

WATER INDUSTRY ACT 1991, SECTION 13 - PROPOSALS BY THE WATER SERVICES REGULATION AUTHORITY (OFWAT) TO MODIFY THE CONDITIONS OF APPOINTMENT OF SUTTON AND EAST SURREY WATER PLC AS A WATER UNDERTAKER

THE PROCESS

This Notice seeks views on the proposed modifications described below. Any representations or objections can be sent in writing to Emma Cochrane, Head of Corporate Finance, Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA (fax 0121-625 3609 or e-mail emma.cochrane@ofwat.gsi.gov.uk) and should be received no later than 5.00pm on 28 September 2007.

DESCRIPTION OF AND REASONS FOR THE PROPOSED MODIFICATION

On 5 January 2007 Deutsche Bank AG (Deutsche) completed the syndication of its stake in Aqueduct Capital (UK) Limited (ACUK). ACUK is the parent company of East Surrey Holdings Limited and the UK holding company of Sutton and East Surrey Water plc (SES). SES is an appointed water undertaker regulated by Ofwat.

We issued a consultation document in May 2007 in which we invited views on:

- the capacity of ACUK and its investors to be the owner of a regulated water company;
- which entity or entities should provide an ultimate controller undertaking to SES under Condition P of its Instrument of Appointment (its 'Appointment'); and,
- whether the ring fencing conditions included in SES's Appointment are adequate or whether further conditions are required, in addition to the cash lock up provision to ensure the regulated company remains appropriately ring fenced within the wider group.

In August 2007 we issued a position paper¹ in which we concluded on these issues and said we would amend SES's Appointment to include the cash lock up provisions as described below.

¹ The syndication of Deutsche Bank's ownership of Aqueduct Capital (UK) Limited and its impact on Sutton and East Surrey Water plc, a position note by Ofwat, August 2007. [http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/PosPaper_synd_deutschebank_160807.pdf/\\$FILE/PosPaper_synd_deutschebank_160807.pdf](http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/PosPaper_synd_deutschebank_160807.pdf/$FILE/PosPaper_synd_deutschebank_160807.pdf)

CASH LOCK UP APPOINTMENT PROVISIONS

Following consideration of responses to the Financing Networks discussion paper², we concluded in MD218³ that it is appropriate that water companies' licences should be amended to include cash lock-up provisions similar to those already applied to energy companies. The new provisions make explicit the steps the regulator requires of the regulated company in order that the financial viability of the regulated company is preserved if its investment grade credit quality is threatened.

We stated that we would seek to introduce cash lock-up provisions into companies' Conditions of Appointment as and when suitable circumstances arise. The change of ownership of SES through the syndication of Deutsche's stake represents such a circumstance.

END

² Financing Networks: A discussion paper, February 2006.

<http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/FinancingNetworks080206>

³ Notification of intent to introduce a cash lock-up provision to Condition F of companies' instruments of appointment – 7 September 2006.

<http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/md218>