turnover of the Appointed Business, or £100,000, whichever is the greater, then that transaction shall not be aggregated under sub-paragraph 6.3 and the Appointee shall include in any accounting statement prepared under paragraph 4 the information about that transaction which is specified in the Appendix in relation to a transaction of that kind and which complies with any guidelines issued by the Water Services Regulation Authority for this purpose.

- 6.5 The Appointee shall, when submitting accounting statements prepared under paragraph 4 to the Water Services Regulation Authority, report to it the turnover of any Associated Company with which the Appointed Business has undertaken any transaction of any kind specified in the Appendix.
- 6.6 Nothing in sub-paragraph 6.2 shall require the disclosure of any information if the aggregate of any amounts required to be disclosed under paragraphs 3, 4, 5 and 6 of the Appendix relating to transactions with the same company or other business or activity of the Appointee is not material to the Appointed Business as a whole. For the avoidance of doubt, if the aggregate of such amounts is material to the Appointed Business as a whole then information shall be disclosed in accordance with this paragraph 6 and the Appendix in relation to each such transaction (subject always to sub-paragraph 6.3). For the purpose of this sub-paragraph 6.6 the question whether an amount is material to the Appointed Business as a whole shall be determined by the Auditors by reference to whichever is the greater of:
- (1) The book value of the asset or liability the subject of, or affected by, the transaction; and
 - (2) The consideration or other charge given, paid or waived.
- 6.7 Nothing in this paragraph 6 or the Appendix shall require the disclosure of information which relates solely to a transaction wholly unconnected with the Appointed Business.
- 6.8 The Appointee shall not, in respect of any Charging Year, make any payments to any Associated Company in respect of the services rendered to the Appointee by that company, which exceeds:
- (i) such prices in respect of the service in question which the Appointee has ascertained by market testing in accordance with such arrangements as the Water Services Regulation Authority may have approved for the purpose of this paragraph 6 and as set out in Regulatory Accounting Guideline 5 (Transfer Pricing in the Water and Sewerage Industry) or any revision or modification of it for the time being in force, provided that those arrangements have no prejudicial effect upon the proper carrying out of the Appointee's functions or any of them; or
 - (ii) if, in the opinion of the Water Services Regulation Authority, the Appointee has demonstrated that market testing as described in (i) above is inappropriate, such proportion as the Water Services Regulation Authority may agree of the Associated Company's costs in providing to the Appointee the service in question (including a reasonable return to the Associated Company).

- 6.9 Without prejudice to sub-paragraphs 6.1 to 6.7 above, the Appointee shall obtain from any Associated Company referred to in sub-paragraph 6.8, such information about the latter's costs as the Water Services Regulation Authority may reasonably require.
- 6.10 The Appointee shall not, without the consent of the Water Services Regulation Authority and otherwise than in compliance with his directions concerning the valuation of the asset and the treatment of the consideration in the Appointee's accounts, transfer to any Associated Company to which sub-paragraph 6.8 applies any right or asset to which paragraph 3 of Condition K of these Conditions applies.
- 6.11(1) The Appointee shall not, without the consent of the Water Services Regulation Authority
- (i) give any guarantee of any liability of any Associated Company; or
 - (ii) make to any such company any loan.
- 6.11(1A) The Appointee shall not, without the consent of the Water Services Regulation Authority,
- (i) enter into an agreement or incur a commitment incorporating a cross-default obligation, or
 - (ii) subject to sub-paragraph 6.11(1B) below, continue or permit to remain in effect any agreement or commitment incorporating a cross-default obligation.
- 6.11(1B) Where liability under the cross-default obligation would arise only on a default by a subsidiary company of the Appointee, the Appointee may permit that cross-default obligation to remain in effect for the period for which it was fixed by the instrument which created it, so long as its potential liability is not increased and no changes are made in the terms under which that liability might arise.
- 6.11(2) For the purposes of this sub-paragraph 6.11
- (a) "**liability**" includes the creation of any mortgage, charge, pledge, lien or other form of security or encumbrance, the making of any loan and the undertaking of any other indebtedness;
 - (b) "**loan**" includes the transfer or lending, by any means, of any sum of money or of any rights of that sum; and
 - (c) "**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.
- 6.12 Without prejudice to the application of sub-paragraph 6.2 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 –

- (i) the dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and
- (ii) under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk.

Ring-Fencing

6A.1 The Appointee shall at all times act in the manner best calculated to ensure that it has adequate:

- (a) financial resources and facilities;
- (b) management resources; and
- (c) systems of planning and internal control

to enable it to secure the carrying out of the Regulated Activities including the investment programme necessary to fulfil its obligations under the Appointment(s). The above requirements must not be dependent upon the discharge by any other person of any obligation under, or arising from, any agreement or arrangement under which that other person has agreed to provide any services to the Appointee in its capacity as a Relevant Undertaker.

6A.1(1A) For the purposes of sub-paragraph 6A.1(1)(c) above, the Appointee shall ensure that its systems of planning and internal control comply with such guidance as the Water Services Regulation Authority may, from time to time, specify in writing for the purposes of this Condition.

6A.1(1B) Paragraph 10 in this Condition F (Guidelines and references to the Competition Commission) shall apply to the guidance referred to in sub-paragraph 6A.1(1A) above, as it applies to the guidelines mentioned in sub-paragraph 10.1.

6A.2A. The Appointee shall, at the same time as it complies with sub-paragraph 9.3 (submission of Accounting Statements) submit to the Water Services Regulation Authority a Certificate in the following terms:

- “(1) that in the opinion of the Directors, the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee’s obligations under the Appointment(s));
- (2) that in the opinion of the Directors the Appointee will, for at least the next 12 months, have available to it –
 - (a) management resources; and
 - (b) methods of planning and internal control

which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1(1) above; and

- (3) that in the opinion of the Directors, all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.”

6A.2B(1) The Appointee shall, when it complies with sub-paragraph 6A.2A, submit with each Certificate a statement of the main factors which the directors have taken into account in giving that Certificate.

6A.2B(2) Without prejudice to sub-paragraph 6A.3 below, the Directors shall inform the Water Services Regulation Authority in writing as soon as they become aware of any circumstances which causes them to believe that the most recent Certificate under sub-paragraph 6A.2A could not be repeated in the light of that circumstance.

6A.3 (1) Whenever the Directors become aware that the Appointee or any Group Company is proposing to embark upon any activity which is not one of those described in sub- paragraph 6A.1 and which may be material in relation to the Appointee's ability to finance the carrying out of the functions mentioned in that sub-paragraph, they shall as soon as practicable, having regard to the purposes of this Condition, notify the Water Services Regulation Authority about that proposal.

6A.3(2) Not later than 14 days after the Directors become aware that the Appointee or any group Company has embarked upon any activity to which sub-paragraph 6A.3(1) applies, they shall submit to the Water Services Regulation Authority a Certificate in the terms specified in sub-paragraph 6A.2(A).

6A.4(1) Each Certificate under sub-paragraph 6A.2A, 6A.2B or 6A.3 shall be either –

- (a) signed by the Directors of the Appointee for the time being; or
- (b) approved by a duly-convened meeting of the board of Directors of the Appointee for the time being, signed (in confirmation of that approval) by a Director or the Secretary of the Appointee and have attached to it a certified copy of an extract of the minutes of the relevant meeting containing the resolution to approve it.

6A.4(2) Each Certificate under sub-paragraph 6A.2A, shall be accompanied by a report prepared by the Appointee's Auditors and addressed to the Water Services Regulation Authority, stating whether they are aware of any inconsistencies between that certificate and either the statements referred to in sub-paragraph 9.3 or any information which the Auditors obtained in the course of their work as the Appointee's Auditors and, if so, what they are.

6A.4(3) Each Certificate under sub-paragraph 6A.2A(2) shall be accompanied by a report prepared by the Appointee's Reporter and addressed to the Water Services Regulation Authority, setting out the Reporter's opinion about the extent to which the Appointee has, during the preceding 12 months complied with its obligation in sub-paragraphs 6A.1(1)(c) and 6A.1(1A)..

6A.5A 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:-

- a) the composition of the Board of the Appointee should be such that the directors, acting as such, are able to act independently of the parent company or controlling shareholder and exclusively in the interests of the Appointee;
- b) the Appointee must ensure that each of its Directors must disclose, to the Appointee and the Water Services Regulation Authority, conflicts between duties of the Directors as Directors of the Appointee and other duties;
- c) 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;
- d) no Director of the Appointee should vote on any contract or arrangement in which he has an interest by virtue of other directorships. This arrangement should be reflected in the Articles of Association of the Appointee;
- e) the Appointee should inform the Water Services Regulation Authority without delay when:
 - (i) a new Director is appointed;
 - (ii) the resignation or removal of a Director takes effect; or
 - (iii) any important change in the functions or executive responsibilities of a Director occurs.

The Appointee should notify the Water Services Regulation Authority 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;

- f) the dividend policy adopted by the Appointee and the implications of sub-paragraph 6.12 of this Condition F; and
- g) 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 Services Authority.

- 6A.5B The Appointee shall, at such times and in such ways as may from time to time be required by the Listing Rules of the Financial Services Authority, publish such information about its annual interim and final results as is by those rules required to be announced by a company whose shares are for the time being listed on the London Stock Exchange.
- 6A.5C(1) Subject to sub-paragraph 6A.5C(2) below, the Appointee shall maintain the listing of a financial instrument and shall use all reasonable endeavours to retain that financial instrument, whose market price should react to the financial position of the Appointee's Appointed business, on the London Stock Exchange, or with the prior agreement of the Water Services Regulation Authority, some other exchange of similar standing.
- 6A.5C(2) The obligation in sub-paragraph 6A.5C(1) applies unless the Appointee satisfies the Water Services Regulation Authority that market conditions make it inappropriate for the Appointee to maintain such a financial instrument.
- 6A.6(1) The Appointee shall use all reasonable endeavours to ensure that it, or any Associated Company as an Issuer of corporate debt on its behalf, maintains at all times an issuer credit rating which is an Investment grade rating.
- 6A.6(2) In this Condition:
- “Investment grade rating”** means a rating recognised as investment grade by Standard and Poor’s Rating Group (or any of its subsidiaries), by Moody’s Investors Services Incorporated (or any of its subsidiaries) or by Fitch Ratings Limited, or any other reputable credit rating agency which has comparable standing in the United Kingdom and the United States of America,
- “Issuer credit rating”** means a credit rating assigned to an issuer of corporate debt by Standard and Poor’s Rating Group (or any of its subsidiaries), by Moody’s Investors Services Incorporated (or any of its subsidiaries) or by Fitch Ratings Limited, or any other reputable credit rating agency which has comparable standing in the United Kingdom and the United States of America.
- 6A.7(1) Except with the prior consent of the Water Services Regulation Authority, the Appointee shall not transfer, lease, license or lend any sum or sums, asset, right or benefit to any Associated Company of the Appointee if:
- (a) the Appointee does not hold an Issuer credit rating that is an Investment grade rating;
 - (b) where the Appointee holds more than one Issuer credit rating, one or more of the ratings so held is not an Investment grade rating; or
 - (c) any Issuer credit rating held by the Appointee is BBB- by Standard & Poor’s Ratings Group or Fitch Ratings Ltd or Baa3 by Moody’s Investors Service, Inc. (or such higher Issuer credit rating as may be specified by any of these credit rating agencies from time to time as the lowest Investment grade rating), or is an equivalent rating from another credit rating agency that has been notified to the Appointee by the Water Services Regulation Authority as of comparable standing for the purposes of sub-paragraph 6A.6(1).and:

- (i) is on review for possible downgrade; or
 - (ii) is on "Credit Watch" or "Rating Watch" with a negative designation;
- or, where neither (i) nor (ii) applies:
- (iii) the rating outlook of the Appointee as specified by any credit rating agency referred to in sub-paragraph (c) above which at the relevant time has assigned the lower or lowest Issuer credit rating that is an Investment grade rating held by the Appointee has been changed from stable or positive to negative.

6A.7(2) Where any of sub-paragraphs F6A.7(1)(a), (b) or (c) apply the exceptions are:

- (a) payment properly due for any goods, services or assets in relation to commitments entered into prior to the date on which the circumstances described in sub-paragraph 6A.7(1) arise, and which are provided on an arm's length basis and on normal commercial terms;
- (b) a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis, on normal commercial terms and where the value of the consideration due in respect of the transaction in question is payable wholly in cash and is paid in full when the transaction is entered into. For the avoidance of doubt this exception does not include a dividend or other distribution out of distributable reserves or a repayment of capital;
- (c) repayment of, or payment of interest on, or payments to an Appointee's financing subsidiary of any fees, costs and other amounts arising under:
 - (i) a loan made between the Appointee and the Appointee's financing subsidiary, for so long as the Appointee's financing subsidiary continues to be an Associated Company of the Appointee; or
 - (ii) a loan not prohibited under other provisions of these Conditions and which was contracted prior to the date on which the circumstances in sub-paragraph 6A.7(1) arise, provided that payment in respect of such loan is not made earlier than the original due date for payment in accordance with its terms; and
- (d) payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received, provided that the payments are not made before the date on which the amounts of tax thereby relieved would otherwise have been due.

6A.7(3) For the purposes of sub-paragraph 6A.7(2)(c) a financing subsidiary is a subsidiary of the Appointee which is wholly owned by the Appointee and is dedicated solely to raising finance on behalf of, and on lent to the Appointee for the purposes of the Appointee's Regulated Activities and this is reflected in the Articles of Association of the financing subsidiary.

7. *Basis of allocations and apportionments*

7.1 The analyses of operating costs and tangible fixed assets prepared under sub-paragraphs 5.1(1), 5.1(3) and 5.2 shall give a description of the bases of any apportionments or allocations of costs and assets and shall be prepared in accordance with any guidelines which may be issued from time to time by the Water Services Regulation Authority under sub-paragraph 7.3.

7.2 Accounting statements prepared under paragraph 4 and, where relevant, the description of transactions prepared under paragraph 6 shall:

- (1) describe the basis of any apportionment or allocation of revenues, costs, assets and liabilities between the Appointed Business and any other business or activity of the Appointee or between the Appointee and any Associated Company;
- (2) specify the nature of the revenues, costs, assets or liabilities which have been so apportioned or allocated; and
- (3) specify between which business, activity or Associated Company the revenues, costs, assets or liabilities have been so apportioned or allocated.

7.3 The Water Services Regulation Authority may, after consulting such bodies as are reasonably representative of undertakers holding appointments made under Chapter I of Part II of the Water Industry Act 1991, or, if none, the Appointee, from time to time by reasonable notice to the Appointee issue such guidelines as are reasonable and appropriate for the purpose set out in sub-paragraph 1(5) as to the bases of allocations and apportionments to be adopted in preparing the analyses required under sub-paragraphs 1.5.1(1), 5.1(3) and 5.2 and in making the allocations and apportionments referred to in sub-paragraph 7.2(1) and thereafter the Appointee shall prepare the analyses and make the allocations and apportionments in accordance with such guidelines as may apply from time to time.

8. *Current Cost Accounting Statements*

8.1 In addition to preparing accounting statements under paragraph 4, the Appointee shall prepare accounting statements on the current cost basis in respect of the same period in accordance with such guidelines as are reasonable and appropriate for the purposes of this Condition as the Water Services Regulation Authority may from time to time, after consulting with such bodies as are reasonably representative of undertakers holding appointments made under Chapter I of Part II of the Water Industry Act 1991 or, if none, the Appointee, notify to the Appointee for the purposes of this paragraph 8.

8.2 Guidelines notified by the Water Services Regulation Authority to the Appointee under sub-paragraph 8.1 may:

- (1) specify the form and content of current cost accounting statements, including information on specified types of revenue, cost, asset or liability and information on the revenues, costs, assets and liabilities attributable to specified activities, provided that the guidelines may not require the Appointee to disclose information in such current cost accounting statements in respect of items in respect of which the Appointee is not required to give information in accounting statements prepared under paragraph 4 from time to time;
- (2) require any reconciliation that may be required with the annual accounts of the Appointee prepared under the 1985 Act;
- (3) specify the accounting principles and the bases of valuation to be used in preparing current cost accounting statements; and
- (4) specify the nature of the report by the Auditors required to be given in respect of accounting statements.

9. *Audit and publication of accounting statements*

9.1 The Appointee shall procure the following reports by the Auditors addressed to the Water Services Regulation Authority:

- (1) in respect of each set of accounting statements prepared under this Condition, a report stating whether in their opinion:
 - (a) proper accounting records have been kept by the Appointee as required by paragraph 3; and
 - (b) that set of accounting statements (including the information required to be shown or disclosed under paragraphs 5, 6 and 7) is in agreement with the Appointee's accounting records and complies with the relevant paragraphs (including any relevant guidelines) or, in the case of accounting statements prepared under paragraph 8, complies with the relevant guidelines;
- (2) in respect of each set of accounting statements prepared under paragraph 4, a report stating whether in their opinion that set of accounting statements represents a true and fair view of the revenues, costs, assets and liabilities of, or reasonably attributable to, the businesses and activities mentioned in paragraph 4; and
- (3) in respect of each set of accounting statements prepared under paragraph 8, a statement of opinion as to such other matters as may be specified in the guidelines applying to those accounting statements.

- 9.2 The Appointee shall enter into a contract of appointment with the Auditors which shall include a term that the Auditors will provide such further explanation or clarification of their reports, and such further Information in respect of the matters which are the subject of their reports, as the Water Services regulation Authority may reasonably require.
- 9.3 The Appointee shall deliver to the Water Services regulation Authority a copy of each set of accounting statements prepared under this Condition and of each report referred to in sub-paragraph 9.1 as soon as reasonably practicable and in any event not later than 15th July following the end of the financial year to which they relate.
- 9.4 Accounting statements prepared under this Condition (excluding the information required to be disclosed under sub-paragraphs 5.1(4) and 5.2, paragraph 6 and sub-paragraphs 7.1 and 7.2 and any information exempted from this sub-paragraph 9.4 from time to time by the Water Services regulation Authority by notice to the Appointee), together with the Auditors' reports delivered to the Water Services regulation Authority under sub-paragraph 9.3 in respect of those accounting statements (but excluding any part of any such report to the extent that it relates specifically to any information excluded or exempted from this sub-paragraph 9.4 as aforesaid), shall be published with the annual accounts of the Appointee prepared under the 1985 Act or, at the Appointee's option, with the annual accounts of its holding company prepared under the 1985 Act and copies thereof made available upon request to customers.
10. *Guidelines and references to the Competition Commission*
- 10.1 The Appointee may, by notice given to the Water Services Regulation Authority within 1 month of the date of any such notice or notification as is referred to in paragraphs 5, 6, 7 and 8, require the Water Services Regulation Authority to refer to the Competition Commission for determination by it the question whether the guidelines the subject of the relevant notice or notification are appropriate and reasonable for the purposes specified in the relevant paragraph.
- 10.2 Where the Appointee requires the Water Services regulation Authority to make a reference to the Competition Commission under sub-paragraph 10.1 any guidelines issued by the Water Services Regulation Authority which are the subject of that reference shall not apply unless and until the Competition Commission determines that they shall apply.

APPENDIX

COLUMN 1	COLUMN 2
<p>1 Any borrowings or sums lent:</p> <p>(a) by or to the Appointed Business to or by any other business or activity of the Appointee; or</p> <p>(b) by or to the Appointee to or by any Associated Company.</p>	<p>1. The principal of the amount borrowed or lent, the date on which or the dates between which repayment is to be made and the rate of interest payable.</p>
<p>1A Any dividend paid to any Associated Company.</p>	<p>1A The basis on which the dividend has been established.</p>
<p>2. The giving of any guarantee or any other form of security by the Appointee for or in respect of any obligations of any Associated Company.</p>	<p>2. The form of the guarantee or other security given, the assets, the subject of the security, the amount of the obligation (including where relevant the rate of interest payable) and the date of maturity of the obligation.</p>
<p>3. The transfer of any asset or liability:</p> <p>(a) to or by the Appointee by or to an Associated Company; or</p> <p>(b) to or by the Appointed Business by or to any other business or activity of the Appointee.</p>	<p>3. The asset or liability the subject of the transfer, the amount of the consideration for the transfer and the value attributed to the asset or liability in the accounting records kept by the Appointee.</p>
<p>4. The supply of any service by or to the Appointee to or by an Associated Company or by or to the Appointed Business to or by any other business or activity of the Appointee.</p>	<p>4. The nature of the service supplied, the terms on which it was supplied and the total charge made for the service.</p>
<p>5 The omission by the Appointee or any Associated Company to exercise a right as a result of which the value* of the aggregate assets less the aggregate liabilities ("net assets") of the Appointee is decreased.</p>	<p>5. The company omitting to exercise the right and the amount by which the value* of the net assets of the Appointee is decreased.</p>
<p>6. The waiver by the Appointee or the Appointed Business of any consideration, remuneration or other payment owed to it by any Associated Company or other business or activity of the Appointee.</p>	<p>6. The amount of the consideration, remuneration or payment waived.</p>

*For this purpose the value shall be taken to be the value attributed to the relevant items in the accounting records kept by the Appointee or, in the case of an interest in land or buildings which is affected by the omission, the open market value of that interest or, where under Condition K a certificate as to the best price of that interest has been furnished to the Water Services Regulation Authority, that best price.

PROCUREMENT OF SERVICES

Condition F1: Procurement of Services

Purpose

1. This condition is required to ensure that the Appointee achieves effective and fair competitive tendering of whatever services it may, from time to time, decide not to provide for itself in the performance of the Regulated Activities. If, when this condition comes into effect, any relevant service is already being performed by a third party then, unless the contract for it was the result of competitive tendering, that service must be either put to tender or brought in-house.

Obligations

2. All procurement of services by the Appointee must comply with the law – especially the Transfer of Undertakings (Protection of Employment) Regulations 1981, the Utilities Contracts Regulations 1996 and the Competition Act 1998.
3. The Appointee's procurement of the services must be such as to ensure, as far as possible, that no existing contractor has any competitive advantage over other prospective contractors.
4. The Appointee's procurement of services must –
 - (a) facilitate the development of a fully competitive market for the provision of out sourced services necessary for the discharge of its functions as a water and a sewerage undertaker;
 - (b) demonstrate that it retains full control of all its assets, and its ability at all times to discharge its functions as a water and a sewerage undertaker (including those occasions when a contractor's performance is in breach of its contractual obligations, or a change of contractor is required for any reason); and
 - (c) ensure that its contractors will give to the Appointee all such information as may be necessary to enable the Appointee to comply with the requirements of the conditions of the Appointments.
- 5(1) The Appointee shall submit to the Water Services Regulation Authority, not later than 31 December 2002, a Procurement Plan covering in detail at least the following three financial years. Thereafter the Appointee shall submit no less frequently than every 18 months a revised and updated Procurement Plan. The Procurement Plan shall set out how the Appointee intends to comply with the primary obligations in paragraphs 2 to 4 of this Condition during the following three financial years.
- 5(2) Without prejudice to the second sentence in sub-paragraph 5(1) above the Water Services Regulation Authority may at any time require the Appointee to submit a revised Procurement Plan if, following any reports submitted under paragraphs 7, 9 or 12 below, it appears to him that the Appointee's performance of its obligations in paragraphs 2 to 4 above is unsatisfactory.

6. The Procurement Plan shall include the following:
 - 6(1) an explanation of the Regulated Activities to which the plan relates;
 - 6(2) an assessment of the current contestability of market(s) associated with each of those activities, as they may be performed in different parts of its Water Supply Area or, as the case may be, its Sewerage Service Area;
 - 6(3) an explanation of the number, mix and type of contracts which are currently let or proposed to be let under the plan, which must be clearly linked to and consistent with the assessment required under 6(2);
 - 6(4) details of the procurement process(es), terms and conditions of contract. These must be supported by an explanation of how the Appointee intends to ensure that it retains proper and effective control over the prospective contractor's operations. Particular attention must be paid to the regulatory requirements relating to the quality of drinking water (and associated matters), the protection of the environment, the provision of proper service to its customers and conformity with the guidance of the Water Services Regulation Authority;
 - 6(5) details of how the Appointee will ensure that its assets, which are to be operated by any contractor will be properly maintained to deliver stable or improving serviceability to customers.
7. The Reporter shall submit to the Water Services Regulation Authority at the same time as the Appointee submits the Procurement Plan to the Water Services Regulation Authority a report assessing the viability and completeness of the Procurement Plan in light of the purpose and general provisions of this condition.
8. The Appointee will, at the request of any person or body, supply them with a copy of the current Procurement Plan and a summary of the report on the Plan prepared by the Reporter under clause 7.
9. At the same time as the Appointee submits its Accounting Statements, and at other such times as the Water Services Regulation Authority may require, it must submit to the Water Services Regulation Authority a written report on its procurement activities.
10. The report required in paragraph 9 shall set out the extent of the Appointee's compliance with the Procurement Plan, together with a full schedule of the number and content of the contracts let or activities that have been brought in-house.
11. In all cases of non-compliance with the Procurement Plan the report must set out a full explanation of the reasons and of the measures taken or proposed, to remedy it.
12. Each report submitted under paragraph 9 to the Water Services Regulation Authority shall be reviewed by the Appointee's Reporter, who shall submit his or her written assessment to the Water Services Regulation Authority, copied to the Appointee.
13. The Appointee must co-operate with the Reporter to enable him or her to carry out the activities required of the Reporter under this condition.
14. The Appointee will not either –

- (i) make any arrangement (whether contractual or otherwise) whose effect (actual or intended) is that responsibility for its functions as a Relevant Undertaker is (or may be) whether wholly or in part, transferred or delegated to any other person; or
- (ii) if it is prosecuted for any alleged offence contrary to any provision in the Water Industry Act 1991, or the Water Resources Act 1991 or any regulations made thereunder, which is alleged to have been committed in relation to any of its functions as the Appointee whose performance was, at the relevant time, covered by any contract, agreement or arrangement with any other person, raise any defence of due diligence such as that in s.70(3)(b) of the Water Industry Act 1991 (or any provision to similar effect) solely on the grounds that responsibility for compliance rested with that other person by virtue of that contract, agreement or arrangement.

Condition P: The role of the Appointee's Ultimate Controller and UK holding company

- 1(1) The Appointee shall, not later than the effective date of this modification (or, in the event of a subsequent change of control of the Appointee, the date on which each such change of control takes effect), procure from the Ultimate Controller of the Appointee and, when the Ultimate Controller is not the UK holding company, procure from the UK holding company of the Appointee, legally enforceable undertakings in favour of the Appointee in a form specified by the Water Services Regulation Authority and expressed to remain in force for as long as the Appointee retains the Appointment.
- 1(2) The undertakings referred to in paragraph (1) above shall provide that:
 - (a) those persons providing the undertakings will, and will procure that each of their subsidiaries (other than the Appointee and its subsidiaries) will, give to the Appointee all such information as may be necessary to enable the Appointee to comply with its obligations under the Act or the conditions of the Appointment;
 - (b) those persons providing the undertakings will, and will procure that each of their subsidiaries (other than the Appointee and its subsidiaries) will, refrain from any action which would or may cause the Appointee to breach any of its obligations under the Act or the conditions of the Appointment; and
 - (c) those persons providing the undertakings will ensure that at all times the Board of the Appointee contains not less than three 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 Appointment and an understanding of the interests of the customers of the Appointee and how these can be respected and protected.
2. The Appointee shall, not later than the date referred to in paragraph 1(1) above, produce to the Water Services Regulation Authority the original of each of the undertakings given to it in accordance with paragraph 1 of this Condition and provide to it such certified copies of those undertakings as the Water Services Regulation Authority may require.
3. The Appointee shall immediately inform the Water Services Regulation Authority in writing if it becomes aware that any one of the undertakings referred to in paragraph 1 of this Condition has ceased to be legally enforceable or that there has been any breach of its terms.
4. The Appointee shall not, except with the written consent of the Water Services Regulation Authority, enter (directly or indirectly) into any contract or arrangement with the Ultimate Controller of the Appointee (or the UK holding company of the Appointee as the case may be) or any Associated Company (other than subsidiaries of the Appointee) at a time when:
 - (i) any one of the undertakings complying with paragraph 1 of this Condition does not subsist; or
 - (ii) there is an unremedied breach of any one of those undertakings.

5. For the purposes of this Condition P, “Ultimate Controller” means any person who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of the Water Services Regulation Authority) 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.
6. For the purposes of this Condition P “person” includes, without limitation, a corporate body.

**Signed for and on behalf of the
Water Services Regulation Authority**

**Regina Finn
Chief Executive**